

Does Islamic Banking Contribute to Increasing Public Welfare? Evidence from Indonesian Province Panel Data

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ABSTRACT

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One of the Sustainable Development Goals (SDGs) targets in Indonesia is to increase the level of public welfare that can be represented in GRDP per capita. Therefore, the purpose of this study is to determine whether Islamic banking through Islamic Commercial Banks (BUS), Islamic Business Units (UUS), and Sharia Rural Banks (BPRS) in 33 provinces in Indonesia, has contributed to GRDP per capita during the 2015-2022 period. GRDP per capita as a proxy indicator for the level of public welfare to encourage the achievement of the sustainable development goals (SDGs) target. This study uses panel data regression analysis because the data is time series and cross-section. The size of the Islamic banking contribution uses Islamic Bank Office (IBO), Financing, and Third-Party Funds (TPF) variables in 33 provinces in Indonesia. Meanwhile, the size of the welfare level of a region uses Gross Regional Domestic Product (GRDP) per capita data. The findings of this study show that the IBO, financing, and TPF variables simultaneously have a significant positive effect on GRDP. However, partially, the IBO variable has a significant negative effect on GRDP, the financing variable has a significant positive effect on GRDP, and the TPF variable does not affect GRDP.

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1. Introduction

The minimal Sustainable Development Goals (SDGs) is a 2030 agenda of sustainable development action plans that encourage based on human rights and equality, has three main pillars, namely encouraging economic, social, and environmental growth [1], [2]. One of the goals of the SDGs in Indonesia is to improve people's welfare in encouraging goal number 8 of the SDGs, namely "Decent Work and Economic Growth" with the first indicator being to maintain economic growth per

capita in accordance with national conditions and, in particular, at least 7 percent growth in gross domestic product per year in less developed countries [3].

According to Michael P. Todaro & Stephen C. Smith, 2015 [4] community welfare is a situation where a person is able to fulfill his basic needs such as a decent home, clothing needs, food needs, education and health. In the economic development paradigm, community welfare is an important component of economic development, because it is considered successful if community welfare increases as a result. According to Central Statistics Agency, 2023 [5] to measure the level of welfare of the population of a region is to know the economic growth from year to year, this can be reflected in the Gross Regional Domestic Product (GRDP) per capita, using the value at constant prices (ADHK).

In the report results SDGs Bappenas, 2023 [3] states that the SDGs in Indonesia have a minimum target of GRDP per capita per year. In 2015, GRDP per capita was 64,721 thousand rupiah, and in 2016 it increased to 72,210 thousand rupiah. However, in 2020, there was a decrease due to the COVID-19 disaster in Indonesia, so that it became 56,930 thousand rupiah. In 2021, the target again increased to 61,900 thousand rupiah, and in 2022, GRDP per capita amounted to 64,721 thousand rupiah. These targets have been set by the National Development Planning Agency (Bappenas) or the Ministry of National Development Planning of the Republic of Indonesia. Based on Fig. 1 below, it shows that from the data of 33 provinces that exceed the minimum target of GRDP per capita, there are only 4 provinces. DKI Jakarta Province is the province with the highest GRDP per capita compared to other provinces. In addition, the province with the highest GRDP per capita in the second rank is East Kalimantan province, the third rank is Riau Islands province, and the fourth rank is Riau province. Meanwhile, 29 other provinces in Indonesia still have not reached the minimum target of GRDP per capita based on the SDGs. Therefore, there is still a development gap at the regional level that is still quite large, this figure still needs to be encouraged for progress in achieving the SDGs.

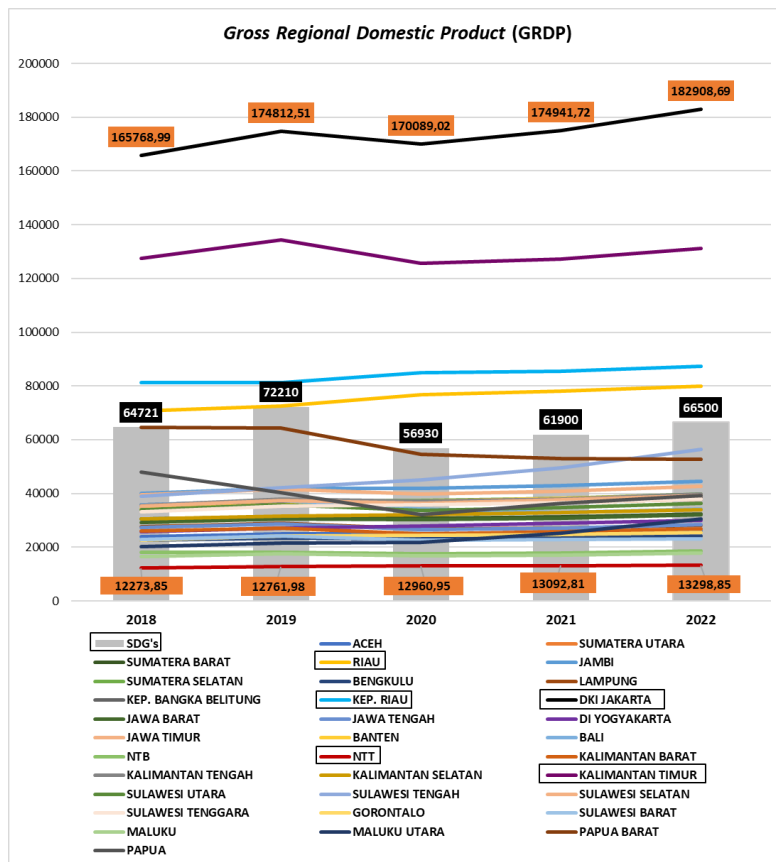


Fig. 1. GRDP per capita of 33 provinces in Indonesia

Based on Fig. 2 below, it shows that the performance data of Islamic banking in Indonesia from 2015-2022 has a positive performance, it can be seen from the financing and TPF variables that have increased every year. Meanwhile, the distribution of the number of offices has also increased, in 2015 there were 2,452 offices until in 2022 there were 2,599 offices, although in some years there was a decrease. Therefore, Indonesia has a strong Islamic banking system and has the potential to continue to grow in the future [6]. In addition, according to Zumaidah, 2018 [7] states that the development of a dynamic banking sector and having a real contribution is very important, because it will have an impact on the economic growth of a country. However, increased economic growth is not necessarily directly proportional to the level of welfare of its people [8].

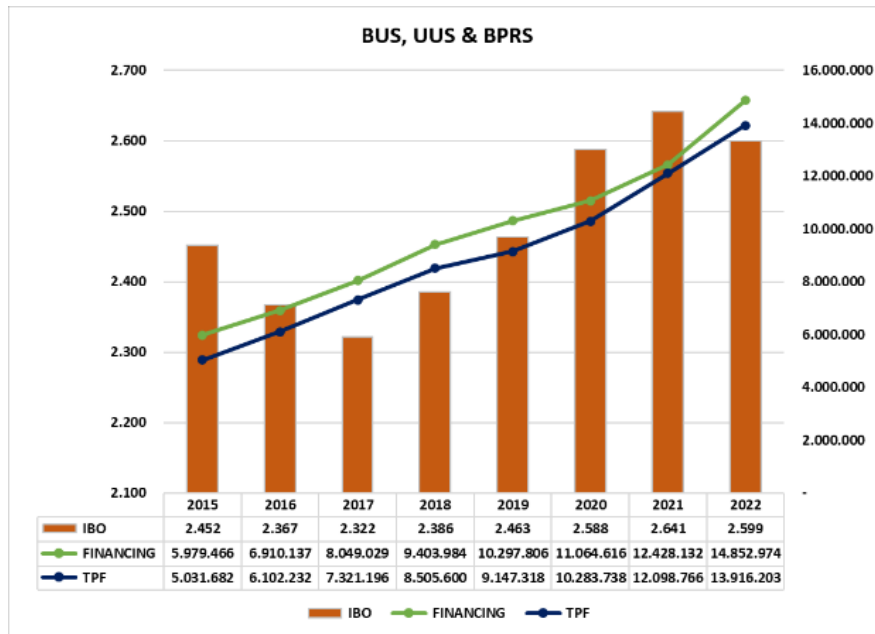


Fig. 2. Islamic banking performance in 2015-2022

In addition, Indonesia is currently the world's largest Muslim country with a Muslim population of 240,666,084 [9]. However, according to Hikmah et al., 2019 [10], Islamic banking has not been able to become a market leader in Indonesia. Based on Fig. 3 below, the slow increase in the market share of Islamic banking in Indonesia is still inferior to conventional banking. This data shows that there are still many things that need to be evaluated from all aspects so that Islamic banking can become a market leader in the future to conventional banking. This data shows that there are still many things that need to be evaluated from all aspects so that Islamic banking can become a market leader in the future.

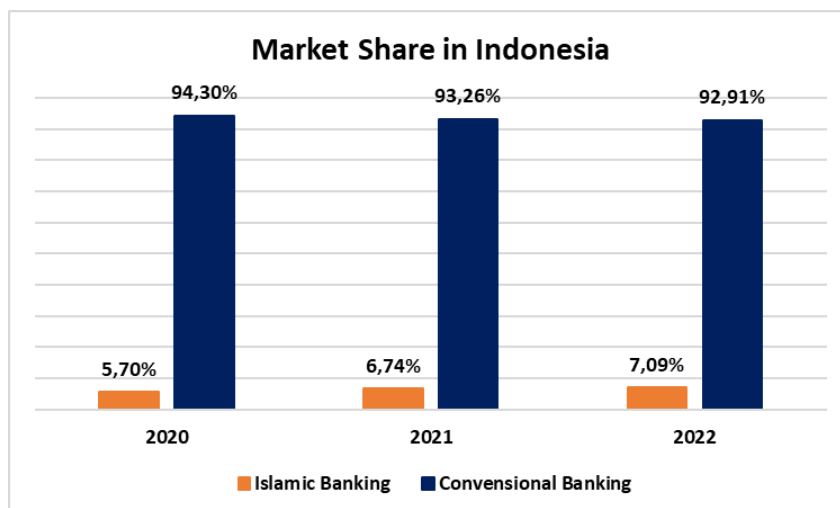


Fig. 3. Banking market share in Indonesia

Based on previous research on the contribution of Islamic banking, according to M. Anwar et al., 2020 [6] Islamic Bank Office (IBO), Total Financing (TF), and Total Deposit (TD) variables have a positive contribution to real GDP in Indonesia. In addition, Kismawadi, 2023 [11] revealed that the variables of total assets and deposits of Islamic banking can encourage economic growth in Saudi Arabia, UAE, Kuwait, Malaysia, Qatar, Bahrain, and Bangladesh. Meanwhile, according to Ghoniyah & Hartono, 2020 [12] states that financing variables and long-term deposits have a significant effect on economic growth in Malaysia. However, it has no short-term effect on economic growth in Malaysia. According to Siddique et al., 2022 [13] Islamic banking products in Pakistan through financing have a positive influence on the rate of economic growth and this encourages the achievement of SDGs in Pakistan. Meanwhile, according to Tabash et al., 2022 [14] Islamic banking in Nigeria through total assets, deposits, and total income has a positive contribution in the long and short term to GDP in Nigeria, but the contribution is not significant. Naz & Gulzar, 2023 [15] stated that the variables of assets, deposits, financing and Islamic stock market have a significant and positive relationship with real GDP in Indonesia.

In contrast to other researchers, such as according to Taujiharrahan 2020 [16] the results showed that the variable number of offices had no significant effect on GRDP in West Java, however, MSME and Non-MSME financing had a positive effect on GRDP in West Java using multiple linear regression methods. In addition, according to Rifai et al., 2021 [17] the total assets and financing variables have a negative effect on economic growth in East Kalimantan. Meanwhile, the DPK variable has a positive effect on GRDP in East Kalimantan using the multiple linear regression method. Meanwhile, according to Sofariah et al., 2022 [18] revealed that in the long term and short term the total assets and ZISWAF variables affect Indonesia's GDP. Meanwhile, DPK has a negative influence on Indonesia's GDP. However, in contrast to financing, the results show positive in the long term and negative in the short term, this uses the ARDL method.

Based on the explanation of the research gap and the problems above, there are 29 provinces that are still below the SDGs target of GRDP per capita, and this shows that there is still a development gap at the regional level. Therefore, with the positive performance of Islamic banking in 2015-2022 and the increase in the market share of Islamic banking, which is still inferior when compared to conventional banking, is there any contribution to GRDP per capita to encourage the target of achieving Sustainable Development Goals (SDGs).

2. Method

This research uses quantitative methods with a descriptive approach. According to Fauzi et al., 2022 [19] the hallmark of quantitative research is the collection of data in the form of numbers with statistically and mathematically based analysis in the form of empirical evidence that is real (ontology). Therefore, using secondary data in the form of GRDP per capita obtained from the Central Statistics Agency (BPS) web and data on the number of offices, financing and deposits obtained from the Financial Services Authority (OJK) web through the Islamic banking statistics report. The sample in this study uses data from 33 provinces in Indonesia.

The analysis method used in this research is panel data regression analysis, because it uses time series and cross section data types. Panel data regression analysis used in this study is to determine the relationship or positive or negative effect that exists in the independent variable (Number of Offices, Financing, and DPK) of Islamic banking on the dependent variable (GRDP per capita). In the analysis process that will be carried out is to select the estimation model, followed by the application of model selection, and classical assumption tests to produce panel data regression statistics. The panel data regression analysis method is rarely used by previous researchers regarding Islamic banking contribution research. Many previous researchers used the ARDL method or multiple linear regression analysis. Thus, the analysis method in this study will be a development of previous research.

3. Results and Discussion

According to Central Statistics Agency, 2023 [5] one of the proxy indicators of the level of welfare of the population of a region is using GRDP per capita, namely, the quotient between the added value obtained from all business units, both goods and services, and the total population. In addition, GRDP at constant prices shows the added value of these goods and services calculated using prices prevailing in a particular year as the base year. Constant GRDP is used to determine economic growth in real terms from year to year or economic growth that is not influenced by price factors.

In addition, according to Muliaman D. Hadad, 2016 [20] Chairman of the OJK Board of Commissioners, said that Islamic finance can be one of the best ways to encourage the achievement of Sustainable Development Goals (SDGs) launched by the United Nations. Therefore, Islamic banking is one of the Islamic financial institutions that will encourage SDGs [12]. Through the number of offices, financing, and deposits of Islamic banking can be used as a measure of the contribution of Islamic banking [6].

According to Financial Services Authority, 2023 [21] states that Islamic Banking provides sharia services to the public through its service offices. As with other service companies, they act as intermediaries between fund owners and fund managers. During the two decades of development of the Islamic banking sector in Indonesia, much progress has been made in terms of institutional structure and supporting infrastructure, regulatory and supervisory systems, and public awareness of Islamic banking services. According to researchers M. Anwar et al., 2020 [6] Islamic Bank Offices in Indonesia make a positive contribution to GDP in Indonesia. Meanwhile, Taujiharrahman, 2020 [16] stated that the variable number of offices in West Java did not have a significant effect on the GRDP of West Java Province. Likewise, researchers Dinanti, 2023 [22] stated that the number of Islamic banking offices in Indonesia has no effect on GDP in Indonesia. Therefore, from several studies that have been mentioned, it shows that there are different results. So, the following hypothesis can be prepared:

H1: The number of Islamic banking offices affects Regional Domestic Product (GRDP) per capita.

In addition, based on Law No. 10 of 1998 article 1 number 12, it states that financing based on sharia principles is the provision of money or bills that are equated with it based on an agreement or agreement between a bank and another party that requires the financed party to return the money or bill after a certain period of time in return or profit sharing. The higher the value of Islamic bank financing that can be channeled, it will help people who are short of fund [6]. Gani & Bahari, 2020 [23] revealed in their research that Islamic Bank Financing has a long-term effect but, not in the short term on real GDP in Malaysia. There is also according to Siddique et al., 2022 [13] the financing variable has an influence on real GDP in Pakistan to encourage the achievement of SDGs and according to Ghoniyah & Hartono, 2020 [12] states that the Islamic banking financing variable in Indonesia makes a positive contribution to SDGs. Meanwhile, Frita et al., 2022 [24] states that financing has no influence on GRDP in the SDGs program. In addition, according Rifai et al., 2021 [17] financing has a negative effect on economic growth as reflected by the GRDP of East Kalimantan Province. Therefore, from several studies that have been mentioned, it shows that there are different results. Then the following hypothesis can be formulated:

H2: Islamic banking financing affects Regional Domestic Product (GRDP) per capita.

Meanwhile, based on Law No. 28 of 2008 concerning Islamic banking, it states that deposits are funds entrusted by customers to Islamic Banks and / or UUS based on *wadi'ah* contracts or other contracts that are not contrary to sharia principles in the form of demand deposits, savings or other forms equivalent to that. The more DPK that is collected and distributed, the greater the economic growth, because DPK can be used as financing and is one of the sources of funding to drive the economy [25]. According to M Anwar et al., 2020 [6] the Total Deposits (TD) variable makes a positive contribution to GDP in Indonesia. In addition, Gani & Bahari, 2020 [23] stated that Islamic Bank Deposits have a long-term effect, however, not in the short term on real GDP in Malaysia. There

is also according to Kismawadi, 2023 [11] the DPK variable has a positive influence on the economy in Saudi Arabia, UAE, Kuwait, Malaysia, Qatar, Bahrain, and Bangladesh. Meanwhile, Sofariah et al., 2022 [18] revealed that the DPK variable has a negative influence on GDP in Indonesia. Therefore, from several studies that have been mentioned, it shows that there are different results. Then the following hypothesis can be formulated:

H3: Islamic banking third party funds (DPK) have an effect on Regional Domestic Product (GRDP) per capita.

Based on the explanation above, regarding the differences that show positively or negatively between the independent variable and the dependent variable. Therefore, whether simultaneously the three variables have an influence or not on GRDP per capita. Therefore, the following hypothesis can be formulated:

H4: The number of offices, financing, and third-party funds (DPK) of Islamic banking simultaneously affect Regional Domestic Product (GRDP) per capita.

Table 1. Descriptive Analysis

	Obs	Mean	Median	Maximum	Minimum	Std. Dev.
GRDP	264	0.040621	0.032000	0.183000	0.011000	0.031052
IBO	264	1.536602	1.568000	2.599000	0.602000	0.575570
Financing	264	4372.44	4580.500	6681.000	1985.000	1285.217
TPF	264	0.154110	0.124000	1.760000	-0.646000	0.266278

Based on the descriptive analysis results in Table 1, it shows that this study has balanced panel data. Balanced panel data is a state of balanced panel data or a balanced number of time series observations for cross section units [26]. Then, the observations or the amount of data in this study were 264 data, from 33 provinces in Indonesia within a period of 8 years. According to Maulidina et al, 2022 [26] the available data is more accurate or normally distributed results if the standard deviation is lower than the mean. Based on the table above, in general, the research variables GRDP, IBO, Financing, except TPF successively obtained a value of 0.040621, 1.436602, 4372.44, 0.154110. It can be concluded that the research results show that each variable is normally distributed except TPF.

Table 2. Chow Test

Prob. F	Indicator	Result	Conclusion
0.0000	Prob. F < Sig. (0.05)	H0 rejected	FEM selected

Table 2 shows that the chow test results have an F-probability value of 0.0000, which is smaller than $\alpha = 0.05$ so that H0 is rejected. Therefore, the selected model is the fixed effect model (FEM). Therefore, the model selection test will be continued in the Hausman test in order to determine the best model.

Table 3. Hausman Test

Prob. F	Indicator	Result	Conclutrion
0.0046	Prob. Chi sq < Sig. (0.05)	H0 rejected	FEM selected

Table 3 shows that, the Hausman test results have a probability value of 0.0046 where the value is smaller than $\alpha = 0.05$ so that H0 is rejected. Therefore, the selected model is the fixed effect model (FEM). Therefore, the model selection test does not need to be continued with the Lagrange test, because the best model has been found, which will use the fixed effect model (FEM).

Table 4. Multicollinearity Test

	IBO	Financing	TPF
IBO	1.000000	0.825621	0.096991
Financing	0.825621	1.000000	0.151739
TPF	0.096991	0.151739	1.000000

According to Setiawati, 2021 [27] if the correlation coefficient value is less than 0.90, there is no multicollinearity or passes the multicollinearity test. Based on Table 4, the correlation coefficient between IBO and Financing is 0.825621. In addition, the correlation coefficient between IBO and TPF is 0.096991. Meanwhile, the correlation coefficient between Financing and TPF is 0.151739. Therefore, based on the results of Table 4, there is no multicollinearity or passes the multicollinearity test because all correlation coefficient variables are less than 0.90.

Table 5. Heteroskedasticity Test

Variabel	Coefficient	Prob.
C	-0.002662	0.3704
IBO	-0.002374	0.1234
Financing	0.000265	0.6480
TPF	-0.000512	0.2139

Heteroscedasticity test is carried out to find out whether there is a difference in variation between one residual and another observation [27]. Based on the results of the table above, the probability values for IBO, Financing, and TPF are respectively 0.1234, 0.6480, 0.2139, the results of which are more than 0.05, which means that there are no symptoms of heteroscedasticity or passing the heteroscedasticity test.

Table 6. Panel Data Regression Results

Variabel	Coefficient	Std. Error	t-Statistik	Prob.
C	-0.000270	0.005953	-0.045425	0.9638
IBO	-0.006737	0.003081	-2.186406	0.0298
Financing	1.18E-05	1.16E-06	10.12163	0.0000
TPF	-0.001433	0.000824	-1.739537	0.0833

Based on Table 6 the equation obtained from the panel data regression model estimation is as follows:

$$\text{GRDP} = -0.000270 - 0.006737\text{IBO} + 1.1770\text{e-}05\text{FINANCING} - 0.001433\text{TPF}$$

The constant value of -0.000270 indicates that the independent variables expressed as zero will give negative results on the value of GRDP. Then, the coefficients of IBO, Financing, and TPF have various coefficient values of -0.006737, 1.1770e-05, and -0.001433, respectively. In addition, the partial test results of each independent variable in this study can be described as follows:

a) Effect of Islamic Banking Office (IBO) on Gross Regional Domestic Product (GRDP) Per Capita

Based on the results of the selected fixed effect model (FEM), the value of IBO is -0.006737 with a probability value of 0.0298 where the probability value is smaller than the significance value of 0.05 and H1 is accepted. Thus, it can be stated that the results of the IBO variable partially have a significant negative effect on GRDP. The significant negative effect in testing this hypothesis shows that the smaller the IBO value spread throughout Indonesia, the greater the GRDP per Capita. This means, to increase the level of social welfare, we must reduce the number of sharia bank branch offices in Indonesia. The aim is to reduce the value of sharia bank operational costs. The reason is, during the

pandemic something called "branchless banking" was introduced, where customers can carry out banking transactions without having to go to a branch office, meaning utilizing financial services via an internet or online connection. The application of this system is only used for areas that are not yet covered by banking office networks or remote areas. If branchless banking is implemented in all sharia banks in Indonesia and the digital banking system is improved, it will have a positive impact on society and can reach people in remote areas. In the long term, branchless banks can encourage people to save and improve household financial conditions, so that the income gap narrows. One of the benefits for customers with digital banking is financial management, for example a customer wants to buy a ready-made house, through digital banking features or products offered customers can save to achieve their financial goals. This will have an impact on increasing the level of welfare.

b) The Effect of Financing on Gross Regional Domestic Product (GRDP) Per Capita

Based on the results of the selected fixed effect model (FEM), the value of Financing is 1.1770e-05 with a probability value of 0.0000 where the probability value is smaller than the significance value of 0.05 and H2 is accepted. Thus, it can be stated that the results of the Financing variable partially have a significant positive effect on GRDP. The significant positive effect in testing this hypothesis shows that the greater the financing provided by Islamic banks, the more GRDP per capita will increase. This explains that business actors who get financing can increase production which has implications for increasing community income. The number of businesses that absorb a large number of workers is a great opportunity in economic development and welfare improvement efforts.

c) Effect of Third-Party Funds (TPF) on Gross Regional Domestic Product (GRDP) Per Capita

Based on the results of the selected fixed effect model (FEM), the TPF value is -0.001433 with a probability value of 0.0833 where the probability value is greater than the significance value of 0.05 and H3 is rejected. Thus, it can be stated that the results of the TPF variable partially have no significant effect on GRDP. This shows that with the increase and decrease in the value of Islamic banking deposits, it will not increase or decrease the value of GRDP per capita. This is because sharia financial services cannot be accessed equally by all levels of society, especially those in remote areas. For example, West Papua province is ranked 5th with the highest GDP per capita in Indonesia. However, the 30th rank received Sharia Banking TPF. Apart from that, Papua Province is ranked 6th with the highest GRDP per capita in Indonesia. However, the 25th rank received Sharia Banking TPF. This shows that there is unequal access to sharia financial services that can be used by people in Indonesia. Another thing is due to the lack of understanding among Indonesian people about the importance of sharia transactions. What can be done is to increase sharia financial literacy among the community. Because with a better understanding of sharia principles and sharia banking products, people will be more likely to use them effectively, which in turn will make people more confident in saving their money in sharia banking compared to conventional banking.

Table 7. F-Test Results and Coefficient of Determination

Weighted Statistics			
R-squared	0.990520	Mean dependent var	0.040621
Adjusted R-squared	0.989064	S.D. dependent var	0.031052
S.E. of regression	0.003247	Akaike info criterion	-8.495888
Sum squared resid	0.002404	Schwarz criterion	-8.008259
Log likelihood	1157.457	Hannan-Quinn criter	-8299944
F-statistic	680.6194	Durbin-Watson stat	0.627850
Prob (F-statistic)	0.000000		

Based on Table 7, the F-statistic value of 0.000000 is obtained which is smaller than the significance value of 0.05 and H4 is accepted. That is, this result explains that the independent variables tested, namely IBO, Financing, and TPF simultaneously have a significant positive effect on the dependent variable, namely GRDP. The results of this study are in accordance with the results of

research conducted by M. Anwar et al., 2020 [6] Islamic Bank Office (IBO), Total Financing (TF), and Total Deposit (TD) variables have a positive contribution to real GDP in Indonesia. In addition, in accordance with research conducted by Ghoniyah & Hartono, 2020 [12], it is stated that Islamic banking is one of the Islamic financial institutions that will encourage sustainable development goals (SDGs).

In addition, an adjusted R-squared value of 0.989064 or 98.91% was obtained. The coefficient value shows that the independent variables IBO, Financing, and TPF are able to explain 98.91% while the remaining 1.09% is explained by other variables that are not shown in this model. According to Maulidina et al, 2022 [26] if the coefficient of determination is closer to 1, the influence of the independent variable on the dependent variable will be greater. Based on the analysis results in Table 5, the adjusted R-squared value obtained is close to 1 (100%). So, it can be concluded that the independent variables in this study have a great influence on the dependent variable.

4. Conclusion

Based on the results and discussion previously described, the conclusions is that Islamic Banking Office (IBO) has a significant negative effect on GRDP per capita. The significant negative effect in testing this hypothesis shows that the smaller the IBO value spread throughout Indonesia, the greater the GRDP per Capita. This means, to increase the level of social welfare, we must reduce the number of sharia bank branch offices in Indonesia. This can reduce bank operational costs. However, Islamic banking needs to encourage digital system transformation so that it can reach a wider community. Through the "branchless banking" system, it can be implemented to reach people in remote areas and improve the digital banking system. Meanwhile, financing has a positive effect on GRDP per capita. This shows that the financing provided can help people who lack funds. Business actors who get financing can increase production which has implications for increasing community income. The number of business actors who absorb a large number of workers is a great opportunity in economic development and efforts to improve welfare.

In addition, TPF has no effect on GRDP per capita. This is because sharia financial services cannot be accessed equally by all levels of society, especially those in remote areas. Apart from that, this is due to the lack of understanding among the people in Indonesia regarding the importance of sharia-compliant transactions, which will have an impact on increasing sharia financial literacy among the public. If people understand, they will be more confident in saving their money in sharia banking compared to conventional banking. Meanwhile, simultaneously IBO, Financing, and TPF variables have a positive effect on GRDP per capita. This shows that Islamic banking has a contribution value to encourage the level of community welfare interpreted by GRDP per capita. The implication can encourage the target of sustainable development goals (SDGs) agreed upon in the UN forum.

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