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Strengthening Islamic Finance's Impact on the SDGs: Strategies to Increase Contribution

Surya Anugrah [1], Windy Permata Suyono[2] and Rochma Sudiati[3]

[1]Department of Accounting, Universitas Negeri Jakarta. (Email: suryaanugrah@unj.ac.id)
[2]Department of Accounting, Universitas Negeri Jakarta. (windypermata@unj.ac.id)
[3]Department of Accounting, Universitas Negeri Jakarta. (Email: rochmasudiati@unj.ac.id)

ABSTRACT

Islamic finance plays an important role in contributing to the Sustainable Development Goals (SDGs) in various countries. The method used in this research is a descriptive qualitative method using literature studies from various journals related to Islamic sustainable finance issues. The relatively lower contribution of Islamic finance in Indonesia compared to countries like Qatar, Australia, and the UK can be attributed to factors such as regulatory frameworks, financial infrastructure, market maturity, product diversity, and human capital in the country. To scale up Islamic finance in Indonesia and contribute to the SDGs, the following strategies can be implemented on Regulatory Framework, Financial Literacy and Awareness, Product Diversification, Collaboration and Partnerships, Innovation and Technology, Sustainability Reporting, Data Collection and Analysis.

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INTRODUCTION

In 2015, the United Nations officially adopted the 2030 Agenda for Sustainable Development, a global framework that includes 17 SDGs. These goals, often referred to as the SDGs, cover various aspects of human and environmental development, from poverty eradication to environmental protection. The agenda marks a global commitment to address the challenges faced by the world community, and directs collective efforts towards a more sustainable and inclusive future.

Despite global efforts to achieve the SDGs, complex and interconnected challenges persist, including economic inequality, unequal access to basic services, environmental degradation and climate change. In this context, it is important to strengthen financial tools capable of supporting inclusive and sustainable economic transformation.

Amidst these challenges, Islamic finance is emerging as a promising alternative in supporting efforts to achieve the SDGs. Islamic finance, which is based on Islamic sharia principles, emphasizes fairness, transparency and social responsibility. The principles of Islamic finance led to the development of sharia-compliant financial instruments, such as mudharabah (profit-sharing), musharakah (partnership), and murabahah (buying and selling with a set profit).

Although Islamic finance has grown rapidly in recent decades, there is still a need to deepen the understanding of its contribution to SDG achievement. Systematic and in-depth research on how Islamic finance principles can be applied to strengthen efforts to achieve the SDGs is essential. In addition, the development of policy frameworks that support the integration of Islamic finance in sustainable development strategies is also crucial.

By understanding more about the potential and challenges of Islamic finance in the context of sustainable development, we can identify new opportunities to strengthen an inclusive and sustainable financial system. Therefore, this study aims to contribute to the literature on Islamic finance and sustainable development by analyzing its role and impact in achieving SDGs, as well as identifying relevant policy implications.

LITERATURE REVIEW

Basic Concepts of Islamic Finance

Islamic finance is based on the principles of sharia, which is Islamic law that includes moral, ethical, and legal rules derived from the Quran and Hadith. Islamic financial mechanisms run by financial institutions cannot be separated from sharia concepts that regulate product mechanisms and operations (Darwis, 2013). The basic concepts of Islamic finance include:

Prohibition of Usury (Interest): Usury, or interest, is considered an unethical practice in Islamic finance. Usury, which is known as an addition that is not accompanied by an exchange of compensation, is prohibited by the Qur'an (Ghofur, 2016). The Qur'an itself has explained in detail the stages of the prohibition of usury. The first stage simply illustrates the negative element in usury (QS. al-Rum [30]:39).

Therefore, any form of interest or fixed profit generated from money lending is prohibited. Instead, Islamic finance advocates profit sharing (mudharabah) or predetermined profit sharing (musharakah) in financial transactions.

Fairness and Transparency: The principles of fairness and transparency are the cornerstones of Islamic finance. Transparency in financial transactions, fair dealings between the parties involved, and avoidance of practices that harm other parties are values that are required by Islamic law. The transparency in financial transactions, fair dealings between the parties involved, and the avoidance of practices that harm others are values emphasized in the Islamic financial system.

Prohibition of Speculation and Uncertainty: Speculation practices that are not based on real assets and contain high uncertainty are also avoided in Islamic finance. In speculation, the perpetrator relies on the fate of luck (game of change) with great risk and often harms other parties (Pati, 2015). The principles of Islamic finance encourage investments that are oriented towards real assets and have the potential to provide long-term benefits to society.

Islamic Financial Instruments

To implement sharia principles, Islamic finance develops various financial instruments that are in accordance with Islamic teachings. Unlike conventional financial instruments, Islamic financial instruments are not only commercial in nature but there are also social financial instruments such as zakat, waqf and alms. (Andiansyah, et all, 2022). Some of the most common Islamic financial instruments include:

Mudharabah: A form of partnership between a party that provides capital (shahibul maal) and a party that manages capital (mudharib), where profits are shared according to a prior agreement, while losses are borne by the capital owner.

Musharakah: A form of partnership where two or more parties provide capital to invest in a specific project. Profits and losses are shared according to prior agreement.

Murabahah: A form of sale-purchase in which the seller discloses to the buyer the cost of goods as well as an agreed profit margin. The buyer pays the specified price over a period of time. The legal basis for murabaha transactions is derived from Q.S. Al-Baqarah[2]:275, which reads, *"And Allah has justified buying and selling and forbidden usury."* Then in Q.S. An-Nisa[4]:29 which means, *"O you who have believed, do not eat of your neighbor's wealth by unlawful means, except by way of mutual trade between you. And kill not yourselves, verily Allah is most merciful to you."*

Sukuk: A financial instrument similar to conventional bonds but in accordance with Shariah principles. Sukuk represent partial ownership of a physical asset or project, with interest payments avoided. Instead, the investor receives payments in the form of a share of the profits or proceeds from the asset it represents.

Sustainable Development Goals

The SDGs is an agenda for sustainable development that was implemented by all UN member states in 2015. The SDGs have 17 goals, 169 targets and 241 indicators. The 17 goals are interconnected and implemented equally without leaving anyone behind. This is done to address the global problems faced by almost every country including those related to poverty, inequality, climate change, environmental issues, and peace and justice.

In Indonesia, the commitment to the SDGs is enshrined in Presidential Regulation Number 59 of 2017, underscoring the government's dedication to implementing these global objectives, as endorsed by President Jokowi. The 17 SDGs encompass a wide range of aims, including eradicating poverty (SDG 1), ending hunger and promoting sustainable agriculture (SDG 2), and ensuring health and wellbeing for all (SDG 3). Additionally, the goals encompass providing quality education (SDG 4), achieving gender equality (SDG 5), and ensuring access to clean water and sanitation (SDG 6). Furthermore, they emphasize affordable and clean energy (SDG 7), decent work and economic growth (SDG 8), and building resilient infrastructure while fostering innovation (SDG 9). The SDGs also target reducing inequality (SDG 10), creating sustainable cities and communities (SDG 11), and promoting responsible consumption and production patterns (SDG 12).

Moreover, they address climate change (SDG 13), marine conservation (SDG 14), and land ecosystem preservation (SDG 15). Additionally, the goals prioritize peace, justice, and strong institutions (SDG 16), as well as global partnerships for sustainable development (SDG

17). By adhering to these objectives, Indonesia aims to foster inclusive, prosperous, and sustainable development across the nation (Ministry of National Development Planning/Bappenas, 2017).This sustainable development goal is launched until 2030, the Sustainable Development Goals agenda is a refinement of the Millennium Development Goals (MDGs) agenda which ended in 2015. The end of the MDGs agenda then led UN members to formulate a global development agenda called the Sustainable Development Goals or SDGs.

RESEARCH METHODOLOGY

The method used in this research is a descriptive qualitative method using literature studies from various journals and articles related to Islamic sustainable finance issues and making the researcher the main instrument (Sugiyono, 2005).

RESULT AND DISCUSSION

Islamic finance plays an important role in contributing to the SDGs in various countries such as Qatar, Australia, the United Kingdom, Indonesia and others. Each country has its own way to improve the SDGs, which still uses Islamic principles and laws in its application. Some countries will be discussed one by one related to SDGs in this study.

Islamic finance plays a pivotal role in Qatar's efforts to contribute to the Sustainable Development Goals (SDGs). Qatar has actively fostered the growth of Islamic finance, aligning with the principles of Maqasid al-Shariah, which prioritize overall human welfare (Ahmed, 2015). Recognizing the potential of Islamic finance in advancing the SDGs, Qatar has incorporated Environmental, Social, and Governance (ESG) principles into its financial sector's masterplan (Gumus, 2019). Moreover, the country has been diligently working on establishing a comprehensive framework for sustainable finance, with a particular emphasis on promoting Islamic finance (Othman, 2022). These initiatives underscore Qatar's commitment to sustainable development and highlight the significant role Islamic finance can play in realizing the SDGs within the country.

Islamic finance plays a crucial role in advancing the Sustainable Development Goals (SDGs) in Australia, particularly in the realms of financial inclusion and sustainable development. Globally valued at over USD 3 trillion and anticipated to surpass USD 3.5 trillion by 2024 (OECD, 2020), Islamic finance is gaining traction in Australia, with its sector contributing to overall economic growth, financial inclusion, and national savings. To foster its growth, the Australian Islamic Finance Council (AAIFC) has been established, serving as a platform for collaboration and knowledgesharing among Islamic financial institutions, investors, and stakeholders. Collaborating with the Australian Securities and Investments Commission (ASIC), the AAIFC actively promotes Islamic finance development in Australia.

Additionally, Islamic finance channels funding into sustainable infrastructure projects like renewable energy and energy efficiency, vital for a sustainable future (Ahmed, 2015). Recognizing its potential, the Australian government is working on crafting a comprehensive framework for sustainable finance, inclusive of Islamic finance promotion (Gumus, 2021). Overall, Islamic finance stands poised to significantly bolster the SDGs in Australia, notably in enhancing financial inclusion and fostering sustainable development.

Islamic finance plays a pivotal role in advancing the Sustainable Development Goals (SDGs) in the United Kingdom. The UK government has actively supported the growth of Islamic finance, exemplified by issuing two sukuk and encouraging UK corporate issuers to follow suit (Dewar, 2024). Additionally, the UK Islamic Finance Council UK (UKIFC) has played a proactive role in advocating for Islamic finance and highlighting its potential to generate financial returns while fostering SDGs impact (UKIFC, 2021). Research conducted by Professor Habib Ahmed at Durham University has further underscored the ways Islamic finance can contribute to SDGs achievement both locally and globally, influencing high-level discussions and driving changes in practice and regulation (Ahmed, 2021).

Over the past decade, the Islamic finance sector in the UK has experienced significant growth, with more than 20 financial institutions offering Islamic finance products, including five fully Shariah-compliant banks (Dewar, 2024). Moreover, the sector has witnessed the emergence of Shariah-compliant digital banks like Algbra, which prioritizes sustainability and ethical values (Dewar, 2024). Recognizing the potential of Islamic finance in advancing the SDGs, the UK's Financial Conduct Authority (FCA) has established a working group to address barriers hindering the industry's progress (Dewar, 2024). These efforts by the FCA underscore its dedication to sustainable development and highlight the pivotal role Islamic finance can play in realizing the SDGs in the UK.

In Indonesia, the Sustainable Development Goals (SDGs) are greatly aided by Islamic finance. The SDGs will cost the nation over $4.7 trillion to accomplish, and funding is needed for several development sectors to meet targets (Rizal, 2023). Through the use of charity and Private-Public Partnerships (PPPPs), Islamic finance can aid in closing the SDG gap (IFAC, 2023). Through the implementation of thorough regulatory frameworks, the streamlining of regulations for goods and services, and increased public knowledge of Islamic banking, the Indonesian Ministry of banking has promoted the expansion of Islamic finance. The nation's attempts to include Islamic finance into the SDGs show how committed it is to sustainable development and how important a role Islamic finance might play in Indonesia reaching the SDGs.

Table 1. Islamic Finance Development Index (IFCI) Score, 2019

Country	Score	Score/Muslim Population
Indonesia	81,49%	0,000034%
Qatar	33,33	0,0016%
United Kingdom	19,11	0,0027%
Australia	2,56	0,000061%

Source: IFCI (2019)

Table 2. Muslim Population by Country

Country	Population	Muslim Population	% Muslim Population
Indonesia	278,696,200	243,023,086	87.2%
Qatar	2,685,053	2,067,491	77.0%
Australia	27,208,900	707,431	2.6%
UK	66,970,000	4,219,110	6.3%

Source: Wikipedia

Based on the information in the table above, although Indonesia has a high score according to IFCI, 2019, if we also compare it with the population in Indonesia, the majority of whose population is Muslim, the percentage is low, namely 0.000034% compared to other countries that have a lower score but a smaller population such as the United Kingdom which has a percentage of 0.0027% the largest compared to Indonesia, Qatar and Australia.

Islamic finance in Indonesia falls behind countries like Qatar, Australia, and the UK for several reasons. Despite efforts to stimulate its growth through regulatory frameworks and awareness campaigns, Indonesia still grapples with regulatory gaps that limit the sector's potential (IFAC,2023). Furthermore, the country's financial infrastructure is less developed compared to other nations, affecting the complexity and expansion of Islamic finance activities (Jivraj,2023). Indonesia's Islamic finance market is also less mature, constraining the scale of initiatives compared to more established markets (IFAC, 2023). Moreover, the limited availability of Islamic financial products and services in Indonesia undermines its ability to contribute significantly to sustainable development goals. Lastly, the scarcity of skilled professionals and expertise in Islamic finance acts as another barrier to the sector's progress, particularly when contrasted with countries boasting more abundant talent pools (Rizal, 2023).

CONCLUSION

To propel Islamic finance in Indonesia forward and bolster its impact on the SDGs, a multifaceted strategy is recommended. Initially, it entails establishing a comprehensive regulatory framework covering all facets of Islamic finance, including banking, capital markets, and insurance, to ensure compliance with global standards and stimulate growth (IFAC, 2023). Concurrently, efforts should be directed towards elevating financial literacy and awareness among the populace through educational initiatives and workshops, underscoring Islamic finance's potential in advancing sustainable development. Crucially, diversifying Islamic finance products and services to suit sectors like infrastructure and social welfare necessitates collaboration among stakeholders to pinpoint and surmount developmental hurdles (Farizi, 2023). Additionally, embracing technological advancements such as fintech and digital banking can broaden access to financial services and bolster sustainable endeavors. Moreover, the adoption of sustainability reporting by Islamic financial institutions can cultivate transparency and accountability, aligning their endeavors with the SDGs.

Integral to this strategy is the collection and analysis of data on the interplay between Islamic finance and the SDGs, facilitating comprehension of their impact and identification of areas for enhancement. Through the implementation of these measures, Islamic finance in Indonesia can assume a more prominent role in closing the funding gap and advancing sustainable development nationwide.

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