

Optimizing Islamic Financial Instruments in Indonesia to Support SDGs: *Maqashid Syariah* Perspective

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Abstract

Objective: Examine how these instruments can be aligned with global development goals while grounded in Islamic principles. This study aims to analyze the optimization of various Islamic financial instruments, such as *Zakah*, *Waqf*, *Sukuk*, and Islamic banking, to support the achievement of SDGs. **Theoretical framework:** *Maqashid Syariah*, which emphasizes the protection of essential human values such as faith, life, intellect, lineage, and wealth, the study highlights the role of Islamic finance in promoting social welfare, economic justice, and environmental sustainability. **Literature review:** Conducted, drawing from academic sources, regulatory documents, and practical implementations of Islamic finance in Indonesia and other Muslim-majority countries. **Methods:** The method used in this study is a qualitative approach with literature study techniques, analyzing relevant literature and Islamic financial policies in Indonesia and the world. **Results:** The study indicate that Islamic financial instruments can contribute significantly to supporting SDGs, especially in the aspects of poverty alleviation (SDG 1), quality education (SDG 4), economic equality (SDG 10), and sustainable consumption and production (SDG 12). However, there are challenges in optimizing implementation, such as regulations that are not yet uniform, low Islamic financial literacy, and limited innovation in instrument development. **Implications:** This study recommends synergy between the government, Islamic financial institutions, academics, and the community in strengthening a sustainable Islamic financial ecosystem. With proper optimization, Islamic finance can be an alternative solution in supporting a green, inclusive, and equitable economy by the principles of *Maqashid Syariah* and the goals of the SDGs. **Novelty:** This research lies in its integrative approach that bridges the ethical vision of *Maqashid Syariah* with the contemporary global development agenda, offering a holistic and faith-based framework for sustainable economic progress in Indonesia.

Keywords: optimizing, islamic finance, sdgs, maqashid syariah, sustainable development

INTRODUCTION

In recent decades, the Islamic economy and finance in Indonesia have experienced rapid development, both in terms of product diversification and the increasing number of financial institutions operating in this system [1][2]. The growth covers various sectors, including Islamic banking, Islamic capital markets, Islamic insurance, and Islamic philanthropic

institutions such as *Zakah*, *Waqf*, and *Infaq*. The existence of these various instruments has formed an increasingly broad, integrated Islamic financial ecosystem that contributes to national economic growth. The response of the Muslim community to this development is very positive because the Islamic financial system is considered more in line with Islamic principles, such as the prohibition of *riba* (interest), *gharar* (uncertainty), and *maysir* (speculation or gambling) [3]. In addition, Islamic finance also emphasizes aspects of justice, transparency, and siding with the real sector and social welfare, making it increasingly attractive to people looking for ethical and sustainable financial alternatives [4].

The rapid development of the Islamic financial sector in Indonesia also has the full support of the government, which is actively designing policies and strategies to strengthen Sharia economic infrastructure. The National Committee for Sharia Economics and Finance (KNEKS) acts as a driving force in developing this industry through various programs and initiatives. Several strategic steps that have been taken include increasing Sharia financial literacy, expanding public access to Sharia financial services, and improving regulations that support the development of the Sharia financial industry [5]. The development of the Sharia economy is also in line with efforts to achieve the *Sustainable Development Goals* (SDGs) in Indonesia [6][7][8]. Through instruments such as green *Sukuk*, productive *Zakah*, and cash *Waqf*, Islamic finance can act as a source of funding for social programs and sustainable infrastructure development. However, despite its great potential, there are still several challenges that need to be overcome, such as low Islamic financial literacy, limited regulations that support product innovation, and the need for stronger synergy between the government, the private sector, and Islamic financial institutions.

As a country with the largest Muslim population in the world, Indonesia has great potential to make Sharia economics one of the main pillars of inclusive and sustainable national economic development. The use of a sharia economic system based on justice, transparency, and risk balance not only benefits Muslims but also the entire community at large [9][10]. In addition, the Sharia economy is also believed to be able to maintain economic stability with an approach based on ethical values and sustainability, so that it can become a major force in realizing Indonesia's vision as a global Sharia financial center [11].

In the long term, Islamic economics has the potential to make a significant contribution to achieving the SDGs, especially in terms of poverty alleviation, financial inclusion, and social welfare. This opinion is in line with the Islamic Welfare Theory put forward by Muhammad Umer Chapra (2000) in his book *The Future of Economics: An Islamic Perspective*. Chapra emphasized that Islamic economics aims to create social welfare by balancing material and spiritual aspects and supporting a fairer distribution of wealth through the mechanisms of *Zakah*, *infaq*, and *Waqf* [12]. In addition, Veithzal Rivai and Andi Buchari outlined the theory of Islamic financial stability, stating that the Islamic financial system is more stable than conventional finance because it is based on the principles of partnership (*mudharabah* and *musyarakah*) and risk-sharing so that it can reduce economic volatility and the risk of financial crisis [13].

As the main foundation, the development of Sharia economics and finance in Indonesia also refers to *Maqashid Syariah*, namely a concept that emphasizes the achievement of Sharia goals in protecting religion (*hifzh ad-din*), soul (*hifzh an-nafs*), reason (*hifzh al-aql*), descendants (*hifzh an-nasl*), and property (*hifzh al-mal*). According to Jasser Auda, the application of *Maqashid Syariah* in the economy aims to create a system that is more just, equitable, and oriented towards welfare and sustainability [14]. This opinion is reinforced by Dusuki and Abdullah in their research on *Maqasid al-Shariah*, *Maslahah*, and Corporate Social Responsibility, stating that the Sharia financial system based on *Maqashid Syariah* can provide a positive impact in creating social justice and equal distribution of welfare [15].

Along with the increasing development of Islamic financial instruments such as Islamic banking, Islamic capital markets, Islamic insurance, and Islamic philanthropic institutions,

optimizing policies and regulations is an important factor in supporting the growth of this industry. The Indonesian government through the National Committee for Islamic Economics and Finance (KNEKS) has initiated various programs to strengthen Islamic financial literacy, access to financial services, and regulatory infrastructure to increase the competitiveness of the Islamic economic sector [16]. Abdul Manan in his book *Theory and Practice of Islamic Economics* states that the effectiveness of sharia economics in national economic development is highly dependent on the role of regulations and policies that encourage the sharia industrial ecosystem to be able to synergize with national macroeconomic policies [17][18]. According to Iqbal and Mirakhor, strengthening the Islamic financial system in a country will be more effective if there is strong integration between Islamic financial instruments and government policies. They emphasized that Islamic Ethics-Based Economic Theory places moral values as the main pillar in financial management so that it can create a more stable and inclusive economic system compared to the conventional financial system [19].

However, despite its great potential, the optimization of Islamic financial instruments in supporting the SDGs still faces various challenges, such as the lack of Islamic financial literacy, minimal synergy between Islamic economic policies and national development policies, and limited innovation of Islamic financial products that are by community needs. Thus, the optimization of Islamic financial instruments through the *Maqashid Syariah* approach is a strategic need in supporting sustainable development and the achievement of SDGs in Indonesia. Therefore, this study aims to analyze how Islamic financial instruments can be optimized to improve community welfare and strengthen Indonesia's competitiveness in the global economy while still being based on Islamic principles.

LITERATURE REVIEW

Sustainable Development Goals (SDGs) and Islamic Finance

Sustainable Development Goals (SDGs) are a global agenda prepared by the United Nations (UN) to address complex and multidimensional development challenges, ranging from poverty, social inequality to climate change. Consisting of 17 goals and 169 targets, the SDGs emphasize the importance of cross-sector collaboration to create inclusive, sustainable, and equitable development. The values contained in the SDGs are basically in line with the basic principles of Islamic finance, which prioritize justice (*al-'adl*), balance (*tawazun*), and social responsibility. In this context, Islamic finance can be a strategic instrument to support the achievement of SDGs, especially through an approach based on ethics, social solidarity, and sustainability [15]. Islamic financial instruments such as zakat, *infak*, *sedekah*, and *waqf* (ZISWAF), as well as financing based on *mudharabah* and *musyarakah* contracts, have great potential to answer the need for socially friendly and sustainable development financing [13]. Zakat can be used to eradicate poverty (SDG 1), while waqf can be developed for the education and health sectors (SDG 3 and 4). On the other hand, Islamic microfinance can encourage the growth of MSMEs and create decent jobs (SDG 8). Thus, Islamic finance is not only a financial instrument, but also a means to achieve holistic development that balances economic, social, and spiritual goals within the framework of *maqashid sharia*.

Maqashid Syariah as a Framework for Evaluating Financial Instruments

Maqashid Syariah is a fundamental concept in Islamic law that refers to the main objectives of implementing sharia, namely maintaining and protecting the five main aspects of human life: religion (*din*), soul (*nafs*), reason (*aql*), descendants (*nasl*), and property (*mal*). In the context of Islamic finance, *maqashid sharia* becomes a normative framework that can be used to evaluate whether a financial instrument truly meets the principles of justice, welfare, and balance. This approach emphasizes that Islamic finance must not only

be legally compliant (legal-formal), but must also have a positive social and moral impact on the wider community. Thus, *maqashid sharia* demands that every Islamic financial product and activity is not merely oriented towards financial profit, but must also foster welfare and avoid social damage (*mafsadah*) [17][18].

Empirical Studies on Islamic Finance and SDGs Alignment

Several empirical studies have shown a positive relationship between the development of Islamic finance and the achievement of sustainable development goals (SDGs). In the Indonesian context, research shows that Islamic microfinance institutions such as *Baitul Maal wat Tamwil* (BMT) contribute significantly to increasing financial inclusion and empowering micro-entrepreneurs. This has a direct impact on reducing poverty levels and improving the welfare of lower-class communities, which are related to SDG 1 (no poverty) and SDG 8 (decent work and economic growth). In addition, the study also noted that zakat and *waqf* funds that are managed productively can finance social programs such as inclusive education and health, supporting the achievement of SDG 3 (good health and well-being) and SDG 4 (quality education) [6][7][8]. However, the effectiveness of Islamic finance's contribution to the SDGs is inseparable from some challenges that still need to be overcome. Empirical studies identify several obstacles, such as low Islamic financial literacy among the community, a lack of data integration between *zakat*, *waqf*, and government institutions, and weak innovation in Islamic financial products that meet the needs of the social sector [13]. In addition, many Islamic financial institutions still focus on profit orientation rather than developing socially based business models that are in line with *maqashid sharia* and the goals of the SDGs. This situation has caused the great potential of Islamic finance in supporting sustainable development to not be optimally utilized. On the other hand, there are also examples of best practices that show the success of integration between Islamic finance and SDGs. One of them is the issuance of green *sukuk* by the Indonesian government, which is used to finance environmentally friendly projects, such as the development of renewable energy and climate change mitigation (supporting SDG 7 and SDG 13). This success is proof that Islamic financial instruments can be developed innovatively to answer global challenges without ignoring Sharia principles. Therefore, future research needs to continue to examine models of integration between Islamic finance and SDGs more systematically, including formulating evaluation indicators based on *maqashid sharia* so that their implementation is more measurable and sustainable.

METHODOLOGY

This research uses a qualitative type with a library research method [20]. The approach applied is descriptive-qualitative concerning the concept of *Maqashid Syariah*, namely research that focuses on understanding the concept, policy, and implementation of Islamic finance in the context of sustainable development in achieving SDGs. The data sources in this study consist of primary sources that include Islamic financial regulations and policies issued by institutions such as Bank Indonesia (BI), the Financial Services Authority (OJK), the National Sharia Council-Indonesian Ulema Council (DSN-MUI), and the Indonesian *Waqf* Board ((BWI). In addition, this study also uses secondary sources in the form of scientific journals, academic books, and publications from various international organizations. Data analysis was carried out using the methods of data reduction, data presentation, and data extraction [21]. Thus, this research method provides a comprehensive understanding of the potential and challenges of Islamic finance in supporting SDGs, as well as how the *Maqashid Syariah* approach can be integrated into sustainable development strategies.

Table 1. Research Method Used in This Study

Aspect	Description
Type of Research	Qualitative
Approach	Descriptive-Qualitative with library research method
Research Objective	To understand the concept, policy, and implementation of Islamic finance in the context of sustainable development (SDGs) using the Maqashid Syariah framework
Rationale for Approach	The descriptive-qualitative approach enables an in-depth exploration of literature and conceptual frameworks to analyze how Islamic finance guided by Maqashid Syariah supports long-term human welfare aligned with SDGs
Key Figures Analyzed	Key regulatory and advisory bodies such as: Bank Indonesia (BI), Otoritas Jasa Keuangan (OJK), Dewan Syariah Nasional-MUI (DSN-MUI), Badan Wakaf Indonesia (BWI)
Main Data Sources	Primary: Official Islamic finance policies and regulatory documents (BI, OJK, DSN-MUI, BWI). Secondary: Academic journals, books, and reports from international organizations on Islamic finance and sustainable development.
Method of Analysis	Miles and Huberman's interactive model: data reduction, data display and conclusion drawing/verification
Theoretical Framework	Maqashid Syariah; focusing on the preservation and promotion of religion (<i>din</i>), life (<i>nafs</i>), intellect (<i>aql</i>), progeny (<i>nasl</i>), and wealth (<i>mal</i>), and how these goals align with the dimensions of SDGs.
Focus of Analysis	Evaluates how Islamic finance institutions and policies are aligned with and contribute to sustainable development, analyzed through the lens of Maqashid Syariah
Expected Outcome	A comprehensive understanding of the role and contribution of Islamic finance in supporting SDGs, and strategic recommendations for integrating Maqashid Syariah principles into economic and financial policy

RESULTS AND DISCUSSION

The Compliance of Islamic Finance with *Maqashid Syariah* in the Context of SDGs

Islamic finance is an economic system based on Islamic principles and oriented towards achieving the welfare of individuals and society at large [4][16]. This concept is in line with *Maqashid Syariah*, namely the main objective of implementing Islamic law which is based on the protection of religion (*hifz ad-din*), soul (*hifz an-nafs*), reason (*hifz al-aql*), descendants (*hifz an-nasl*), and property (*hifz al-mal*) [14]. In the context of global development, the principles of *Maqashid Syariah* have strong relevance to the Sustainable Development Goals set by the United Nations (UN). According to Shahida Shahimi, Siti Aisyah Zahari in book *Principles of Sustainability in Islamic Finance*, the Islamic financial approach based on justice, transparency, and sharing of risks and benefits can create a more stable and sustainable economic system [22]. This is in line with the goals of SDG 8 (inclusive economic growth), SDG 10 (reducing economic disparities), and SDG 1 (poverty eradication). Implementing the principle of prohibiting usury, speculation (*gharar*), and unethical transactions, Islamic finance can encourage fairer economic development and is oriented towards social welfare.

Maqashid Sharia also emphasizes the importance of balance between economic, social, and environmental aspects, which are the core of the concept of sustainable development. In Alfitri's view, the implementation of Islamic law should not only stop at textual compliance with classical fiqh, but must continue to develop with dynamic *ijtihad* that is relevant to current socio-economic conditions [23]. This confirms that Islamic finance must continue to innovate to answer the challenges of the modern economy, including supporting the achievement of the SDGs. One real form of the implementation of *maqashid sharia* in the

SDGs is the use of Islamic financial instruments such as *Zakah*, *Waqf*, and social *Sukuk* to fund projects with high social impacts. Ascarya emphasized that these instruments can be a solution to the limitations of the conventional financial system in creating broader financial inclusion, thereby helping to achieve SDG 9 (innovation and infrastructure) and SDG 17 (global partnerships) [24].

Islamic finance is an instrument that is in line with *Maqashid Syariah* and Sustainable Development Goals. There is also debate about its effectiveness in achieving sustainable development goals which considers that the Islamic financial system has structural challenges that can hinder its implementation on a wider scale. According to Mohamed Ariff and Munawar Iqbal, the Islamic financial system based on profit-loss sharing (PLS) can create better financial stability compared to the conventional system which is often vulnerable to financial crises due to excessive speculation [25]. This approach is considered to be able to support SDG 8 (inclusive economic growth) and SDG 10 (reducing economic inequality) because it encourages a more equitable distribution of profits. This concept offers risks and profits to be shared proportionally between the party providing capital (*shahibul maal*) and the party running the business (*mudharib*). The advantages of this system are first, Reducing Systemic Risk, namely Unlike conventional systems that rely on interest-based debt, the PLS system ensures that funds are only given to economically viable projects. This prevents financial crises due to speculative bubbles. Second, Encouraging Entrepreneurship and Innovation, namely With a profit-sharing system, parties who receive funding are encouraged to work more productively, because the profits obtained will determine the return for investors. This is in line with SDG 8 (inclusive and sustainable economic growth) and SDG 9 (industry, innovation, and infrastructure). Third, Reducing Social and Economic Disparities, One of the criticisms of the conventional financial system is that profits are often only concentrated on a handful of parties who have access to capital. With the PLS approach, benefits can be distributed more evenly, thus supporting SDG 10 (reducing economic inequality) [22][5].

In addition, according to Usman and Adell Malik, Islamic finance is more ethical and sustainable than conventional finance [26]. This is because the Sharia system prevents exploitation and encourages real asset-based transactions, which are more in line with SDG 12 (responsible consumption and production). The principles offered are because exploitation and uncertainty (*gharar* and *maysir*) are prohibited, real asset-based (asset-based finance), and ESG-based investments (environmental, social, and governance). Islamic social finance has great potential to create a more equitable economic system, by supporting SDG 1 (poverty eradication) and SDG 3 (health and well-being) [7][8]. Although Islamic finance aims to create economic justice and support sustainable development, there have been many criticisms regarding its actual implementation in the global financial sector. Rodney Wilson in *The Development of Islamic Finance in the GCC* highlights that many Islamic financial institutions are more oriented towards commercial profit than achieving social justice, as mandated by *Maqasid Shariah* [27]. One of the main criticisms raised by Wilson is the dominance of murabahah-based financial products compared to profit-loss sharing (PLS) instruments such as *mudharabah* and *musyarakah*. In fact, in Islamic economic theory, PLS-based instruments better reflect the principles of justice and partnership that are the basis of Islamic finance [28][29].

Islamic finance is not just an economic system that is free from usury, but also has a social dimension and economic justice that is by *Maqashid Syariah*, namely the main objective of Islamic law. This principle emphasizes the welfare of humanity as a whole by ensuring a fair distribution of wealth, protection of individual rights, and economic sustainability. In line with the Sustainable Development Goals initiated by the United Nations (UN), Islamic finance has a value alignment in creating an inclusive, equitable, and sustainable economic system [30]. According to Ascarya, Islamic financial instruments such as *Zakah*, *Waqf*, and social *Sukuk* have a strategic role in financing social and economic

projects that support SDG 9 (innovation and infrastructure) and SDG 17 (global partnerships) [24]. According to Al-Ghazali (in Chapra, 2000) and Asy-Syatibi, *Maqashid Syariah* in the context of economics focuses on five main aspects, namely first, *Hifzh ad-Din* (Protection of Religion) Avoiding usury and speculative transactions (*gharar*) which are prohibited in Islam. Second, *Hifzh an-Nafs* (Protection of Soul), Realizing social welfare through instruments such as *Zakah* and *Waqf*. Third, *Hifzh al-'Aql* (Protection of Reason), Encouraging sharia financial literacy and transparency in business. Fourth, *Hifzh an-Nasl* (Protection of Descendants), Developing a sustainable economy and investment that does not harm future generations. Fifth, *Hifzh al-Mal* (Protection of Property), Prioritizes real asset-based transactions and a more equitable distribution of wealth [31] [32].

Islamic finance has a significant role in supporting the achievement of various SDGs through Islamic economic principles that emphasize justice, social welfare, and sustainability. In the context of SDG 1 (Eradicating Poverty) and SDG 10 (Reducing Economic Disparities), Islamic finance contributes through wealth redistribution mechanisms such as *Zakah*, *infaq*, and *sedekah*, which aim to help underprivileged communities meet their basic needs and increase economic capacity through empowerment programs [33][8]. This social fund can be used to provide business capital for economically disadvantaged groups, support education programs, and provide access to health services for those who are less fortunate. Thus, the Islamic financial system offers a structural solution to address poverty and economic inequality more effectively than conventional approaches that often rely solely on government social assistance. In addition, Islamic finance also plays a role in SDG 8 (Decent Work and Economic Growth) by prioritizing a profit-loss sharing scheme through instruments such as *mudharabah* and *musyarakah*. This scheme can create a more inclusive economic system, where small and medium enterprises (MSMEs) gain access to partnership-based funding, without having to bear the risk of burdensome interest rates as in the conventional financial system [28][29]. Thus, Islamic finance not only drives sustainable economic growth but also creates a fairer and more exploitation-free business ecosystem.

In supporting SDG 9 (Innovation and Infrastructure), Islamic finance offers innovative financing solutions through infrastructure *Sukuk* instruments, which have been implemented in various countries to support road, bridge, public housing, and other public facility construction projects [34]. Infrastructure *Sukuk* has advantages compared to conventional bonds because it is based on real assets, thus reducing the risk of speculation and increasing the sustainability of the financed projects. The use of *Sukuk* in sustainable development also reflects the commitment of Islamic finance to creating a more stable economic system free from the high volatility that often occurs in the global financial system. Meanwhile, in the context of SDG 12 (Responsible Consumption and Production), Islamic finance encourages more ethical and sustainable business practices by ensuring that every transaction carried out is based on real assets and free from elements of *gharar* (uncertainty) and *maysir* (speculation) [7][8]. This concept contributes to creating a more transparent and responsible trading mechanism, both on an individual and corporate scale. Thus, Islamic finance not only ensures economic sustainability but also avoids the negative impacts of excessive consumption behavior and uncontrolled exploitation of resources.

In addition to its domestic role, Islamic finance also supports SDG 17 (Global Partnership) through various collaborative initiatives in the development of Islamic finance at the international level. Countries with a Muslim majority population have begun to build a more integrated Islamic financial ecosystem through cooperation between Islamic financial institutions, international organizations, and global regulatory bodies such as the Islamic Development Bank (IsDB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). This global partnership aims to strengthen Islamic financial standards, increase the accessibility of Islamic financial products, and ensure that the Islamic-based financial system can have a broader impact on inclusive and sustainable global

economic development [35][36]. Thus, Islamic finance has great potential in realizing sustainable development goals through principles that emphasize justice, inclusion, and social welfare. Optimal implementation of Islamic financial instruments in the global economic system can be a more stable and ethical alternative to the conventional financial system while strengthening the world's commitment to achieving SDGs holistically.

Islamic Financial Instruments as a Solution for Sustainable Development

Islamic finance has great potential in supporting the Sustainable Development Goals (SDGs) through instruments that are not only based on economic benefits alone but also oriented towards social values and sustainability. *Zakah*, *Waqf*, and social *Sukuk* are some of the Islamic financial instruments that have been proven to be able to contribute to overcoming various development challenges, especially in the aspects of wealth redistribution, social financing, and sustainable infrastructure.

***Zakah* as an Instrument for Wealth Redistribution (SDG 1 & 10)**

Zakah is one of the fundamental pillars of Islamic economics that aims to create social justice by distributing part of the wealth of individuals or institutions to underprivileged groups in society (*mustahik*). According to Chapra in *Islam and the Economic Challenge*, the *Zakah* system functions as a redistribution mechanism that can reduce social inequality and create more equitable welfare [37]. In the context of SDGs, *Zakah* plays a role in SDG 1 (Eradicating Poverty) and SDG 10 (Reducing Economic Disparities) by supporting economic empowerment based on social justice.

Zakah funds can be used productively for micro-business capital and skills training for poor groups, thereby increasing economic independence. Ascarya emphasized that *Zakah* not only functions as social assistance, but also as capital for small businesses that need support to grow [24]. Countries such as Malaysia and Indonesia have developed digitalization of *Zakah* to increase transparency, effectiveness, and accountability in its distribution. For example, in Indonesia, the National *Zakah* Agency (BAZNAS) has developed a *Zakah*-based empowerment program covering the education, health, and micro-enterprise sectors, which has been proven to improve the welfare of the poor and narrow the gap in economic inequality [38][39].

***Waqf* as a Source of Social Financing (SDG 4, 9, & 11)**

Waqf is a Sharia financial instrument that has great potential to support sustainable development, especially in the aspects of education (SDG 4), innovation and infrastructure (SDG 9), and sustainable urban development (SDG 11). Unlike *Zakah* which is a short-term distribution, *Waqf* is more long-term because the assets that are donated are maintained and only the results or benefits of these assets are distributed for social interests. According to Salman and Ghafar, *Waqf* has an important role in financing social infrastructure projects such as schools, hospitals, and public facilities, which ultimately improves the quality of services for the wider community [40]. In some countries, the concept of productive *Waqf* has been developed, where *Waqf* assets are managed professionally to generate income that is used for social purposes. For example, Al-Azhar University in Egypt has utilized *Waqf* to finance educational activities sustainably [41], while in Türkiye, *Waqf* institutions are used to fund free health services for the poor.

Innovation in *Waqf* management is increasingly developing with the application of blockchain technology to increase transparency and accountability in *Waqf* asset management. Halon said that blockchain-based *Waqf* certification can reduce the potential for misuse of funds and increase public trust in *Waqf* donations [42]. Several countries such as Malaysia and the United Arab Emirates have begun to adopt this model in their *Waqf* management systems. In Malaysia, blockchain technology is applied in the certification of

Waqf assets to make them easier to audit by regulators and the public. In addition, blockchain-based platforms track *Waqf* funds that have been converted into productive investments, such as in the education, health, or social infrastructure development sectors [43]. Meanwhile, in the United Arab Emirates, blockchain technology is being used to support fintech-based *Waqf* initiatives where people participate in digital *Waqf* donations.

Social and Infrastructure *Sukuk* (SDG 9 & 11)

Another Islamic financial instrument that has a major impact on sustainable development is social *Sukuk*, which is a Sharia bond used to finance sustainable social and infrastructure projects. According to Hasan, *Sukuk* has advantages over conventional bonds because it is based on real assets and is free from speculative elements, so it is more stable and can be used to finance infrastructure projects that have a broad social impact. [44]. One example of the application of *Sukuk* in sustainable development is green *Sukuk* which has been issued by Indonesia and Malaysia to finance environmentally friendly projects such as the development of renewable energy and green infrastructure. Green *Sukuk* allows countries to obtain funding from global investors who are interested in investments based on sustainability and Sharia principles. According to Faizi (2020) in Islamic green finance, green *Sukuk* is an attractive alternative to funding environmental projects because it connects economic, social, and ecological aspects in one financial instrument based on ethics and sustainability [45].

Sukuk Waqf instruments have also begun to be applied in several countries to fund social projects such as the construction of hospitals and free education. Nisful (2024) stated that the combination of *Sukuk* and *Waqf* can create a more inclusive and sustainable funding scheme because it combines the long-term benefits of *Waqf* with the flexibility of *Sukuk* in attracting funds from various sources [46]. This model has been implemented in Malaysia and Saudi Arabia as a solution to overcome the limitations of financing for social and infrastructure projects in developing countries.

Table 1. The Role of Islamic Financial Instruments in Supporting Sustainable Development Goals (SDGs)

Islamic Financial Instruments	Role and Function	Supported SDGs	Implementation Example	Latest Innovations
Zakah	As an instrument of wealth distribution to reduce poverty and social inequality. Used for micro-enterprise financing and skills training.	SDG 1 (No Poverty), SDG 10 (Reduced Inequalities)	BAZNAS empowerment program in Indonesia; digitalization of zakat in Indonesia and Malaysia.	Digitalization of zakat for transparency, effectiveness, and accountability.
Waqf	As a source of long-term social financing in education, health and public facilities.	SDG 4 (Quality Education), SDG 9 (Industry, Innovation & Infrastructure), SDG 11 (Sustainable Cities & Communities)	Productive Waqf at Al-Azhar University, Egypt; free Waqf-based health services in Turkey.	Blockchain implementation in Waqf certification and tracking in Malaysia and UAE.
Social Sukuk & Waqf Sukuk	Financing of sustainable social and infrastructure projects based on sharia principles and	SDG 9 (Industry, Innovation & Infrastructure), SDG 11 (Sustainable Cities & Communities)	Green Sukuk for renewable energy projects in Indonesia & Malaysia; Waqf Sukuk for free	Combination of Sukuk and Waqf for an inclusive and sustainable financing model.

	real assets.		hospitals and education.	
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Challenges in Optimizing Islamic Finance for SDGs

Islamic finance has great potential in supporting the achievement of SDGs, especially in creating a more inclusive, equitable, and sustainable financial system. However, the implementation of Islamic finance in Indonesia still faces various challenges that need to be overcome to contribute maximally to national development.

Suboptimal Regulations and Policies

Sharia financial regulations and policies in Indonesia have undergone significant developments, with the enactment of Law Number 21 of 2008 concerning Sharia Banking and various derivative regulations from the Financial Services Authority (OJK) and Bank Indonesia (BI). Law Number 19 of 2008 provides a legal basis for the issuance of sharia-based financing instruments by the state, such as State *Sukuk*, which are used to fund infrastructure projects and national development sustainably. Meanwhile, Law Number 21 of 2008 regulates the governance of Sharia banking, including provisions regarding the principles of Sharia banking business, the supervisory mechanism by the Financial Services Authority (OJK), and the obligation to comply with fatwas issued by the National Sharia Council-Indonesian Ulema Council (DSN-MUI).

The existence of this regulation aims to ensure that Islamic financial institutions operate within a clear legal corridor, as well as maintain a balance between aspects of Sharia compliance, financial system stability, and consumer protection. According to Ascarya, one of the main challenges in implementing Islamic financial regulations in Indonesia is the harmonization between positive law and sharia law, considering that the Indonesian legal system still accommodates conventional financial principles [24]. Therefore, Islamic financial regulations must continue to be strengthened to provide legal certainty for industry players and increase public trust in Islamic financial products.

The Indonesian government has also established various institutions tasked with overseeing and developing the Sharia financial industry, such as the National Committee for Sharia Economics and Finance (KNEKS), the Financial Services Authority (OJK), and Bank Indonesia (BI). According to Antonio, the effectiveness of regulation in the Sharia banking industry is highly dependent on the government's commitment to creating policies that support the growth of the Sharia financial sector and ensure strict supervision of the operations of Sharia financial institutions [47]. In this context, Bank Indonesia and OJK play a role in issuing various implementing regulations, such as Bank Indonesia Regulations (PBI) and OJK Regulations (POJK), which regulate capital mechanisms, governance, and products and services permitted in the Sharia financial system.

Sharia financial regulations in Indonesia have also accommodated the development of digital technology, such as OJK Regulation Number 12/POJK.03/2021 concerning Commercial Banks, which allows commercial banks to adopt a Sharia-based digital banking model (Sharia Digital Banking). This is in line with Hasan's opinion (2019) in *Islamic Economics: Theory and Practice*, stating that Sharia financial regulations must be adaptive to changes in the times to be able to face the challenges of the global financial industry [17]. Therefore, government policy in supporting the digitalization of Islamic finance is an important aspect in increasing the competitiveness of Islamic banking and expanding financial inclusion for people who have not been reached by conventional financial services.

Although Islamic financial regulations in Indonesia are quite comprehensive, there are still several challenges that need to be overcome, such as harmonization of regulations between the conventional and Islamic financial sectors, increased supervision of Islamic financial institutions, and the need for innovation in regulations to support the development

of more competitive Islamic financial products. Therefore, strengthening Islamic financial regulations must continue to be carried out through more progressive policy adjustments, increased coordination between regulators, and collaboration with international institutions in preparing global Islamic financial standards. Thus, Islamic financial regulations in Indonesia can be more optimal in supporting the growth of the Islamic financial industry and contribute significantly to achieving the SDGs and sustainable economic development.

In addition, regulations related to Islamic social financial instruments, such as *Zakah*, *Waqf*, and social *Sukuk*, still need to be strengthened to be more effective in supporting the achievement of SDGs. Currently, the management of *Zakah* and *Waqf* is still spread across various institutions without uniform standards, thus hampering transparency and efficiency of fund distribution. According to Judijanto, weak regulations in the management of *Zakah* and *Waqf* can reduce public trust and reduce the effectiveness of these instruments in empowering the people's economy [48]. Therefore, more progressive policy reforms are needed, including strengthening the government's role in integrating Islamic finance with national development programs.

Low Sharia Financial Literacy

Another challenge in optimizing Islamic finance in Indonesia is the low level of Islamic financial literacy in society. A survey conducted by the Financial Services Authority (OJK) in 2022 showed that the level of Islamic financial literacy in Indonesia only reached 9.1%, much lower than conventional financial literacy which reached 49.68%. This shows that the majority of people still have a limited understanding of the concept and benefits of Islamic finance, thus hampering the increase in Islamic financial inclusion in Indonesia.

According to But and Irfan, the lack of public understanding regarding the principles of Islamic finance is one of the main reasons for the low penetration of Islamic banking in various Muslim countries [49]. Many people still consider Islamic financial products to be not much different from conventional products, so they are less interested in switching to a Sharia-based financial system. Therefore, efforts to increase Islamic financial literacy need to be carried out massively through formal education, public campaigns, and the use of digital technology for broader and more effective Islamic financial education. In addition, the role of educational institutions, Islamic boarding schools, and religious organizations is also very important in increasing public understanding of Islamic finance. According to Iqbal and Mirakhor, Islamic financial education must start early through a curriculum that integrates aspects of Islamic economics with modern financial science, so that it can create a generation that is more literate in Islamic finance and able to optimize its use in everyday life [19].

Limitations of Islamic Financial Product Innovation

One of the biggest challenges in the development of Islamic finance in Indonesia is the limited innovation in Islamic financial products and services. Until now, most Islamic banking products are still dominated by murabahah-based instruments (buying and selling with a fixed profit margin), which structurally have characteristics similar to conventional credit. According to Rodney Wilson in *The Development of Islamic Finance in the GCC*, excessive reliance on the murabahah scheme reduces the competitiveness of Islamic banking and hinders the development of profit-loss sharing (PLS)-based instruments, such as *mudharabah* and *musyarakah*, which should be the main characteristics of Islamic finance [27]. In addition, the development of digital technology-based Islamic financial instruments is still relatively slow compared to the conventional financial industry. While Islamic-based financial technology (fintech) is starting to develop, challenges such as minimal access to funding for Islamic fintech startups, inadequate regulations, and low adoption of technology by Islamic financial institutions are the main obstacles in accelerating the digitalization of

Islamic finance. According to Alshater (2022), the use of technology such as blockchain, smart contracts, and artificial intelligence (AI) in Islamic finance can increase efficiency, transparency, and public trust in Islamic financial products [50].

Strategy for Optimizing Islamic Financial Instruments in Indonesia Based on Maqasid Syariah

Optimizing sharia financial instruments in Indonesia must be in line with the principles of maqasid sharia, which emphasizes the protection of religion (*hifzh ad-din*), soul (*hifzh an-nafs*), reason (*hifzh al-'aql*), descendants (*hifzh an-nasl*), and property (*hifzh al-mal*) [31][32]. In the context of economics, maqasid sharia aims to ensure social justice, economic welfare, and the sustainability of sharia finance in supporting national development. To achieve these goals, the strategy of optimizing Sharia financial instruments can be done through:

Increasing Synergy between Government, Islamic Financial Institutions, and the Community

One of the main challenges in optimizing Islamic financial instruments in Indonesia is the lack of strong synergy between the government, Islamic financial institutions, and the community. According to Ibnu Qizam, the success of the Islamic financial system depends not only on strong regulations but also on collaboration between stakeholders in creating an ecosystem that supports Sharia-based economic growth [51]. The government has a strategic role as a regulator that sets policies and incentives for the development of Islamic finance, while Islamic financial institutions are responsible for providing financial services by the principles of maqasid sharia. On the other hand, the public must have sufficient understanding of Islamic financial products and services to participate actively.

The Indonesian government has implemented various policies to support Islamic finance, such as the Masterplan for Islamic Economics and Finance in Indonesia (MEKSI) 2019-2024, which targets strengthening the legal infrastructure and regulations of Islamic finance. However, some experts believe that this policy still has challenges in terms of implementation. Chong emphasized that the Islamic financial system must be more than just formal regulations, but also requires an ethical and social approach that can build public trust. Without strong trust, people tend to prefer the conventional financial system which is considered more transparent and easily accessible [52]. Therefore, the role of the government is not only limited to regulators but also as facilitators that encourage Islamic financial institutions to be more inclusive and innovative in offering Islamic financial products.

Islamic financial institutions such as Islamic banks, BAZNAS, and *Waqf* management bodies have the responsibility to increase the efficiency of collecting and distributing Islamic social funds to provide optimal impacts for society. Dusuki and Abdullah stated that *maslahah* (public interest) must be the main principle in managing Islamic finance [15]. In this context, Islamic banks and *Zakah*/*Waqf* institutions need to develop a more accurate and targeted social fund distribution model. Several countries such as Malaysia have successfully implemented a digital *Zakah* and *Waqf* system that can distribute funds more efficiently through a blockchain-based platform. Indonesia can adopt a similar approach to increase transparency and accountability in the management of Islamic social funds.

In addition to the role of government and Islamic financial institutions, community participation is also a key factor in strengthening the Islamic financial ecosystem. However, low Islamic financial literacy is still a major obstacle in Indonesia. According to Ascarya, the lack of public understanding of Islamic finance is often an obstacle to the expansion of this industry [24]. Therefore, the strategy of Islamic financial literacy must be strengthened through formal and non-formal education. For example, the integration of Islamic economics

curricula in universities and literacy campaigns through digital media can increase public understanding of the importance of Islamic financial instruments in supporting sustainable development. However, there is debate about the effectiveness of collaboration between the government, Islamic financial institutions, and the community. Anjum (2022) in book *An Islamic critique of rival economic systems' theories of interest* argues that excessive government intervention in Islamic finance can cause market distortions and reduce the competitiveness of Islamic financial institutions globally [53]. On the other hand, Iqbal and Mirakhor emphasized that government involvement is needed as a catalyst in creating a conducive environment for the growth of Islamic finance, especially during the transition from a conventional system to a Sharia-based system [19]. Therefore, the ideal approach is a balanced synergy between regulation, institutional innovation, and community participation in building sustainable Islamic finance.

Increasing synergy between the government, Islamic financial institutions, and the community is a key factor in optimizing Islamic finance in Indonesia. The government needs to act as a regulator and facilitator that creates pro-Islamic finance policies, while Islamic financial institutions are responsible for increasing transparency and efficiency in the collection and distribution of Islamic social funds. On the other hand, the community as the main stakeholder must be encouraged to increase their participation through Islamic financial literacy.

Strengthening Regulation and Incentive Policy for Islamic Financial Instruments

Strong regulation and adequate policy incentives are key factors in increasing the competitiveness of Islamic financial instruments in Indonesia. Law Number 21 of 2008 concerning Islamic Banking has provided a legal basis for the development of this sector, but its implementation still faces various challenges, especially in terms of legal certainty, protection of stakeholder interests, and adaptation to digital-based financial innovations. Although Islamic banking regulations have developed, there are still legal loopholes that need to be fixed so that Islamic financial instruments can compete with conventional financial systems. Regulatory uncertainty regarding aspects of Islamic financial dispute resolution, the legal status of Sharia-based contracts, and accounting and reporting standards are the main inhibiting factors in accelerating this industry [4][5][8]. Therefore, more comprehensive regulations are needed to accommodate the development of sharia financial instruments, including green *Sukuk*, sharia fintech, and digitalization of *Zakah* and *Waqf*.

In the context of incentive policies, the government needs to encourage fiscal stimulus for Islamic financial institutions so that they can contribute more to social and economic financing based on *maqasid sharia*. Hasan (2019) in *Islamic Economics: Theory and Practice*, stated that Islamic finance has advantages in creating economic justice, but often experiences limitations in terms of competitiveness due to a tax system that does not favor Sharia-based products [17]. For example, Islamic financing is often subject to double taxation, because *murabahah* and *ijarah* contracts in Islamic banking are considered buying and selling transactions, not loans. Unlike conventional banking which is only subject to interest tax, Islamic banking transactions have a higher tax burden, which ultimately reduces the attractiveness of Islamic products in the market. Therefore, tax policy reforms that are more in favor of Islamic finance, such as the elimination of double taxation and the provision of incentives for Islamic financial institutions that are active in social financing, are strategic steps to increase the competitiveness of this industry.

Malaysia has implemented various incentive policies that have proven effective in increasing the role of Islamic finance in economic development. Hasan and Abu Bakar (2020) in their research explained that the tax rebate policy for corporate *Zakah* has made many companies more interested in allocating part of their profits in the form of *Zakah*, thereby increasing the redistribution of wealth more evenly [43]. This policy model can be

adapted in Indonesia by providing tax reductions for companies that distribute *Zakah*, *Waqf*, or infaq funds through official institutions such as BAZNAS and LAZ. In addition, providing subsidies for Islamic financial institutions that develop microfinance programs based on *Zakah* and productive *Waqf* can be a strategic policy to increase the role of this sector in supporting inclusive economic growth.

According to Anjum, excessive government intervention in Islamic financial regulation can cause market distortion and reduce innovation in this industry [53]. On the other hand, Iqbal and Mirakhor emphasized that the role of government in Islamic finance cannot be ignored, especially in building legal infrastructure and policies that encourage the growth of this industry [19]. One of the proposed solutions is principle-based regulation, rather than rule-based regulation. This approach allows flexibility in Islamic financial innovation while maintaining compliance with the maqasid of Sharia. The use of technologies such as blockchain and artificial intelligence (AI) in Islamic finance is also a strategic step to increase the efficiency and transparency of the Islamic financial system. Chong said that the application of blockchain technology in *Zakah* and *Waqf* can increase transparency in fund distribution, reduce the risk of misappropriation, and accelerate the process of distributing funds to beneficiaries [52]. In addition, AI can be used in big data analysis to develop more accurate risk models in Islamic banking, thereby increasing operational efficiency and expanding financial access for people who have not been reached by formal banking services.

Development of Innovation in Technology-Based Sharia Financial Products

Technological innovation has become a major factor in increasing the competitiveness of Islamic financial instruments in the digital era. Digital transformation has not only changed the way financial transactions are carried out but also expanded access to Islamic financial services to segments of society that have not been reached by conventional banking. Hudaefi (2020) emphasized that the application of financial technology (fintech) in Islamic finance has great potential to increase financial inclusion, especially in countries with large Muslim populations such as Indonesia. The digitalization of Islamic finance also accelerates transparency, reduces transaction costs, and increases efficiency in the collection and distribution of Islamic social funds [7]. However, the implementation of fintech in Islamic finance still faces several challenges, such as the lack of clear regulations, low financial literacy among the community, and limited digital infrastructure in several regions.

One of the innovations that has been implemented in the Islamic financial sector is Sharia-based crowd funding. This model allows people to invest in productive economic projects without violating Sharia principles, such as usury, *gharar*, and *maysir*. SIBL (Syariah Investment and Blockchain Lending), as an example of a Sharia crowd funding platform, uses blockchain technology to ensure transaction transparency and minimize the risk of misuse of funds. According to Alshater, blockchain has the potential to increase trust in Islamic financial transactions by creating a record-keeping system that cannot be manipulated [50]. In addition, Abdullah et al. (2024) added that the use of smart contracts in Sharia crowdfunding can eliminate the need for intermediaries, thereby reducing transaction costs and increasing financing efficiency for Sharia-based small and medium enterprises (MSMEs) [4]. However, there is still debate about whether smart contracts can completely replace the role of traditional Islamic financial institutions, given the importance of the sharia supervision aspect in every Islamic financial transaction. In addition to crowdfunding, digitalization in the *Zakah* and *Waqf* sector has also shown a significant impact in increasing community participation in Islamic philanthropy. BAZNAS Digital and Dompot Dhuafa are examples of platforms that allow people to distribute *Zakah* and *Waqf* online with a more transparent reporting system. Manadi Ahmad (2019) in his research stated that one of the main challenges in managing *Zakah* and *Waqf* is the lack of transparency and accountability, which often leads to low public trust in Islamic social fund management institutions [54].

Utilizing digital technology, *Zakah* and *Waqf* management can be more professional, efficient, and able to reach more *mustahik* in a targeted manner. However, regulatory standardization is still needed to ensure that digital *Zakah* and *Waqf* remain by sharia principles and are not misused by irresponsible parties. Thus, synergy is needed between the government, Sharia financial institutions, and the technology sector to develop policies that support innovation in technology-based Sharia finance. The government can play a role in creating more flexible regulations still based on Sharia principles, while Sharia financial institutions must continue to adapt to technological developments without neglecting the role of the Sharia supervisory board. In addition, increasing digital-based sharia financial literacy among the public is also a key factor in ensuring the sustainability of this industry. With a holistic approach and based on *maqasid syariah*, innovation in technology-based sharia financial products can be an effective instrument in increasing financial inclusion and supporting the growth of the Islamic economy globally.

CONCLUSION

The results of the study can conclude that Islamic finance has a strategic role in supporting the achievement of Sustainable Development Goals (SDGs) in Indonesia through the principles of *maqasid syariah*, which emphasize economic justice, social welfare, and equitable distribution of wealth. Instruments such as *Zakah*, *Waqf*, *Sukuk*, and profit-sharing financing have proven effective in supporting sustainable development, especially in alleviating poverty, improving education, and expanding financial access for people who are underserved by the conventional banking system. However, the implementation of Islamic finance in Indonesia still faces various challenges, such as regulations that do not fully support Islamic financial innovation, lack of synergy between stakeholders, and low Islamic financial literacy in the community. To optimize the role of Islamic finance in achieving the SDGs, it is necessary to strengthen regulations and policies that are more flexible and adaptive to technological developments. The government can encourage fiscal incentive policies for Islamic financial institutions, strengthen digital infrastructure to increase the efficiency of collecting and distributing Islamic social funds, and ensure that the digitalization of Islamic finance remains by the principles of *maqasid syariah*. In addition, synergy between the government, Islamic financial institutions, the private sector, and the community needs to be improved to accelerate the realization of the goals of a just and sustainable Islamic economy. With the right strategy, Islamic finance can be a key instrument in building an inclusive, sustainable, and Islamic-compliant economic system. Increasing Islamic financial literacy, utilizing technology in managing *Zakah* and *Waqf*, and strengthening regulations that support Islamic financial innovation will strengthen Indonesia's role as a global Islamic financial center that is not only oriented toward economic growth but also toward broader social welfare.

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Author Contribution

All authors contributed equally to the main contributor to this paper, some are as chairman, member, financier, article translator, and final editor. All authors read and approved the final paper .

Conflicts of Interest

All authors declare no conflict of interest.

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