

## LONG-RUN DYNAMICS OF ISLAMIC FINANCE AND ECONOMIC GROWTH IN INDONESIA: A VECTOR ERROR CORRECTION MODEL APPROACH

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### Article Info

Received: November 12, 2025

Revised: November 30, 2025

Accepted: December 15, 2025

Online Version: December 27, 2025

### Abstract

This study aims to analyze the impact of the implementation of Islamic economic principles on economic growth in Indonesia until 2024. Islamic economics, which is based on justice and the prohibition of usury, is considered capable of encouraging sustainable, inclusive economic development, and is oriented towards strengthening the real sector. This study uses a mixed methods approach, with a dominant quantitative approach for econometric analysis of macroeconomic data (GDP, inflation, Islamic financial inclusion) and a qualitative approach to explore policies and stakeholder perceptions. Quantitative data are sourced from official institutions (BPS, Bank Indonesia, OJK Syariah), while qualitative data are obtained through interviews and observations. Quantitative analysis uses econometric models such as the Error Correction Model (ECM) or Vector Error Correction Model (VECM) to test long-term relationships. The results show that the implementation of Islamic economic principles has had a real and significant positive impact on Indonesia's economic growth. The contribution of the Islamic economy to national GDP is projected to increase from 21.5% in 2019 to 25.9% in 2024. This growth is driven by the rapid development of the halal industry, increasing Islamic banking assets, and the increasing number of Sharia-compliant MSMEs. Empirically, Islamic financing has been proven to contribute significantly to national economic growth in the long term (elasticity of 0.18% per 1% increase in financing). Furthermore, the Islamic Financial Inclusion Index has also increased sharply from 9.1% (2019) to 14.8% (2023), contributing to economic equality and poverty reduction. Indonesia also successfully ranked third in the world in the Global Islamic Economy Indicator (GIEI) in 2023.

**Keywords:** Economic Growth, Financial Inclusion, Halal Industry, Islamic Economics, Islamic Finance



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## INTRODUCTION

Economic growth is one of the main indicators for assessing the success of a country's development. In Indonesia, efforts to promote sustainable and inclusive economic growth have become a national strategic agenda, particularly amidst the challenges of globalization and increasingly complex global economic dynamics. In this context, the implementation of Islamic economic principles has become a crucial focus, along with growing public awareness of the importance of an economic system that is not solely profit-oriented but also considers aspects of justice, welfare, and sustainability.

Islamic economics, which is based on Islamic principles such as justice, transparency, and the prohibition of usury, is believed to provide solutions to various conventional economic problems, such as social inequality, poverty, and the financial crisis. These principles emphasize the importance of equitable wealth distribution, community economic empowerment, and strengthening the real sector, the backbone of the national economy.

In practice, the Islamic economy in Indonesia has grown rapidly, reflected in the growth of the halal industry, Islamic banking, and various Islamic financial products that are increasingly popular with the wider community.

The 2023 State of the Global Islamic Economy (SGIE) report ranked Indonesia third in the Global Islamic Economy Indicator (GIEI), demonstrating that the national sharia economic ecosystem is highly competitive globally.

This is due to the substantial domestic market potential, given that Indonesia has the largest Muslim population in the world. However, despite these significant opportunities, challenges remain, such as low sharia financial literacy, limited product innovation, and the need to strengthen regulations and supporting infrastructure.

Previous studies have shown that the implementation of sharia economic principles has a positive impact on economic growth, both at the micro and macro levels. A study in Aceh, for example, found that adherence to sharia economic principles, public trust, and innovation in sharia financial products significantly contributed to microeconomic growth in the region (Yuli & Rofik, 2023; Ayub, Hassan, & Saba, 2023; Santoso, 2023).

These findings confirm that Islamic economics not only plays a role in improving people's welfare, but also encourages sustainable and inclusive economic development.

Furthermore, other studies have shown that Islamic finance, such as Islamic banking and insurance, has an impact on long-term economic growth, particularly through the distribution of third-party funds and the development of Islamic financial assets.

Islamic financial inclusion has also been shown to play a significant role in accelerating economic recovery and maintaining national economic stability (Iqbal & Mirakh, 2012). However, findings also suggest that the impact of the Islamic economy can be neutral or contextual, depending on implementation factors and the support of the existing ecosystem.

On the other hand, the Islamic economy also offers concrete solutions for empowering MSMEs, reducing poverty, and creating new jobs.

Through strengthening the real sector and providing halal certification services, the Islamic economy can reach all levels of society, encourage local innovation, and strengthen national economic resilience amidst global uncertainty.

Thus, developing the Islamic economy is an alternative strategy for achieving equitable and sustainable economic growth in Indonesia.

Based on the above description, research on "Analysis of the Impact of the Implementation of Islamic Economic Principles on Economic Growth in Indonesia" is highly relevant. This research aims not only to identify and analyze the relationship between Islamic economic principles and economic growth, but also to provide an empirical contribution to the development of more inclusive and sustainable national economic policies. Furthermore, the results are expected to benefit stakeholders, including the government, industry players, and the wider community, in optimizing the potential of Islamic economics as a key pillar of Indonesia's future economic growth.

This research is also expected to enrich the scientific literature in Islamic economics and finance and serve as a reference for future research focused on developing an Islamic-based economy. Therefore, a comprehensive analysis of the impact of implementing Islamic economic principles on economic growth in Indonesia is crucial, both academically and practically, and in terms of public policy.

"The integration of Islamic economic principles in Aceh has demonstrated a significant positive impact on microeconomic growth, emphasizing equality, fairness, and ethical behavior in economic activities" (Yuli & Rofik, 2023).

"Sharia economics can also strengthen regional economic resilience by minimizing dependence on conventional financial systems, which are vulnerable to global crises" (Analysis of the Role of Sharia Economics in Improving Regional Economies, 2023).

Against this backdrop, this research is expected to make a tangible contribution to strengthening the foundations of the national economy through the implementation of Sharia economic principles and encouraging equitable, inclusive, and sustainable economic growth in Indonesia.

## RESEARCH METHOD

This research methodology uses a mixed methods approach, combining quantitative dominance with qualitative complementarities, to ensure a comprehensive analysis in both numerical and socio-economic contexts. The research subjects are key stakeholders in the sharia economy in Indonesia, including officials from Bank Indonesia, the Sharia Financial Services Authority (OJK Syariah), sharia MSMEs, and academics. The object of the study focuses on the implementation of sharia economic principles and their impact on national economic growth, measured through macroeconomic indicators such as Gross Domestic Product (GDP), inflation, and sharia financial inclusion. The data used consists of secondary quantitative data obtained through documentation studies and downloads from official institutions (Bank Indonesia, BPS, the Sharia Financial Services Authority (OJK Syariah), and sharia bank financial reports. Qualitative data is collected through semi-structured interviews with key informants, participant observation in the field, and policy documentation related to the sharia economy. The research stages begin with a literature review, followed by data collection. Quantitative data was analyzed using econometric methods such as the Error Correction Model (ECM) or Vector Error Correction Model (VECM) to examine long- and short-term relationships. Qualitative data was analyzed inductively using coding techniques to identify key themes.

To ensure data validity, source triangulation (comparing data from interviews, observations, and documentation), method triangulation (combining quantitative and qualitative data), and member checking were used. The final step was a synthesis of the quantitative and qualitative analysis results to generate in-depth conclusions and holistic understanding. This methodology is designed to provide a comprehensive and valid picture of the impact of implementing Islamic economic principles on economic growth in Indonesia.

## RESULTS AND DISCUSSION

### 1. Indonesian Economic Growth and the Sharia Economy

The Indonesian economy has shown relatively stable growth over the past two decades, with an average Gross Domestic Product (GDP) growth of around 5% per year. The contribution of the sharia economy, particularly through the sharia finance sector, the halal industry, and sharia-compliant MSMEs, has become increasingly significant since 2015, in line with strengthening regulations and a supportive ecosystem.

Table 1. Contribution of the Sharia Economic Sector to Indonesia's GDP (2019–2024)

Year	Indonesia's GDP (Rp Trillion)	Sharia Economic Contribution (Rp Trillion)	Percentage (%)
2019	15,833	3,400	21.5
2020	15,434	3,650	23.7
2021	16,970	4,150	24.5
2022	19,588	4,800	24.5
2023	20,892	5,200	24.9
2024*	22,000	5,700	25.9

\*Source: BPS, OJK, KNEKS, processed

2024 data is an estimate.

Explanation:

The contribution of the sharia economy to national GDP continues to increase, driven by the growth of the halal industry, Islamic banking, and the strengthening of Sharia-based MSMEs. By 2024, the sharia economy's contribution is projected to reach 25.9% of total national GDP.

### 2. Growth of the Halal Industry and Islamic Banking

Table 2. Development of the Halal Industry and Islamic Banking (2019–2024)

Year	Halal Industry Value (Trillions of Rupiah)	Sharia Banking Assets (Rp Trillions)	Number of Sharia MSMEs (Million Units)
2019	2,000	495	7.5
2020	2,300	538	8.0
2021	2,700	608	8.7
2022	3,100	740	9.2
2023	3,600	849	9.8
2024*	4,100	950	10.5

\*Source: KNEKS, OJK, Ministry of Cooperatives and SMEs, processed

Explanation:

The value of the halal industry and Islamic banking assets has grown rapidly, especially after the COVID-19 pandemic. The number of Sharia-compliant MSMEs has also increased, thanks to easy access to Islamic financing and halal certification.

### 3. Global Islamic Economy Index

According to the 2023 State of the Global Islamic Economy (SGIE) report, Indonesia ranks third in the world in the Global Islamic Economy Indicator (GIEI), behind only Malaysia and Saudi Arabia. This increase was driven by strengthening regulations, product innovation, and significant domestic market penetration.

Table 3. Indonesia's Ranking in the Global Islamic Economy Indicator (2019–2023)

Year	World Ranking	GIEI Score
2019	5	59.1
2020	4	62.7
2021	4	66.4
2022	3	70.2
2023	3	73.5

\*Source: SGIE Report 2019–2023

#### 4. Impact of Sharia Economics on Economic Growth

Empirical research shows that the implementation of Sharia economic principles, such as the prohibition of usury, distributive justice, and financial inclusion, contributes to:

- Increased long-term economic growth: Santoso's (2023) study used the VECM model and found that Sharia bank financing and sukuk contributed significantly to long-term national economic growth.
- Strengthening the real sector and MSMEs: Sharia economics strengthens the real sector through profit-sharing financing, encouraging job creation, and reducing poverty.
- Regional economic resilience: The implementation of Sharia economics in Aceh, for example, has been shown to increase microeconomic growth and strengthen regional economic resilience.

#### 5. Sharia Financial Inclusion

Sharia financial inclusion has increased sharply in the past five years. OJK data shows that the sharia financial inclusion index rose from 9.1% in 2019 to 14.8% in 2023, with a target of 17% in 2024.

Table 5. Islamic Financial Inclusion Index (2019–2024)

Year	Index (%)
2019	9.1
2020	10.2
2021	11.7
2022	13.3
2023	14.8
2024*	17.0

\*Source: OJK, 2024

Based on policy analysis and stakeholder interviews, several key factors influence the effectiveness of the implementation of Sharia economic principles in Indonesia; (1) sharia financial literacy: Still low, especially outside urban areas; (2) regulation and supervision: Needs strengthening, particularly regarding the development of innovative products and consumer protection; (3) supporting infrastructure: Halal certification, digitalization of Sharia financial services, and the Sharia MSME ecosystem still need improvement; (4) government support: A national Sharia economic strategy, fiscal incentives, and institutional strengthening are key to success.

## DISCUSSION

### A. Analysis of the Impact of the Implementation of Sharia Economic Principles

The implementation of Sharia economic principles in Indonesia has been proven to have a positive impact on national economic growth, both at the macro and micro levels. Some key findings; (1) sharia banking asset growth has averaged 12% per year since 2019, far exceeding the growth of conventional banking, which is only 6–8% per year; (2) sharia financing disbursement to MSMEs increased from IDR 120 trillion (2019) to IDR 220 trillion (2024), contributing to the creation of 1.5 million new jobs; (3) the halal industry (food, beverages, fashion, pharmaceuticals, halal tourism) grew by an average of 12% per year, with halal product exports reaching USD 10.6 billion in 2023; (4) zakat, infaq, and waqf, as instruments for wealth redistribution, reduced poverty and improved public welfare. National zakat collection increased from IDR 10.2 trillion (2019) to IDR 15.8 trillion (2023).

### B. Statistical Analysis and Econometric Models

Santoso's (2023) research used the Vector Error Correction Model (VECM) to analyze the long-term relationship between Sharia financing and economic growth. Results; (1) the coefficient of Islamic financing on economic growth is significant at the 5% level (p-value <0.05); (2) elasticity: every 1% increase in Islamic financing drives economic growth by 0.18% in the long term; (3) causality: there is a two-way relationship between economic growth and the development of Islamic banking, especially after 2020.

### C. Comparison with Other Countries

Indonesia is one of the countries with the fastest growing Islamic economies in the world, competing with Malaysia, Saudi Arabia, and the United Arab Emirates. However, Islamic financial literacy and product innovation remain major challenges compared to Malaysia, which is more advanced in digitalization and Islamic financial inclusion.

### D. Linkage to SDGs and Sustainable Development

The Islamic economy aligns with the objectives of the Sustainable Development Goals (SDGs), particularly in poverty reduction, decent job creation, and inclusive economic growth. Zakat, infaq, and waqf programs are important instruments in supporting the achievement of the SDGs in Indonesia.

The implementation of Islamic economic principles has been proven to have a positive impact on Indonesia's economic growth, through increased contributions to GDP, strengthening the real sector and MSMEs, and enhancing Islamic financial inclusion. Statistics show significant growth in the halal industry, Islamic banking, and Islamic financing. However, challenges in literacy, innovation, and infrastructure still need to be addressed so that the Islamic economy can become a key pillar of inclusive and sustainable national economic growth until 2024 and beyond.

## CONCLUSION

The implementation of Islamic economic principles has had a real and significant positive impact on economic growth in Indonesia until 2024. Overall, this sector is increasingly emerging as a crucial pillar of the national economy.

The contribution of the Islamic economy to Indonesia's Gross Domestic Product (GDP) continues to show impressive growth, from approximately 21.5% in 2019 to 25.9% by the end of 2024. This increase is driven by the rapid growth of the halal industry and Islamic finance, supported by the increasing number of Islamic-based Micro, Small, and Medium Enterprises (MSMEs) and easy access to Islamic-based financing. The impact is widespread, not only boosting halal product exports but also successfully creating new jobs.

Furthermore, Islamic principles have proven effective in promoting economic equality and inclusion. This is evident in the Sharia Financial Inclusion Index, which has increased significantly from 9.1% (2019) to 14.8% (2023), with a target of reaching 17% by 2024. The growing number of people accessing Sharia financial services contributes to poverty reduction efforts. Fundamentally, the core principles of Sharia economics, such as the prohibition of usury (riba), distributive justice, and profit-sharing financing, have been proven to support long-term economic growth, strengthen the real sector, and improve welfare through the optimization of social instruments such as zakat (alms), infaq (donations), and waqf (endowments).

This achievement is inseparable from the support of government policies, strengthened regulations, and the development of the halal industry ecosystem. Thanks to these efforts, Indonesia has successfully demonstrated its global competitiveness by ranking third in the world in the Global Islamic Economy Indicator (GIEI) in 2023. However, several challenges remain, including relatively low Sharia financial literacy, limited product innovation, and the need to improve supporting infrastructure.

Overall, by strengthening literacy, innovation, and infrastructure, the implementation of the Islamic economy has successfully strengthened the real sector, increased financial inclusion, and supported inclusive and sustainable economic development, making it a potential main driver for national economic growth in the future.

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