



Local Government's Role in Aceh's Sharia Banking Transition: Legal and Institutional Perspectives

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Article	Abstract
Keywords: Sharia Economy; FPIC Principle; Local Governance; Indigenous Legal Framework; Indigenous Communities. Article History Received: Jan 18, 2025; Reviewed: Feb 2, 2025; Accepted: Apr 8, 2025; Published: Apr 11, 2025.	<i>This study examines the Aceh Government's authority in converting conventional financial institutions into Sharia-compliant entities under Aceh Qanun No. 11 of 2018 and evaluates its practical implementation. Employing a normative legal research approach, the study analyses statutory regulations, legal principles, and doctrinal interpretations while incorporating historical context and relevant precedents. The findings confirm that the Aceh Government is legally mandated to oversee this financial transformation. However, several critical challenges impede its execution, including inadequate infrastructure, limited Sharia-compliant financial products, restricted access to Sharia banking capital, minimal adoption by non-banking financial institutions, and low financial inclusion. Among these, the lack of financial infrastructure and product diversity emerge as the most significant obstacles. To enhance the effectiveness of this transition, strategic interventions are necessary. These include expanding Sharia banking infrastructure, introducing diversified and innovative financial products, facilitating broader capital access for Sharia-compliant financial institutions, and strengthening financial literacy programs. A multi-stakeholder approach, integrating government agencies, financial institutions, and the community, is essential to establishing a robust and sustainable Sharia financial system in Aceh.</i>

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INTRODUCTION

The transformation of Aceh's financial institutions under Aceh Qanun No. 11 of 2018 represents a major step forward in the province's efforts to comprehensively adopt Islamic Sharia. The Aceh government, financial institutions, and stakeholders

must work together to overcome implementation challenges and realise the objective of a Sharia-compliant economic system for the Qanun to succeed despite the strong legal basis it provides for this transformation (Sulistiani et al., 2023).

As a province with special autonomy within the Unitary State of the Republic of Indonesia, Aceh holds a unique legal status that allows it to implement Islamic law (Sharia) comprehensively. This distinction is rooted in its historical background and the socio-political developments that have shaped its governance. The formalisation of Aceh's authority to enforce Islamic law was reinforced through the Helsinki Memorandum of Understanding (MoU) in 2005, which ended a prolonged conflict between the Indonesian government and the Free Aceh Movement (GAM). This agreement led to the enactment of the Aceh Governance Law No. 11 of 2006, granting Aceh greater autonomy in religious, educational, and economic affairs, including the implementation of Sharia-based financial regulations (Bakry et al., 2021).

A critical aspect of Aceh's Sharia governance is its economic framework, particularly in the financial sector. The enactment of Aceh Qanun No. 11 of 2018 concerning Sharia Financial Institutions mandated the full transition of financial institutions from conventional banking to Sharia-compliant operations (Zada, 2023). This regulation required all financial entities in Aceh to convert their systems within three years, aiming to establish a fully Sharia-based financial ecosystem by January 2022. This transformation represents a significant shift in the province's economic structure, aligning local financial practices with Islamic legal principles (Zouari & Abdelhedi, 2019).

However, despite the legal mandate, the transition process has encountered several challenges, including the limited availability of Sharia-compliant banking products, infrastructural deficiencies, low financial literacy, and restricted access to capital for businesses and financial institutions (Hidayatullah & Yusuf, 2024). Additionally, conventional banks operating in Aceh were required to restructure their operational models, which posed both regulatory and economic difficulties. The success of this transition depends on the effectiveness of government policies, the readiness of financial institutions, and public acceptance of the new financial system (Kantika et al., 2022).

This study aims to analyse the implementation of Aceh Qanun No. 11 of 2018, focusing on the challenges faced by financial institutions, businesses, and the general public. It seeks to answer key research questions: To what extent has the transition to Sharia banking been successful? What are the primary obstacles in the implementation process? How effective is government intervention in facilitating this transition? By employing a normative legal research approach, this study examines statutory provisions, regulatory frameworks, and the broader socio-economic impact of Sharia banking in Aceh. Through this analysis, the research aims to provide insights into the

effectiveness of policy implementation and propose strategic recommendations to enhance the sustainability of Sharia financial institutions in Aceh.

METHOD

This study uses normative legal research methodology with comparative, historical, and juridical-normative approaches (Al-Fatih, 2023). The comparative approach analyses the transformation of conventional financial institutions into Islamic financial institutions in Aceh by identifying best practices from other regions. The historical approach examines the evolution of legal norms underlying Aceh Qanun No. 11 of 2018 concerning Islamic Financial Institutions. The juridical-normative approach assesses legal norms in Indonesian financial regulations and Islamic legal principles. Primary data sources include Aceh Qanun No. 11 of 2018, national financial regulations, and DSN-MUI fatwas, while secondary sources include academic literature, previous studies, and government reports. Data was collected through document analysis, literature review, and expert interviews. Data analysis was conducted qualitatively with content analysis to examine legal texts, comparative legal analysis to see similarities and differences in regulations, and thematic analysis to identify key issues such as policy gaps and best practices. The research findings aim to provide strategic recommendations for optimising Islamic financial integration in Aceh and overcoming existing regulatory challenges.

RESULTS AND DISCUSSION

The Application of the Dual Banking System within the National Financial Framework

Revising Law No. 7 of 1992 through Law No. 10 of 1998 marked a pivotal moment for Islamic banking in Indonesia. This amendment provided a comprehensive legal framework, facilitating the coexistence of conventional and Islamic banks within a dual banking system. By explicitly recognising Sharia-compliant financial institutions, the law encouraged their growth and integration into the national financial infrastructure (Andika et al., 2021). Under this framework, conventional commercial banks were allowed to offer Sharia-based financial services by establishing dedicated branches, converting existing ones, or creating separate Islamic business units. However, Islamic banking remained closely linked to conventional institutions due to the dual banking system. Law No. 21 of 2008 was enacted to address this limitation, strengthening the legal foundation for independent Islamic banking operations (Koyyimah et al., 2023).

This legislation is intended to enhance the institutional and operational landscape of Islamic banking by embedding Sharia principles into financial transactions (Hidayat et al., 2022). It introduces a profit-and-loss sharing mechanism that aligns with Islamic values, emphasising ethical investment, discouraging speculative activities, and promoting fairness. By prioritising equity, Islamic banking

contributes to sustainable economic growth while upholding moral and social values (Hirsanudin & Martini, 2023).

As part of Indonesia's dual banking model, Islamic banking offers diverse products and services, expanding financial accessibility. The Indonesian Banking Architecture incorporates this system to provide inclusive financial services, supporting national economic development by mobilising funds across various sectors. Bank Indonesia envisions a modern, inclusive, and accessible Islamic banking system for all Indonesians (Ma'ula & Mi'raj, 2022). Despite their distinct operational principles, Islamic and conventional banks compete for financial resources, particularly in deposit attraction. Customers often transfer funds between systems based on market conditions (Aulia Fitria Yustiardi et al., 2020).

For instance, when interest rates fluctuate, some prefer the profit-sharing mechanisms of Islamic banking, while others seek higher returns in conventional banking. This competitive dynamic showcases the adaptability of customers and the growing appeal of Islamic financial products (Amaliyah & Hartono, 2022). However, Islamic banking remains constrained by financial literacy gaps and limited inclusion. Many Indonesians are unfamiliar with Sharia financial principles, reducing participation (Che Arshad & Nurfadilah, 2017). The government and financial institutions have launched initiatives such as literacy campaigns, educational programs, and digital banking services tailored to Sharia compliance to address this. For example, Bank Indonesia and the Financial Services Authority (OJK) promote Islamic banking through public seminars, digital finance innovations, and microfinance programs for underserved communities (Affandi et al., 2024).

Islamic banking prohibits *riba* (usury practices) and speculative transactions, operating instead on profit-sharing models to finance trade, sales, and services. Unlike conventional banks, Islamic banks treat financial distributions as partnerships rather than loans. The dual banking system mitigates systemic risks by diversifying financial activities and enhancing economic stability (Karbhari et al., 2020). Indonesia's Islamic Banking Law facilitates this system through conversions of conventional banks, establishment of Sharia business units, and integration of Sharia-compliant financial windows within existing institutions (Sutikno et al., 2022). With continuous regulatory support and financial literacy efforts, Islamic banking in Indonesia has the potential to expand further, providing ethical and inclusive financial solutions while complementing the broader national banking system (Aliyu et al., 2017).

Legal Framework for Sharia Financial Institutional in Aceh

The implementation of Qanun No. 11 of 2018 by the Aceh Government represents a significant legal shift towards establishing Sharia-compliant financial systems. This framework provides the foundation for Sharia Financial Institutions (*Lembaga Keuangan Syariah/LKS*), but its effectiveness in achieving its objectives—particularly financial inclusion, investor attraction, and societal acceptance—requires

careful evaluation. While the law is designed to enhance the Islamic economic system in Aceh, its practical impact is influenced by how well it integrates Islamic banking principles with the region's financial needs and business practices (Alidar et al., 2024). The transition from a dual banking system to a fully Sharia-compliant model raises critical questions about the legal and economic outcomes, including whether it can meet the expectations of the broader population and attract both local and international investors.

With its strong Islamic identity, the Acehnese community generally supports the transition. However, the law has sparked concerns, especially among businesses, financial consumers, and non-Muslim residents. Public perception plays a pivotal role, with some seeing the policy as an important step for the region's economic development. In contrast, others worry about the accessibility of financial services, the efficiency of service delivery, and the availability of diverse financial products. This raises concerns about the compatibility of the law with the region's broader economic goals and whether it can expand financial inclusion, particularly for non-Muslim residents and marginalised groups (Zamharira et al., 2024).

Financial literacy is a serious challenge. Sharia banking principles, such as profit-sharing (*mudharabah*) and joint ventures (*musharakah*), remain unfamiliar to many individuals and businesses, which can hinder participation in Sharia-compliant financial systems (Alqarni et al., 2024). Without adequate financial education, misconceptions may limit engagement, reducing the overall effectiveness of the law in fostering a more inclusive economy (Ibrahim & Ismail, 2020). Moreover, the mandatory nature of the law, which requires non-Muslims to engage with Sharia banking, raises legal concerns regarding religious freedom and whether such requirements are compatible with the constitutional and human rights principles that guarantee individual freedoms and equal treatment (Asyiqin & Alfurqon, 2024).

To evaluate the legal framework's effectiveness, assessing its compatibility with national laws, including Indonesia's Constitution and human rights standards, is essential. This includes considering whether the Qanun's provisions respect the rights of non-Muslims and whether its mandatory nature could face legal challenges related to religious freedom. Furthermore, the law's ability to attract investment and support economic development in Aceh requires a closer examination of its economic impact, including its role in fostering investor confidence and creating a competitive financial environment (Karbhari et al., 2020).

Several strategies are required to address societal concerns and ensure the success of the policy. Strengthening public awareness through comprehensive financial literacy campaigns can help build trust in Sharia-compliant financial products and services. Additionally, expanding the variety of Sharia-compliant financial products to cater to different sectors and community needs can make the transition smoother for businesses and individuals (Indrawati, 2021). Fostering inclusive dialogue between

policymakers, financial institutions, and non-Muslim communities is also crucial for ensuring the law accommodates the needs of all residents. Lastly, technological innovations such as digital banking can increase accessibility, especially for rural areas with limited infrastructure.

By addressing these legal, cultural, and economic considerations, the implementation of Qanun No. 11 of 2018 can move beyond legal compliance to create a reinforcing and inclusive Sharia financial ecosystem in Aceh. However, for this to succeed, the law must be evaluated within the broader context of Indonesia's legal framework and its alignment with Islamic economic principles, ensuring it is effective and fair in achieving its financial inclusion and economic development goals.

Aceh Government Authority in Changing Financial Institutions Conventional to Sharia Financial Institutions

In this context, transformation refers to restructuring an existing financial system that adheres to a more advanced or entirely new framework, such as converting conventional financial institutions into Islamic financial institutions. This process entails a fundamental legal and operational shift, aligning with Sharia principles to meet regulatory and societal expectations (Jan et al., 2023). As pivotal components of Indonesia's economic infrastructure, financial institutions significantly influence the nation's economic development. Aceh mirrors these economic dynamics as an integral part of Indonesia while incorporating its unique legal and cultural context. The enactment of Aceh Qanun No. 11 of 2018 concerning Islamic Financial Institutions exemplifies this transformation by mandating that all conventional financial entities operating within Aceh conform to Islamic law principles. This legal directive underscores the region's commitment to fostering a Sharia-compliant financial ecosystem, ensuring its economic development is rooted in ethical and equitable practices prescribed by Islamic jurisprudence (Kurniawan et al., 2023). The authority of the Aceh Government to transform conventional financial institutions into Islamic financial institutions is granted by Law No. 11 of 2006 concerning the Government of Aceh, as outlined in Article 155, paragraph (1) said *"The economy in Aceh is focused on enhancing productivity and competitiveness to achieve prosperity and the well-being of the populace. This is achieved by maintaining Islamic values, justice, equality, the participation of the public, and efficiency within a sustainable development framework."*

By the authority provided by Law No. 11 of 2006 concerning the Aceh Government, the Aceh Government established Qanun No. 8 of 2014 concerning the Principles of Islamic Sharia. Specifically, Article 21, paragraph (1), addresses the regulation of Sharia financial institutions, stipulating *"Sharia principles must be the foundation of financial institutions operating in Aceh."*

The enactment of Qanun No. 11 of 2018 provides a robust legal foundation for the Aceh Government's authority to mandate the transformation of conventional financial institutions into Islamic ones. This regulatory framework plays a pivotal role

in advancing the strategic development of the Islamic banking sector within the region. By leveraging this authority, the Aceh Government has positioned Islamic financial institutions as central facilitators of financial transactions within the provincial administration and at the district/city levels. The comprehensive implementation of Qanun No. 11 of 2018, which obliges all financial institutions to operate following Sharia principles, underscores Aceh's commitment to fostering a dynamic and ethically grounded Islamic financial ecosystem. This regulatory milestone supports the rapid expansion and institutionalisation of Islamic banking in Aceh and establishes the region as a model for the broader implementation of Sharia-compliant banking systems. Such an approach promotes integrating Islamic values into economic practices while enhancing financial inclusion and sustainability (Umuri et al., 2023).

Establishing Islamic financial institutions necessitates a comprehensive legal conversion process, reflecting a fundamental shift in financial entities' operational and regulatory framework. This transformation policy significantly impacts banks' ability to comply with banking regulations while providing financial services that adhere to Islamic principles. Beyond the legal restructuring, the policy encompasses critical elements such as management frameworks, supervisory mechanisms, financial performance metrics, operational strategies, and corporate governance standards. The enactment of Qanun No. 11 of 2018 concerning Islamic Financial Institutions has further accelerated this transition, mandating the conversion from conventional financial institutions into Sharia-compliant entities. Article 2, paragraph (1) of Qanun No. 11 of 2018 stipulates that all financial institutions operating within Aceh are required to align their operations with Islamic law. This regulation reinforces the legal obligation for Sharia compliance and signifies a transformative shift in Aceh's financial landscape, promoting ethical financial practices and fostering an inclusive Islamic economic system *"Under Sharia principles, all financial institutions are required to execute transactions that are consistent with their operational base."*

This refers to conventional financial institutions that are in the process of transforming or converting. They recognise that the scope of their core activities or business in Aceh is becoming more limited. Therefore, they must take the necessary steps to adapt to this situation. As a result, several changes have been made, primarily focusing on altering the transaction mechanisms to ensure they comply with Sharia principles.

In 2008, a trend emerged of converting conventional banks into Islamic ones through three methods: 1) the Sharia Business Unit (SBU) of a conventional bank acquires and converts a smaller bank into an Islamic bank, merging it with the SBU; 2) a conventional bank without an SBU acquires and converts a smaller bank; 3) a conventional bank spins off to create a new Islamic bank. This conversion process is regulated by Bank Indonesia Regulation No. 11/15/PBI/2009, which sets the

procedures for aligning operations with Sharia principles, subject to Bank Indonesia approval.

The bank must seek approval from Bank Indonesia. This process involves submitting an application that includes a business plan, a feasibility study on market opportunities and economic potential, a plan for settling customer rights and obligations, information on prospective controlling shareholders, members of the board of commissioners, directors, and the Sharia Supervisory Board, as well as a draft amendment to the articles of association, as specified in Article 14, paragraph (1). According to Article 16, a conventional bank authorised to transition into an Islamic bank must incorporate the term "Syariah" in its name, logo, documents, products, and office networks. Once the conversion permit is granted, the bank must begin operating under Sharia principles within 60 days. Additionally, Article 18 stipulates that the conventional bank must settle its rights and obligations from conventional operations within one year of the conversion approval. In Aceh, three state-owned banks have undertaken the conversion procedure from conventional banks to Islamic banks (Din & Abubakar, 2021):

1. In Purwokerto, Central Java, on December 16, 1895, Bank BRI Syariah (Bank Rakyat Indonesia) was established. BRI is the first government bank in Indonesia, as outlined in Government Regulation No. 1 of 1946. BRI converted its name to PT Bank Rakyat Indonesia (Persero) Tbk and was listed on the Indonesia Stock Exchange (IDX) in 2003. The public possesses 30% of BRI, while the state currently holds 70%.
2. Bank BNI Syariah (Bank Negara Indonesia), established on July 5, 1946, serves all levels of society and supports Indonesia's increasingly strategic economy. Currently, BNI operates over 1,000 branches in Indonesia and eight branches abroad. BNI also owns subsidiaries such as BNI Syariah and BNI Securities.
3. Bank Mandiri Syariah, a banking institution in Indonesia, operates under the name Mandiri Syariah. Founded in 1955 as Bank Industri Nasional, the bank underwent several name changes, finally becoming Bank Syariah Mandiri in 1999, after previously being known as Bank Susila Bakti, owned by the Welfare Foundation of the Employees of Bank Dagang Negara and PT Mahkota Prestasi. This year, Bank Mandiri Syariah has been engaged in Islamic banking operations after previously being a conventional bank.

Implementing Aceh Qanun No. 11 of 2018: Advancing Sharia Financial Practices in Aceh

The creation of a *Qanun* is generally influenced by the social, political, and economic context of the community and must remain consistent with the boundaries set by the Qur'an and Hadith in addressing social issues. Nonetheless, any *Qanun* enacted must also align with Indonesia's constitutional framework (Zulkarnaini et al., 2023). The formulation and implementation of *Qanun* No. 11 of 2018 concerning

Islamic Financial Institutions in Aceh comply with national constitutional requirements, granting it legal legitimacy within Indonesia's legal hierarchy. However, its implementation in the financial sector has become a subject of debate due to the sector's complexity and the transformative nature of this regulation. Hence, there is a critical need to deepen the understanding of its application, particularly due to its strong connection to regional economic challenges (Din & Abubakar, 2021).

One of the primary functions of this *Qanun* is to govern Aceh's transition from conventional to Islamic banking under the framework of special autonomy granted by the Indonesian government. This autonomy allows Aceh to regulate economic matters within its territory, prompting the transformation of conventional banks into Islamic banks. While some argue that this regulation is appropriate—given Aceh's strong Islamic values that resonate with the principles of Islamic economics—others highlight the disruptive nature of such a significant systemic change, especially in a region long accustomed to conventional financial practices (Alqarni et al., 2024).

Aceh's approach to implementing Islamic banking through *Qanun* No. 11 of 2018 primarily involved a conversion mechanism. Indonesia provides two main models for such conversion: the "spin-off" model—where an Islamic business unit is separated from its parent conventional bank—and the full conversion of a conventional bank into an Islamic bank (Budiman, 2021). Article 1, Number 32 of Law No. 21 of 2008 concerning Islamic Banking defines the "spin-off" and is supported by Article 68, which mandates such separation when the assets of the Islamic unit reach 50% of the parent bank's total assets. This process has been observed in major banks such as PT Bank Negara Indonesia and PT Bank Rakyat Indonesia, which are driven largely by regulatory pressures (Tiara et al., 2023).

Different models of conversion have also been employed. PT Bank Mandiri Syariah transitioned into an Islamic bank through acquisition, evolving from PT Bank Susila Bakti into the second Islamic bank in Indonesia after PT Bank Muamalat. Meanwhile, PT Bank Aceh undertook a full institutional transformation from a conventional to an Islamic bank. The Financial Services Authority (OJK) introduced Regulation No. 28/POJK/2019 concerning Banking Synergy in Single Ownership to expand the scope and service capacity of Islamic banking. Prior to this, regulations like Bank Indonesia Regulation No. 15/13/PBI/2013 had already governed Islamic Business Units, though with limited operational flexibility (Yuspin et al., 2023).

The 2013 Synergy Banking regulation permitted conventional bank branches to offer Islamic banking services under the Islamic bank's name, provided that certification from Bank Indonesia was obtained (Article 19). This requirement ensured operational clarity and brand distinction and reduced risk by mandating that Islamic services be co-located with the parent bank's branches. Additionally, it introduced

technical and spatial standards for office usage and branch management (Yusmalinda et al., 2022).

Despite the comprehensive nature of Aceh's implementation, the discussion would benefit from comparative analysis with other regions or countries that have adopted Islamic banking systems. For instance, Malaysia has adopted a dual banking system, allowing Islamic and conventional banks to coexist while gradually strengthening Islamic financial institutions through a robust regulatory and infrastructural framework. Similarly, in Pakistan, the State Bank of Pakistan actively promotes Islamic banking through phased transitions and dedicated legal instruments. These comparative cases offer valuable insights: Malaysia demonstrates how Islamic banking can thrive within a plural financial ecosystem, while Pakistan shows the role of strong central oversight and public acceptance. By contrast, Aceh's transition appears more abrupt and localised, emphasising regulatory mandates over gradual adoption and market-based incentives. Therefore, this comparison highlights the uniqueness of Aceh's Islamic financial transformation and the need for continuous policy refinement, particularly regarding regulatory mechanisms, institutional readiness, and public engagement.

According to OJK regulations, the transition from conventional to Islamic banks must be gradually implemented. The Qanun on Islamic Financial Institutions mandates that all banks operating in Aceh offer Islamic banking services. Additionally, institutions within Aceh's jurisdiction are required to adhere to the legal framework set by the Aceh government (Wahyuni et al., 2021). Consequently, all conventional banks in Aceh are obligated to operate based on Islamic banking principles, establishing a standardised governance system across the region (Ma'f'ula & Mi'raj, 2022).

One of the challenges that the Aceh government has faced to date is the implementation of the Sharia Financial Institutions (LKS) Qanun, which include (Jihad et al., 2024) limited financial inclusion in Aceh. The government ensures that financial services are accessible to all members of society by implementing financial inclusion programs. The public's capacity to utilise financial services, the alignment of financial services with the public's requirements, the impact after the community receives financial services, and limitations in financial service access are all components of the financial inclusion process. Ensuring financial inclusion necessitates accessibility. By expanding financial services, it is anticipated that small and medium-sized enterprises (SMEs) will have an easier time securing capital. The National Vision for Financial Inclusion is designed to generate economic growth, poverty reduction, income equality, and the stability of the financial system in Indonesia by establishing a financial system accessible to all segments of society. Financial inclusion's objectives are as follows:

- a. To incorporate inclusive finance strategies into the broader economic development, poverty reduction, income equality, and financial system stability strategies.
- b. To provide financial products and services specifically designed to meet the needs of the public.
- c. To enhance the public's understanding of financial services.
- d. To enhance the availability of financial services.
- e. To enhance the collaboration among non-bank financial institutions, banks, and microfinance institutions.
- f. To optimise the utilisation of information and communication technology (ICT) to improve the accessibility of financial services.

Three categories of the population still lack access to financial services:

1. The most impoverished of the impoverished
The poorest population who do not have a source of income due to factors like illness or physical disability.
2. Low-Income Poor
People with limited access to all types of financial services, including those working in low-wage, seasonal, or informal sectors like agriculture.
3. Working Poor
This group comprises the poor who earn enough to meet their basic needs through informal sector work.

Additionally, there are three cross-category groups without access to financial services:

1. Domestic and International Migrant Workers
Indonesia is the third-largest recipient of remittances in the Asia-Pacific region. Approximately 80% of migrant workers (TKI) are women, and over 85% are employed in the informal sector. These workers frequently require secure and cost-effective financial services to ensure they can send money back home often located in remote regions. (Zulkarnaini et al., 2023).
2. Women
In numerous developing countries, there are substantial gender disparities in the availability, demand, and selection of financial services. Savings accounts are accessible to men and women in Indonesia. Nevertheless, males establish accounts predominantly for credit purposes, while women do so for future requirements. Women typically favour education insurance, while males tend to consider life insurance and, to a lesser extent, property insurance.
3. Population in Remote Areas
Approximately 52% of Indonesia's population resides in rural regions, with approximately 60% lacking access to financial services. Rural areas are home to 64% of the 12.49% of the population that lives below the poverty line. The

significance of a national inclusive financial strategy prioritising those in remote areas is underscored by these statistics and Indonesia's geographical conditions as an archipelago. Information and communication technology, such as mobile money, can facilitate transfers and payments between rural, urban, and island areas, thereby partially addressing this category's disparity in financial service access.

The Aceh government also encourages the public to switch to Islamic finance, as this system applies justice principles. According to Bank Indonesia's research, Aceh's financial literacy rate is just 32.7%, meaning only 23 out of 100 people in Aceh are financially literate. However, financial inclusion in Aceh is 73%, meaning 73 out of 100 people interact with financial services. Meanwhile, the level of Sharia financial literacy in Aceh is only 21%, with an inclusion rate of 41%. Through various policies, the government aims to empower and develop businesses, especially SMEs, to positively impact the national economy and people's livelihoods. The involvement of SMEs can influence economic growth in Indonesia. SMEs cannot thrive alone and require government support to keep the economy moving (Kamaly et al., 2022).

Government policies to enhance the financial capacity of small and medium-sized enterprises (SMEs) have been crucial in addressing these businesses' problems, particularly during crises such as the COVID-19 pandemic. SMEs are vital to Aceh's economy, with the Department of Cooperatives and SMEs reporting a population of 74,810 SMEs in the region. However, these businesses have historically struggled with access to financing, which has been exacerbated in times of crisis. Financial support mechanisms such as the People's Business Credit (KUR) have provided capital to SMEs, which helps alleviate these issues. Data from Bank Indonesia's Aceh Representative Office indicates that as of December 2021, SME financing in Aceh reached IDR 8.3 trillion, with KUR disbursements accounting for IDR 2.4 trillion (61.83% of the IDR 3.9 trillion disbursement limit). While these statistics highlight the government's efforts to foster SME growth through accessible financial instruments, it is crucial to critically assess the relationship between this financial support and the effectiveness of the new Islamic banking system in the region. Implementing Sharia-compliant financial systems, as mandated by Qanun No. 11 of 2018, poses opportunities and challenges for SMEs. While financial products like KUR are available, the shift to Islamic finance may impact how these financial instruments are delivered. For instance, SMEs may face challenges adapting to the profit-sharing and risk-sharing models inherent in Islamic finance, such as *mudharabah* and *musharakah*, which differ fundamentally from conventional loan structures (Umuri et al., 2023).

Therefore, evaluating whether the existing financial support programs, like KUR, fully comply with Islamic finance principles and whether SMEs are receiving adequate guidance and support to transition to this system is essential. Although KUR has provided crucial funding, its effectiveness in addressing the unique needs of SMEs

in Aceh, particularly under the constraints of Islamic banking, requires examination. Further research and analysis should focus on the outcomes of these financing programs in the context of the new Sharia-compliant system and how they contribute to the resilience of SMEs in Aceh. In other words, despite the financial data demonstrating the government's commitment to SME growth, there is a need for a deeper analysis of how these funding mechanisms conform to the Islamic banking system and their broader impact on financial inclusion and economic sustainability in Aceh. Understanding these dynamics is critical for ensuring that SMEs can thrive within the new regulatory framework and continue to drive local economic development.

The government's support for SMEs extends beyond financial aid to enhancing business adaptability, notably through the promotion of digitalisation. Many SMEs in Aceh have joined online platforms like Shopee and Tokopedia. Additionally, the government introduced Digipay, a platform designed to streamline government payments and empower SMEs. While Digipay is implemented across Indonesia's State Treasury and Payment Service Centres (KKPN), Aceh has not adopted this payment system since Qanun Aceh No. 11 of 2018 mandates the transition of all provincial financial institutions to Sharia-compliant systems. Because Digipay's implementation in Aceh faces issues, Aceh relies on conventional financial institutions (Yahya et al., 2023).

Islamic financial products and services align with Sharia principles, facilitating the flow of funds between those needing financial resources and those with surplus funds within the Islamic financial framework (Jan et al., 2023). This system integrates two key influences: Sharia principles, rooted in the Qur'an and Sunnah, and human reasoning, which addresses economic challenges such as management, finance, and business. Consequently, the Islamic financial system possesses distinct characteristics, emphasising efficient utilisation of human and natural resources to promote economic growth (Afdal et al., 2024). However, Islam's ultimate goal is not merely substantial economic expansion. Activities prohibited by Sharia, such as producing alcoholic beverages, gambling, narcotics, and prostitution, are not considered legitimate means of achieving material welfare. The Islamic economic framework prioritises equitable prosperity and socio-economic justice, highlighting the concept of universal brotherhood. Justice principles and solidarity are deeply embedded in Islamic teachings, making their incorporation into monetary policy a spiritual duty to ensure the economic well-being of society.

Interest rates serve as the foundation of the conventional financial system. The demand for money for fundamental necessities and investments is diminished due to efforts to regulate finances through interest rates. This will hamper the fulfilment of the country's economic development objectives, causing instability in the monetary sector and overall economy. It is imperative to comprehend that the health of the

economy is affected differentially by the Islamic and conventional systems (Renie, 2021). The Islamic financial system endeavours to establish a financial system founded on justice, benefit, unity, honesty, freedom, balance, transparency, anti-exploitation, anti-oppression, and anti-injustice, all achieved through Islamic banking and non-banking institutions (Sulistiawati et al., 2023).

CONCLUSION

The study highlights the significant role of Aceh's legal framework in transitioning conventional financial institutions to Sharia-compliant ones. Through laws like Law No. 11 of 2006, Qanun No. 8 of 2014, and Qanun No. 11 of 2018, Aceh has laid a solid foundation for Sharia finance, focusing on eliminating exploitative practices and promoting economic justice. These legal instruments help foster a fair and Islamic economy, ensuring that financial activities align with Sharia principles. However, the research also identifies ongoing challenges, particularly in financial inclusion and literacy. To address these, the study suggests enhancing financial literacy programs incorporating Islamic financial principles, expanding access to digital banking services, and offering incentives to support the transition of conventional institutions to Sharia-compliant models. Collaboration between government bodies, financial institutions, and religious authorities is also essential for effective regulation and implementation. This study helps understand how legal frameworks can shape the development of Sharia finance in Aceh and offers practical strategies to overcome barriers, ensuring the system's alignment with Islamic principles and promoting sustainable economic growth. The study's findings fill gaps in understanding Sharia finance integration while suggesting future research areas for improving financial inclusion in Aceh.

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