
THE ROLE OF THE STATE IN ISLAMIC FINANCE DEVELOPMENT: A *WORLDWIDE GOVERNANCE INDICATOR* *APPROACH*

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Abstract

This research aims to empirically examine the institutional quality variable as a moderating variable between macroeconomic stability and the development of global Islamic finance and the indicators of global sukuk instruments. This is to prove previous research which states that macroeconomic stability influences financial developments. Macroeconomic stability also influences the development of the sukuk market. There is empirical research that states that institutional quality moderate financial developments, so research is directed at examining institutional quality as a moderator of macroeconomic stability in the development of the global sukuk market. Exploratory quantitative research method, using secondary data panel data models in the form of development of sukuk with proxies for issuance of sukuk in countries that are active in issuing sukuk and registered on the International Islamic Financial Market (IIFM), and institutional quality comes from WGI -BI. The results of the analysis show that the quality of institutions moderates the macroeconomic stability of the development of sukuk, especially on the exchange rate and inflation indicators. While the GDPP moderation test for the development of sukuk there is no evidence that institutional quality is a moderating variable. This research contributes empirically to the limitations of previous research which analyzed macroeconomic stability without including the variable quality of government institutions which can be used as a basis for making decisions for investors in investing, regulators in making rules, and issuers when issuing sukuk.

Keywords: macroeconomy, institutions, Islamic finance, sukuk

1. INTRODUCTION

Instrument Islamic finance that has potency development significant besides Islamic banking is sharia bonds or sukuk. Based on In the 2021/2022 Indonesia Halal Market report, the issuance of sukuk in Indonesia occupies a portion of the world's largest with a figure 22.18%, bigger than Saudi Arabia which is at 19.34 % (Indonesia, 2022) . Sukuk are in demand by all elements no only by the private sector, but also by the state. The results of a survey on investor preferences for sukuk show that there is no single dominant factor that makes investors choose diversification as a reason for investing in sukuk instruments if compared to conventional capital markets and considered *real estate* riskier. Especially for considering investors obedience to sharia (Reuters, 2017) . Among the unique risks associated with Islamic

finance modes such as sukuk is there is a prohibition on debt-based financial activities with the concept of profit-loss sharing (PLS), risk must be represented in any financial transaction so that the transaction complies with Sharia rules and regulations (Kayed, R., & Mohamed, 2007)

Sukuk as one _ product Capital market investment can not be separated from influence many factors, namely policy institutional, both ongoing and likely to occur in the future, so affect the rate of return and investment risk. There are three major factors in the investment climate namely: first conditions and stability macroeconomics, economic openness, market competition, as well social and political stability. Second situation government and institutional including clarity and effectiveness of regulations, taxation, legal system, financial sector. And third labor market flexibility and the existence of an educated and skilled workforce (ADB., 2005) .

A study about the influence of stability economy macro to the issuance of sovereign sukuk in Indonesia, Malaysia, and Brunei Darussalam was conducted by Abdul Manab and Agus eco Sujianto. Study this use level of growth country 's economy , income per capita , inflation , rate rates and levels ethnic group flower reference as variable stability economy (Abdul Manab, 2016) . Temporary that is, variable quality institution government Becomes variable new research that can affect the sukuk market in Indonesia.

Ideally, economic conditions are considered stable when economic growth increases, per capita income increases, the inflation rate did not show significant changes, the foreign exchange rate was strong, and the benchmark interest rate was low (Sukirno, 2004) . variable the in a manner empirically proven could increase climate investment in Indonesia, especially those who have characteristics namely : (1) proven _ as ownership of something assets, rights benefits , services or activity investigation certain ; (2) the *returns* given form reward , margin, share results , accordingly with type contract used _ moment publishing ; (3) free from element usury, gharar and maysir ; (4) require exists *underlying* investment assets and (5) usage *proceeds* must following sharia principles . Element usury the related with flower , gharar related with uncertainty , and maysir about speculation (Manab, A., & Sujianto, 2016) . Character investation they are very identical with Investments in Islamic financial instruments are included sukuk instrument.

Factor important others can _ influence climate investation is role so - called government with role institutional. Government agencies Becomes most important source as determinants of a failed or advanced state economy (Vukovic, 2012) . Country with leadership through institution established or inclusive governments (*inclusive economic institutions*) tend to have good economic performance.

In Thing this institution government is present not to abolish market mechanisms, but to ensure that the market operates with clear signs so that all economic actors have equal access and certainty in doing business (Yustika, 2012) .

Institutional framework drives economic growth, while weak institutional activity causes stagnant economic growth (Jain, PK, Kuvvet, E., & Pagano, 2017) . The link with a country's finances is that a high-quality institutional environment is important in explaining the development of a market's finances (Law, SH, & Azman-Saini, nd) . As there has been much evidence that institutional factors also play an important role in economic and financial development and put pressure on policymakers to build stable reforms to reduce uncertainty (Cherif, M., & Gazdar, 2010) (Cherif & Gazdar, 2010) . The unclear role of government institutions for the development of Islamic financial bonds as an independent variable or moderating variable is important for conducting an empirical evidence study by making institutions a moderating variable between macroeconomics and the development of Islamic finance.

Macroeconomic stability is one of the basic prerequisites for the development of financial markets (Cherif, M., & Gazdar, 2010) . The link between macroeconomics and the stock market is evidenced by (Garcia, VF, & Liu, 1999) stating that macroeconomics determines the development of the stock market. Other empirical evidence regarding the important position of macroeconomic stability in the capital market (Bhattacharyya, S., & Hodler, 2014) ; . Many proof empirical macroeconomics and the development of the capital market and stock market in conventional markets as well as the Islamic market, shows that growth economy influences on the development of sukuk (Manab, A., & Sujianto, 2016) ; (Said, A., & Grassa, 2013) ; (Elkarim, 2012).

Apart from macroeconomics, another variable that also influences financial developments, including the capital market and stocks, is the quality of government institutions. Empirical research shows that institutional quality is an independent variable, one of which is research (Febrina, P., 2014) , his research concluded that institutional quality has a positive effect on Foreign Direct Investment (FDI). (Huang, 2010) found a positive impact of increasing the country's political stability (an indicator of institutional quality) on financial development. In addition to economic growth, a macroeconomic variable that has the potential to influence financial developments is inflation. inflation will affect sukuk with a negative relationship (Elkarim, 2012) and significance (Rini, 2012) .

But there is other evidence proving the position of institutional quality not only as an independent variable, but also as a moderating variable. Among them is research conducted by

Wang which states that institutional quality plays an important role in mediating the impact of economic development in terms of foreign direct investment (Wang, Y., Cheng, L., Wang, H., & Li, 2014) . Other research shows that institutional quality is a moderating variable between macroeconomic volatility and FDI (Effah, M., Adjasi, CKD, & Latif, 2016) . Khan mentions in his article that institutional quality plays a role in moderating the relationship between renting and lending resources and finance, and recommends future research to consider institutions as an important element to produce realistic estimates for policy makers for policy inputs (Khan et al., 2019) . Meanwhile, Elgin found that institutional quality is a moderating factor between economic development and the size of a country's informal sector (Elgin & Oztunali, 2014) .

The purpose of this research is to empirically test the variables quality institutional as variable moderation Among stability macroeconomics to development global Islamic finance with global sukuk instrument indicators . it _ for prove study previously mentioned _ that stability macroeconomics take effect to development finance.

2. METHOD

Unit every data used in study this different and necessary treatment special before performed the MRA test, i.e with change too many units big be a logarithmic model. So that the sukuk data from million USD unit changed be a logarithmic model so the data changes Becomes model percent. Likewise exchange rate data changed Becomes logarithm so that Becomes percent. As for inflation permanent because from source at first have unit percent.

quality data institutions used _ in study this is indicator aggregate using the average of six quality institutions (*Voice and Accountability (VA)*, *Political Stability and Absence of Violence/Terrorism (PSAV)*, *Government Effectiveness (GE)*, *Regulatory Quality (RQ)*, *Rule of Law (RL)*, and *Control of Corruption (CC)*) and indicators individual from six dimensions quality institutional that is sourced from WGI-WB with unit percent. Use indicator aggregate with averages based on research previously by (Said, A., & Grassa, 2013) ; (Wang et al., 2014) ; (Alam , A., & Yazdifar, 2019) ; (Khan et al., 2019) .

The analytical technique used in study this is the MRA (*Moderated Regression Analysis*) interaction test method, namely application from multiple linear regression, where in the similarities contain element interaction (multiply two / more variable independent), with the equation model as following:

$$Y = a + \sum \beta_1 X_1 + \sum \beta_2 X_2 + \sum \beta_3 X_1 X_2 + \varepsilon \dots\dots\dots 3.7$$

$$Y = a + \sum \beta_1 X_1 + \sum \beta_2 X_2 + \sum \beta_3 M_{1-3} + \varepsilon \dots\dots\dots 3.7$$

where:

α : value constant

β : value coefficient variable

Y : Variable Dependent (Sukuk)

X_1 : variable independent 1 (Stability macroeconomics), consists of GDP, EXCHANGE, and INFLATION

X_2 : variable independent 2 (Quality Average institutional)

$X_1 X_2$: moderating variable (interaction Among variables X_1 and X_2) or with “M” notation

On the research MRA method this will enter in a manner one by one alternating each of three variable stability macroeconomic (GDP, EXCHANGE, INFLATION) as X_1 , and variables quality institutional with indicator aggregate (average quality institutional) as X_2 , next started with make M1 up to M is product between X_1 (stability macroeconomics) and X_2 (quality institutional) in the built model.

3. RESULTS AND DISCUSSION

MRA interaction test has conducted with include moderating variables quality institutional government. Intermediate MRA test macroeconomics against sukuk with variable quality institutional in a manner aggregate averages and factors institutional show that quality institutional moderate exchange rate with sukuk. For more in detail, the following table shows the results of the MRA test that has been done conducted with Quality of Government Institutions as variable moderating and independent variables in the form of GDP, inflation, and exchange rates currency.

Table 3.1
MRA test results

Moderation	Formula Regression	oe	- Htg	F	- Htg	ig	S	A
M1 = (LnGDPP)*KL	R1 = $\alpha + \beta$ (lnGDPP) + β KL + β M1	.024	2,229	1	.687	.494	0	0
M2 = (Incurrence)*KL	R2 = $\alpha + \beta$ (incurse) + β KL + β M2	0.060	3,113	1	5,510	,000***	0	0
M3 = (Inflation)*KL	R3 = $\alpha + \beta$ (inflation) + β KL + β M3	0.007	,297	5	2,861	.005***	0	0

MRA test results above could seen that variable quality institutional have difference test results when tested with three indicator stability macroeconomics ; GDP, Exchange Rates , and Inflation . MRA Test between GDP, Exchange Rate and Inflation to development of

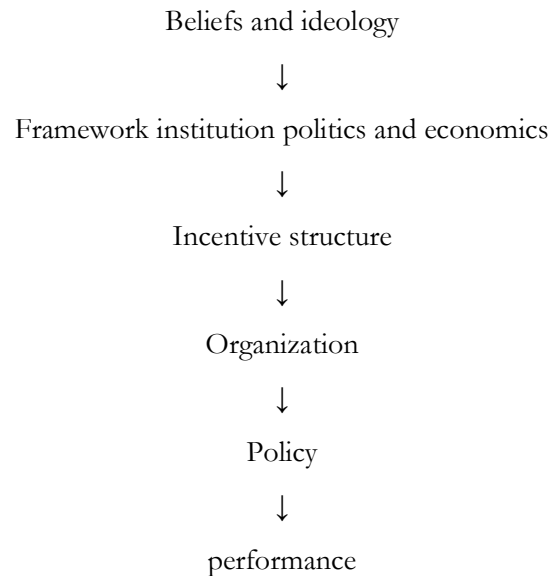
sukuk with quality institutional (KL) as variable moderation is as following : GDPP no significant at α 1%, 5% and even 10%. Based on the test results show that the GDPP is not as moderation , however pure as the independent variable that gives influence on the development of sukuk without moderated by quality institutional .

Test the MRA on the exchange rate to development of sukuk with KL as variable moderation show score probability significant at α 1% (sig. 0.000), that is quality institutional as intermediate moderator exchange rate with development of sukuk . Moderator position between exchange rate with the development of the sukuk is explained more detail on the calculated t - values shows minus numbers (-5.510; and -2.861), negative values explain opposite direction _ it means quality institutional be the intermediate moderator exchange rate and inflation with score significant show quality institutional give significant influence also depends on the development exchange rate and inflation that alone .

The results of the moderation test Among inflation as indicator stability macroeconomics with KL as variable moderation towards sukuk show that KL indicator with coefficient negative and significance of $0.005 < 0.05$. The overall results of the MRA test provide big points, namely: KL as a whole aggregate proven be the intermediate moderator macroeconomics to the development of sukuk especially in indicators exchange rate and inflation . As for the GDPP, no found proof empirical exists connection moderation Among indicator macro exchange rate and inflation to development of global sukuk. it _ in accordance with study (Khan et al., 2019) based on a strong cointegration approach ensures that TOS is a significant prerequisite for financial development in the United States .

These results also support conclusion from study (Bhattacharyya, S., & Hodler, 2014) which states that if institution weak in a country can exacerbate enforcement contract . Meanwhile , weak enforcement contract cause loss big on development finance , on the other hand more institutions _ good will lead in the direction enforcement good contract anyway , so useful in stimulate development finance .

Main point as part from study this is whereabouts of KL in the development of the global sukuk market overall test supports hypothesis beginning that KL played a role active and positive in a manner significant in the development of the global sukuk market, either in a manner aggregate as well as individually. Likewise when _ conducted regression model testing moderation produce conclusion that on condition In particular, KL also acts as an intermediary moderator variable macroeconomics against sukuk. Theory order because consequences put forward by (Dequech, 2006) could used as connection plot because KL 's effect on development of sukuk, as for the causal model the stated consequences two figure above _ is as following :



Started from *Mental models and ideologies (beliefs)*, namely how belief great desire and vision _ in development Islamic finance in particular development of the absolute sukuk market needed as base from whole determining elements and factors . _ Of course, this belief and desire must come from all components, starting from the investor community that wants to invest in sharia products, companies as issuers of sharia instruments, and the state as issuers and policy makers of sharia finance, especially for sukuk instruments. So, when the beliefs and models to the vision for the development of the sukuk market have been realized and exist, then the second important channel that must exist is *the Institutional framework of polity and economy* or framework institutional government and economy .

Framework institutional Becomes important because he will determine where to direction developing and strengthening strategies for ideas and roles institutional government as *regulators* for reach desired vision to be realized destination in Thing this development of the sharia market. So that with proof empirical a number of studies related connection positive between KL and the development of the global sukuk market led to a big point for increase the market for sukuk of course must strengthening CL. The importance KL fix for strengthening sector finance emphasized also by (Pagano, M., & Volpin, 2005) who highlighted role intervention political in development finance . Framework institutional government next will form Adjusted incentive *structure* with vision mission destination development of the sharia market. When *the incentive structure* walk, of course will form next organization _ will materialized superior and powerful *performance* _ good from side quantity nor quality.

Governance of government and companies Becomes important in the enhancement quality and quantity of something product finance. Product-based instrument _ trust need proof

real with indicator governance that convinces stakeholders to follow as well as joined in business and investment. With Thus, strengthening confidence in the sukuk market is necessary enhancement more management _ well, that is by realizing enhanced governance in the entire sukuk cycle, which begins from Step publishing, marketing, underwriting on market quality, enabling environment and regulations, as well strong stakeholder trust with continuous evaluation _ with surveys and assessments direct.

See the potential and position of the sukuk instrument has been Becomes alternative financing conventional, no only for Fulfill needs finance companies but already sukuk Becomes alternative fulfillment state funding, its important enter issue macroprudential in management and development of financial instruments.

Policy macroprudential needed for reducing risk system created by the institution finance large and institutional finance social. Question appears on the design institutional best for example, the responsible party answer on policy macroprudential. The problem main, related tightly with design institutional, is how political economy from policy macroprudential will play. If the test results show that exchange rate and inflation relate opposite direction with the development of sukuk, that is two variable macroeconomics (exchange rate and sukuk) requires treatment specials and policies special in stabilize it, mainly related in policy macroprudential economy.

One important lesson from the 1998 and 2008 financial crises is that apart from monetary policy and microprudential supervision, macroprudential policy is also needed to maintain financial stability. Macroprudential regulation is rooted in fundamental market inefficiencies that rationalize microprudential interventions and links externalities between a bank and non-bank financial institutions as well as between the financial sector and the real economy , especially the course will be also related to activity export-import goods and services . Several countries have have institutions controlling and supervising authority _ stability finance from side exchange rate and inflation , but in some countries not yet formed institution special independent _ to handle stability exchange rate and inflation (Ismail, AG, & Ahmad, 2016) ; (Mohammed, 2016).

4. CONCLUSION

Study this give proof empirical that quality institutional impact on moderation Among stability economy macro to the development of sukuk, especially in indicators exchange rate and inflation. While the moderation test on GDPP against the development of Sukuk is not there is proof quality institutional Becomes variable moderation. That is, governance

government, and companies Becomes important in enhancement quality and quantity something product finance.

Product based instrument trust need proof real with indicator governance that convinces stakeholders to follow as well as joined in business and investment the. Important for issuers (publishers) of sukuk for notice Quality institutions ((Voice and Accountability/ VA, Rule of Law/ RL, Regulatory Quality/ RQ, Political Stability and AV/ PSAV, Government Effectiveness / GE, and Control of Country/ CC)) for entered Becomes indicator consideration decision issuance of sukuk and development of the sukuk market. based on evidence empirical influence quality institutional to development of sukuk with valuable data test results positive and significant at the α level of 5%. this _ show that quality institutional take effect big to development of sukuk, meaning that investors are interested to sukuk instruments for made choice in invest them.

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