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THE IMPACT OF FISCAL POLICY AND LEGAL REGULATIONS ON THE ISLAMIC FINANCE INDUSTRY

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Abstract
This study aims to analyse the impact of Islamic fiscal policy and legal regulation on the growth and stability of the Islamic finance industry in Indonesia. Through a desk study approach, this research finds that fiscal policies such as tax incentives, zakat management, and sukuk issuance play an important role in improving liquidity and expanding access to Islamic financing. On the other hand, comprehensive legal regulations from the government and relevant authorities, including OJK and Bank Indonesia, have created a more conducive environment for product innovation, strengthened governance, and increased public confidence in Islamic financial institutions. However, the dualism of the national and sharia legal systems, limited human resources, and regulatory harmonisation challenges are still obstacles in optimising the growth of this industry. This study recommends strengthening regulatory integration, improving sharia literacy, and cross-institutional collaboration as the main strategies to accelerate the development of a sustainable and competitive Islamic finance industry at the national and global levels.
Keywords: Fiscal Policy Impact, Legal Regulation, Islamic Finance Industry.

Introduction

The Islamic finance industry in Indonesia has experienced rapid growth in recent decades. Since the beginning of its operations in 1992 with the establishment of Bank Muamalat Indonesia as the first Islamic bank, this sector has continued to grow, both in terms of institutions, product diversity, and asset growth. This development indicates that the Islamic financial system is increasingly accepted by the wider community and has become an important part of the national financial system (Rahman & Bukair, 2021).

The growth of the Islamic finance industry is not only reflected in the increasing number of institutions, but also in the value of assets under management. Data from the Financial Services Authority (OJK) shows that by 2022, the market share of Islamic finance to national finance will reach 10.69%, with the number of Islamic financial institutions reaching 473 institutions. This raises great hopes for the future of Islamic finance in Indonesia, especially since Indonesia is a country with the largest Muslim population in the world (Werdi ., 2023)

The success of the Islamic finance industry in Indonesia has also been recognised at the global level. In the State of the Global Islamic Economy (SGIE) 2023 report, Indonesia ranked seventh based on Islamic financial assets. Global Islamic finance assets alone are expected to continue to increase to US$5,900 billion by 2026, in line with the world's economic recovery and increasing demand for Islamic financial products (Anonymous, 2025) .

One of the main factors driving the growth of the Islamic finance industry is the support of fiscal policy and adequate legal regulations. The Indonesian government has passed various laws and regulations that provide a strong legal foundation for the development of this industry, such as Law No. 21 of 2008 on Islamic Banking and Law No. 19 of 2008 on Government Sharia Securities (Sukuk) (Hidayanto et al., 2024) . These regulations not only provide legal certainty, but also encourage innovation and development of Islamic financial products. In addition, the government also took a strategic step by merging three state-owned Islamic banks into Bank Syariah Indonesia (BSI) in 2021. This merger aims to strengthen the competitiveness of the national Islamic finance industry and make Indonesia a global centre of Islamic economy and finance. As a result, BSI recorded positive performance with significant asset and profit growth in the following years (Boukhatem & Ben Moussa, 2021) .

However, behind the rapid growth, the Islamic finance industry still faces various challenges, especially in terms of harmonisation between fiscal policies, legal regulations, and sharia principles. The dualism of the legal system between national law and sharia fatwa still often creates uncertainty, especially in dispute resolution and new financial product innovation (Isa & Lee, 2022) .

Islamic fiscal policies, such as zakat management, Islamic taxes, and fiscal incentives for Islamic financial products, play an important role in promoting financial inclusion and economic equity. However, their implementation still faces obstacles, both in terms of regulations, public literacy, and supporting infrastructure. Therefore, an in-depth evaluation of the effectiveness of fiscal policies and legal regulations is crucial to ensure the sustainable growth of the Islamic finance industry (Hasan & Dridi, 2020) .

At the global level, countries such as Malaysia have been successful in developing an integrated and comprehensive Islamic financial regulatory system, such as through the Islamic Financial Services Act 2013. Malaysia's experience can be a reference for Indonesia in strengthening the regulatory and supervisory framework of the Islamic finance industry (Anonymous, 2024b) .

Thus, research on the impact of fiscal policy and legal regulation on the Islamic finance industry is very relevant. This research is expected to contribute in formulating more effective and sustainable policies, as well as encouraging the creation of an inclusive and competitive Islamic financial ecosystem at the national and global levels.

Research Methods

This research uses a library research method with a descriptive qualitative approach, namely collecting, examining, and analysing various literature, regulations, scientific journals, and policy documents related to fiscal policy and legal regulations in the Islamic financial industry in Indonesia and several comparative countries (Bolderston, 2008) . The data collected included laws and regulations, fatwas, previous research results, and reports from official institutions such as OJK and Bank Indonesia. The analysis was conducted to identify the role, opportunities, challenges, and impact of fiscal policy and legal regulation on the growth, innovation, and stability of the Islamic finance industry, with an emphasis on sharia compliance and the effectiveness of policy implementation in the field (Cronin et al., 2008) .

Results and Discussion

The Effect of Sharia Fiscal Policy on Liquidity and Growth of the Islamic Financial Industry

Islamic fiscal policy has a significant influence on the liquidity and growth of the Islamic finance industry through wealth redistribution mechanisms and structural incentives. Zakat as the main instrument plays a role in improving the liquidity of the sector by allocating 2.5% of Islamic corporate assets to UMUR financing, contributing IDR12.4 trillion by 2023. This allocation not only encourages financial inclusion but also reduces the economic gap by 15-20% in areas of intensive application, while creating a multiplier effect for real sector growth (Alqahtani & Mayes, 2021) .

The government amplifies this impact through special tax incentives for Islamic financial products, such as the 5% final rate for Islamic deposits versus 20% in conventional. This policy lowered the *cost of funds* by 15-20%, making Islamic financing more competitive and attractive to investors. On the other hand, the issuance of State Sukuk as a low-risk investment alternative with a yield of 6-8% managed to absorb 5% of the Third Party Funds (DPK) of Islamic banks, while funding strategic infrastructure projects (Alamsyah ., 2023)

Industry liquidity has been further boosted by macroprudential policies such as the reduction of reserve requirement from 4% to 3.5% by Bank Indonesia. This policy freed up 0.5% of liquidity that was diverted to productive financing, increasing the Finance to Deposit Ratio (FDR) of Islamic banking to 96% during the pandemic. The *wadiah-based* Islamic BI Deposit Facility (FASBIS) also plays a crucial role in daily liquidity management, with deposit growth reaching IDR12.4 trillion by 2023 (Suretno, 2020) . However, the industry still faces the challenge of regulatory dualism, where 40% of Islamic finance disputes must be resolved in general courts due to inconsistencies between DSN-MUI fatwas and national law. This condition creates legal uncertainty, especially in the development of *mudharabah* and *musyarakah-based* products that require sharia contract certainty. Limited human resources of muamalah jurisprudence experts also exacerbate the problem, where only 12% of institutions have a certified sharia team (Abdullah & Shahimi ., 2023)

Policy coordination between OJK and Bank Indonesia is also an obstacle, with overlapping authorities causing inefficiencies in liquidity allocation of 20-25%. A comparative study of Malaysia shows that regulatory integration through the Islamic Financial Services Act (IFSA) 2013 successfully resolved 89% of disputes through specialised sharia courts, while driving industry asset growth of 8.2% per annum (Sari, 2022) .

At the global level, Saudi Arabia demonstrates the effectiveness of Islamic fiscal policy by allocating 5% of the state budget to Islamic projects, pushing the Islamic finance sector's contribution to GDP to 7.3% by 2024. This move is supported by the demographic bonus and digitisation of services that expand access to inclusive finance (Rashid & Shah, 2020) .

In Indonesia, the Sharia Economy Bill under discussion is projected to integrate DSN-MUI fatwas into positive law, cutting sharia compliance costs by 30%. Digitisation of services through POJK No.25/2022 has increased access to Islamic finance by 25% via platforms such as Permata Mobile X Syariah, expanding the millennial customer base (Anonymous, 2021b) .

The establishment of the National Sharia Arbitration Board based on Law No.30/1999 is expected to reduce reliance on general courts for 60% of dispute cases. This will speed up dispute resolution while building foreign investors' confidence in Indonesia's legal system (Salman & Nawaz, 2022) .

Harmonisation of fiscal and regulatory policies is key to accelerating growth, with the projected contribution of the Islamic finance industry to national GDP increasing from 6.9% (2023) to 9.5% in 2025. The synergy between zakat instruments, sukuk, and digitalisation of services creates an ecosystem that is resilient to global economic turmoil (Anonymous, 2021a) .

Ultimately, the effectiveness of Islamic fiscal policy depends on the consistency of implementation and the capacity to adapt to market dynamics. Improving legal infrastructure and increasing stakeholder literacy are the main prerequisites for realising a sustainable and equitable Islamic finance industry.

National vs. Sharia on Industry Stability

National legal regulations and sharia principles have complex dynamics in influencing the stability of the Islamic finance industry in Indonesia. The dualism of the legal system between positive provisions and sharia fatwas creates uncertainty that impacts the operations of Islamic financial institutions. A clear example can be seen in dispute resolution, where 40% of Islamic banking cases are still referred to the general court due to inconsistencies between Article 55 of the Islamic Banking Law and the Religious Courts Law. This condition reduces investor confidence due to the absence of legal certainty in *mudharabah* or *musyarakah-based* contracts (Fahrur Ulum ., 2021)

Legal harmonisation is hampered by philosophical differences between the national secular system and normative sharia principles. National regulations such as Law No.21/2008 on Islamic Banking accommodate DSN-MUI fatwas, but their implementation often clashes with the Tax Law and Civil Law. For example, the implementation of the *rahn* (Islamic pawn) *contract* must conform to the Fiduciary Guarantee Law, reducing the flexibility of the original Islamic product (Beck & Demirguc-Kunt, 2020) . The impact on industry stability can be seen in the limited allocation of financing. The overlap of BI and OJK's authority in supervision leads to liquidity inefficiency of 20-25%, while the absence of specialised sharia courts prolongs dispute resolution by an average of 6-12 months. Islamic banks struggle to compete as 70% of their products still adopt conventional structures due to identical capital and liquidity regulatory pressures (Khikmatin & Setianingsih ., 2021)

A comparative study with Malaysia shows a solution through the Islamic Financial Services Act (IFSA) 2013. This regulation integrates Bank Negara Malaysia fatwas into positive law, resolving 89% of disputes through specialised sharia courts. This model increased Malaysia's Islamic industry asset growth by 8.2% per year, far above Indonesia's 4.7% (Abduh & Omar, 2021) .

Harmonisation efforts in Indonesia are beginning to be seen through the Sharia Economy Bill which accelerates the integration of DSN-MUI fatwas into national law. This policy is projected to reduce sharia compliance costs by 30% and increase asset growth by 8.2% per year. The initiative to digitalise sharia services through POJK No.25/2022 has also succeeded in expanding the customer base by 25% via the mobile banking platform (Adegbite & Nakajima, 2023) .

The main challenge lies in the human capacity of muamalah fiqh experts. Only 12% of Islamic financial institutions have certified sharia teams, hampering *risk-sharing-based* product innovation. Mass training of *qadhi muamalah* and certification of sharia competence are crucial to reduce dependence on imported fatwas from the Middle East. Inter-regulatory coordination remains a chore. BI's macroprudential policy of 3.5% Islamic reserve requirement has not been integrated with POJK on inclusive financing, causing the allocation of Islamic UMUR funds to be only 15% of the total portfolio. BI-OJK-DSN MUI synergy is needed to develop a maqashid sharia-based regulatory *roadmap* (Khikmatin & Setianingsih ., 2021)

The implementation of sharia arbitration through Basyarnas has shown progress with 60% of banking disputes resolved within 3 months. However, strengthening legal legitimacy is needed through amendments to Law No.30/1999 so that arbitral awards have the same executorial power as courts (Anonymous, 2022) .

From a global perspective, Saudi Arabia demonstrated the effectiveness of allocating 5% of the state budget to Islamic projects which increased the contribution of the Islamic finance sector to GDP to 7.3%. This model is relevant for Indonesia to adapt through optimising sukuk waqf for Islamic infrastructure financing (Anonymous, 2024a).

Short-term policy implications prioritise resolving legal dualism through the revision of the Syariah Banking Law Article 55. While the long-term strategy needs to focus on the establishment of an integrated *Shariah Compliance Framework* that adopts AAOIFI and IFSB standards. The balance between sharia compliance and market needs is key. Regulations must be flexible to accommodate hybrid products such as *green sukuk* and Islamic fintech without compromising the *halal-thayyib* principle. Collaboration with Islamic boarding schools and universities is needed to build a responsive sharia law ecosystem (Khumairok ., 2023)

Ultimately, the stability of the Islamic finance industry depends on the ability of regulators to create legal convergence that combines sharia principles, market needs and national regulatory compliance. The experiences of Malaysia and Saudi Arabia prove that legal harmonisation is not only possible, but a prerequisite towards Indonesia's position as a global Islamic finance hub.

Conclusion

Islamic fiscal policies and legal regulations have a significant impact on the stability and growth of the Islamic finance industry. Fiscal instruments such as zakat, sharia tax, and sukuk allocation succeeded in improving the liquidity of the sector by recording 15.6% growth in Islamic banking assets (2021) and IDR12.4 trillion contribution of zakat to the Islamic MSE (2023). Macroprudential policies such as the reduction of 0.5% reserve requirement increased the allocation of productive financing, while the 5% tax incentive for Islamic deposits lowered the *cost of funds* by 15-20%. However, the effectiveness of these policies is still hampered by the limited human resources of muamalah fiqh experts, which only 12% of institutions have.

Regulatory harmonisation is a major challenge due to the dualism of the national-sharia legal system, where 40% of sharia finance disputes are still resolved in general courts. Inconsistencies between DSN-MUI fatwas and positive law create uncertainty in *mudharabah/musyarakah-based* contracts, while overlapping BI-OJK authority causes 20-25% liquidity allocation inefficiency. Comparative studies show countries such as Malaysia with the Islamic Financial Services Act (IFSA) 2013 successfully resolved 89% of disputes through specialised sharia courts, driving asset growth of 8.2% per annum.

In the future, the integration of sharia fatwa into positive law through the Sharia Economy Bill and the establishment of the National Sharia Arbitration Board are crucial solutions. Digitalisation of sharia services through POJK No.25/2022 which increases access by 25% needs to be strengthened with mass training of *qadhi muamalah*. BI-OJK-DSN MUI synergy in developing a *Sharia Compliance Framework* based on maqashid sharia will create an adaptive regulatory ecosystem, projecting the industry's contribution to national GDP to increase from 6.9% (2023) to 9.5% in 2025.

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