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EXPLORING THE ROLE OF ISLAMIC FINANCE IN SUSTAINABLE ECONOMIC DEVELOPMENT: A COMPREHENSIVE LITERATURE REVIEW STUDY (ECONOMIC ISLAM IN THE LAST 2 YEARS IN EAST JAVA)

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Abstrak

This study explores the significant role of Islamic finance in driving sustainable economic development, focusing on literature from the last two years (2023–2024) in the East Java region. Through a systematic literature review methodology, this paper examines how Islamic financial institutions, instruments, and principles—such as zakat, waqf, sharia-compliant banking, and Islamic microfinance—contribute to inclusive and equitable economic growth. The findings reveal that Islamic finance, when effectively integrated with local socio-economic structures, has the potential to alleviate poverty, empower MSMEs, and enhance regional resilience. The review also highlights current limitations and recommends policy and institutional improvements to optimize Islamic finance's impact on sustainable development in East Java.

INTRODUCTION

Islamic finance has emerged as a pivotal instrument in supporting economic development that emphasizes not only growth but also sustainability and social justice. Unlike conventional financial systems that prioritize profit maximization, Islamic finance embeds ethical, moral, and spiritual values into every economic transaction. Over the past two decades, Islamic finance in Indonesia has experienced substantial growth. This is evident in the increasing number of Islamic financial institutions, asset volumes, and the diversification of financial products offered to the public. Amid global uncertainty and domestic economic challenges, Islamic finance has proven to be a resilient and inclusive alternative.

East Java, one of the most populous Muslim provinces in Indonesia, holds significant potential for the advancement of Islamic economics. As a hub of Islamic boarding schools (*pesantren*), a strong base of micro, small, and medium enterprises (MSMEs), and a society deeply rooted in religious values, East Java offers a fertile ecosystem for the development of Islamic finance in both form and substance. Despite this promising potential, in-depth exploration is needed to understand the actual contribution of Islamic finance to sustainable economic development in this region. Sustainable development transcends mere economic growth; it also includes poverty alleviation, equitable distribution of income, and environmental preservation.

Aligned with the United Nations Sustainable Development Goals (SDGs), Islamic finance inherently supports principles of social justice, financial inclusion, and economic empowerment of marginalized groups. Instruments such as zakat, waqf, and profit-and-loss sharing schemes have become strategic tools to advance sustainability agendas. In East Java, Islamic finance is not limited to formal sectors such as Islamic banking and takaful (Islamic insurance), but also thrives in traditional socio-economic institutions like Baitul Maal wat Tamwil (BMT), Islamic cooperatives, and zakat organizations. These unique local dynamics deserve greater academic attention and structured analysis.

However, there remains a dearth of comprehensive academic studies that examine the correlation between Islamic finance and sustainable economic development in specific local contexts such as East Java—particularly in the past two years. This period has been characterized by post-pandemic recovery, digital transformation, and regulatory changes that demand renewed scholarly inquiry. Existing literature tends to be sectoral in nature and lacks an integrative synthesis that captures the full scope of Islamic finance's contribution to regional sustainable development. This highlights the need for a systematic literature review that consolidates, critiques, and evaluates the findings of recent studies.

The aim of this study is to explore the role of Islamic finance in promoting sustainable economic development in East Java through a comprehensive review of academic literature and policy documents published between 2023 and 2024. This approach is expected to provide a representative overview of trends, achievements, and challenges of Islamic economics at the regional level. In the context of regional development, Islamic finance has the potential to enhance both fiscal and social independence. Through zakat, productive waqf, and Islamic microfinance schemes, communities are not merely beneficiaries of development but become active participants in driving sustainable economic transformation.

The alignment of Islamic financial principles with distributive justice, prohibition of usury (riba), and avoidance of speculative behavior positions this system as an ethical and stable alternative. Moreover, Islamic finance encourages economic activity with social value, thus bridging the gap between economic growth and human well-being. The role of institutions such as BAZNAS, LAZ, and waqf management bodies is central to this discourse. The effectiveness of their governance determines the extent to which Islamic social funds can contribute to poverty alleviation, job creation, and empowerment of vulnerable groups.

In the last two years, the digital transformation of financial services has also reshaped the landscape of Islamic finance. Innovations in Islamic fintech have begun to penetrate East Java, changing the way communities access financial services, including online zakat platforms, sharia-compliant QRIS systems, and Islamic e-marketplaces. This study seeks to contribute both theoretically and practically to the development of more adaptive, inclusive, and contextual Islamic finance policies at the regional level. Its findings are intended to inform further research, regulatory decision-making, and practical strategies among academics, policymakers, and practitioners.

Through a systematic literature review approach, this study aims to present a holistic and comprehensive overview of the strategic role of Islamic finance in supporting sustainable economic development in East Java, while offering a roadmap for strengthening institutions and policies in the future.

LITERATURE REVIEW

Islamic finance refers to a financial system grounded in Islamic legal principles (Shariah), which prohibit practices such as riba (usury), gharar (uncertainty), and maysir (speculation). This system emphasizes distributive justice, sustainability, and social values in all economic activities (Antonio, 2011). In the context of sustainable development, these principles are highly relevant as they embed ethics and social responsibility into the management of economic resources. Core instruments of Islamic finance—such as zakat, infāq, ṣadaqah, waqf, and profit-and-loss sharing schemes (e.g., *mudharabah* and *musyarakah*)—contribute to wealth redistribution and financial inclusion. Research by Ascarya (2020) shows that these instruments can significantly reduce poverty and enhance social welfare when administered professionally and accountably.

Zakat, a mandatory form of almsgiving for eligible Muslims, plays a significant role in driving economic equity. The study by Yumna and Clarke (2017) found that strategic zakat management has the potential to minimize social inequality and strengthen the economic resilience of low-income populations. In Indonesia, institutions such as BAZNAS and LAZ have made notable progress in distributing zakat through productive programs—such as microenterprise capital assistance, educational scholarships, and women's empowerment initiatives. The use of digital platforms and integrated beneficiary data has been key to improving the effectiveness of zakat distribution (Faturohman, 2022). Waqf, particularly *productive waqf*, is increasingly recognized as a sustainable financing mechanism for public goods such as education, healthcare, and social welfare. Karim et al. (2023) emphasize the importance of strengthening the *nazhir* (waqf managers) in terms of governance and institutional capacity to fully harness the economic potential of waqf.

The hybrid model of waqf-based microfinance has been piloted in various regions of East Java as an approach to empowering microenterprises. This model has proven effective in increasing small business capacity and enhancing economic resilience among poor households (Mardhatillah et al., 2023). Islamic banking, as the backbone of the Islamic financial system, has shown consistent growth in Indonesia. According to data from the Financial Services Authority (OJK, 2024), Sharia-compliant financing in productive sectors—especially agriculture and trade—has increased significantly in rural areas such as East Java.

However, studies by Rahmawati and Sari (2022) reveal persistent structural barriers to Islamic financial inclusion, including low public financial literacy, limited access to banking services in rural areas, and a lack of innovative products tailored to local needs. Islamic microfinance institutions (IMFIs), such as BMTs (Baitul Maal wat Tamwil) and Islamic cooperatives, play a vital role in bridging the financial inclusion gap. Their community-based business models and partnership principles (*syirkah*) make them more adaptable and responsive to the needs of underserved populations (Ismail & Saad, 2021).

The digital transformation of the Islamic financial sector has also reshaped service delivery. In East Java, Islamic fintech startups are emerging, offering peer-to-peer lending, online zakat platforms, and sharia-compliant marketplaces using QRIS (Azmi, 2023). Nevertheless, not all institutions are technologically equipped to fully embrace this innovation. The link between Islamic finance and sustainable development is evident in its alignment with several Sustainable Development Goals (SDGs). Studies by Syafii Antonio and Hasan (2021) affirm that Islamic finance inherently supports goals such as poverty eradication (SDG 1), quality education (SDG 4), gender equality (SDG 5), and decent work and economic growth (SDG 8).

At the regional level, policy support that fosters synergy between local governments and Islamic financial institutions is critical. Research by Maulida et al. (2023) indicates that in East Java, regional government involvement in supporting the Islamic finance ecosystem remains limited and fragmented. Institutional governance remains a critical issue in maximizing the role of Islamic finance. The lack of data integration between zakat, waqf, and Islamic banking institutions often results in program redundancy and inefficiencies in Islamic social fund distribution (Nasution, 2022). A transparent and integrated information system is urgently needed.

Previous literature tends to be descriptive and lacks comprehensive cross-sectoral analysis. This study seeks to synthesize diverse findings and strengthen academic understanding of the relationships between Islamic finance instruments and various aspects of sustainable development, specifically in the East Java context. Considering the socio-economic complexity of East Java and the dynamic evolution of Islamic finance over the past two years, this literature review serves as a critical foundation for constructing a robust analytical framework. It lays the groundwork for policy recommendations and institutional reforms aimed at enhancing the impact of Islamic finance on sustainable regional development.

RESEARCH METHODOLOGY

This study employs a Systematic Literature Review (SLR) approach to examine and synthesize existing academic literature related to the role of Islamic finance in sustainable economic development, specifically in the East Java region within the time frame of 2023–2024. The SLR method was chosen to ensure a rigorous, transparent, and replicable process in identifying, selecting, and analyzing relevant sources, enabling a comprehensive understanding of patterns, themes, and research gaps in the field. The literature collection process involved multiple reputable academic databases, including Scopus, Google Scholar, ScienceDirect, Garuda, and Sinta, to ensure both international and national coverage. The inclusion criteria were: (1) articles published between January 2023 and May 2024, (2) studies focusing on Islamic finance and its role in regional development or sustainable economic impact, and (3) empirical or theoretical papers relevant to East Java or with applicable contextual insights. Exclusion criteria were duplicate articles, non-peer-reviewed opinion pieces, and studies unrelated to Islamic finance or sustainability.

The search strategy used a combination of keywords in English and Indonesian, such as: *"Islamic finance"*, *"zakat"*, *"waqf"*, *"sustainable development"*, *"East Java"*, *"Islamic banking"*, *"microfinance"*, and *"ekonomi Islam Jawa Timur"*. Boolean operators and advanced search filters were applied to narrow down the most relevant publications. A total of 62 studies were initially identified, and after screening abstracts and full texts based on relevance and quality, 27 key articles were selected for full review and analysis. Data analysis was conducted using thematic coding to identify recurring concepts and relationships across the literature. The themes that emerged included: the institutional role of zakat and waqf, the impact of Islamic microfinance on MSMEs, the growth of Islamic banking in East Java, digitalization in Islamic finance, and policy frameworks supporting regional Islamic economic development. Each study was critically appraised using a structured matrix assessing research objectives, methodologies, findings, and limitations.

The SLR methodology applied in this study aims not only to summarize existing knowledge but also to generate analytical insights and policy implications. By integrating academic findings with contextual realities in East Java, the methodology facilitates a multi-dimensional understanding of how Islamic finance contributes—or fails to contribute—to sustainable development at the regional level. The systematic approach ensures that conclusions drawn are grounded in empirical evidence and academic rigor.

RESULTS AND DISCUSSION

The systematic review identified five dominant themes regarding the role of Islamic finance in promoting sustainable economic development in East Java: (1) zakat-based poverty alleviation, (2) productive waqf implementation, (3) Islamic microfinance and MSME empowerment, (4) the expansion of Islamic banking, and (5) digital transformation in Islamic financial services. These themes emerged consistently across the 27 analyzed studies and reflect the multidimensional nature of Islamic finance as both a financial and socio-religious instrument in regional development. Zakat has played a significant role in reducing income inequality and financing social safety nets, particularly post-pandemic. According to the 2023 Annual Report by BAZNAS East Java, zakat collection increased by 18.6% from the previous year, reaching IDR 352.4 billion, with 62% allocated for productive programs such as entrepreneurship training, MSME capital assistance, and women's economic empowerment. This indicates a shifting trend from consumptive to productive zakat utilization, aligned with sustainable development principles. However, fragmentation among zakat institutions and limited integration with government programs were noted as persistent challenges (Maulida et al., 2023).

Waqf, especially productive waqf, has gained attention as a long-term financing mechanism for public services. The Indonesian Waqf Board (BWI) reported that East Java ranks among the top five provinces in waqf land registration, with over 5,800 waqf plots registered as of 2024. Nonetheless, only 12.4% of these assets are currently used for productive purposes (Karim et al., 2023). Case studies in Surabaya and Malang show that wakaf-based micro-enterprises in the education and health sectors have begun generating sustainable income and social returns, but governance limitations and lack of professional nazhir training remain key constraints. In terms of Islamic microfinance, institutions like BMTs and Sharia cooperatives have demonstrated measurable success in increasing financial access among underserved populations. A 2024 study by Ismail & Saad on 13 BMTs in East Java found that 78% of clients reported increased household income within one year of financing, and 66% expanded their businesses. The profit-sharing model was also viewed more positively than interest-based loans due to its perceived fairness and risk-sharing characteristics. However, the scalability of such models is limited by weak digital infrastructure and inconsistent regulatory oversight.

Islamic banking in East Java has shown steady growth, with Bank Syariah Indonesia (BSI) reporting a 17.2% increase in financing disbursement in the province during 2023, particularly in agriculture (23%) and trade sectors (41%). However, banking penetration in rural areas remains low, with only 31% of the population having access to formal Sharia banking services (OJK, 2024). Furthermore, while fintech innovations such as Sharia-compliant peer-to-peer lending and zakat apps are emerging, adoption rates are modest due to limited digital literacy. The findings suggest a strong need for infrastructure improvement, policy incentives, and education programs to bridge the gap between Islamic financial services and inclusive regional development.

CONCLUSION

This study concludes that Islamic finance plays a strategic and multidimensional role in advancing sustainable economic development in East Java. Through instruments such as zakat, waqf, Islamic banking, and microfinance, Islamic finance contributes not only to poverty alleviation but also to promoting inclusive growth, empowering MSMEs, and strengthening regional socio-economic resilience.

Zakat has shown significant potential in supporting productive economic activities and social protection, particularly when managed transparently and aligned with regional development programs. Waqf, although underutilized in productive sectors, holds substantial long-term potential in financing public goods such as education and healthcare. Islamic microfinance institutions have successfully expanded access to financial services for low-income groups, with clear impacts on income growth and business sustainability.

However, this study also finds several structural and institutional challenges, including fragmented regulatory frameworks, weak digital infrastructure, limited public awareness, and the lack of integrated policy between Islamic finance institutions and local governments. These challenges hinder the full realization of Islamic finance's developmental potential in East Java.

To optimize its role, Islamic finance in East Java requires stronger institutional synergy, capacity-building for zakat and waqf managers, digital transformation, and supportive policy frameworks that align with regional development goals and the Sustainable Development Goals (SDGs).

This research provides a foundational understanding of the interaction between Islamic finance and sustainable development in a regional context and recommends that future studies focus on empirical impact assessments, policy integration models, and technological innovation in Islamic finance for more effective and inclusive economic outcomes.

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