

Empowering The Informal Economy Through Islamic Social Finance: Insights from Islamic Economic Principles for Inclusive Development

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ARTICLE INFO

Keywords:

Empowerment; informal economy; Islamic economics; maqāṣid al-sharī'ah; ZISWAF,

How to Cite:

Karimah, H., Akbariani Ahmad, A., & Athallah Akbar, M.A. "Empowering The Informal Economy Through Islamic Social Finance: Insights from Islamic Economic Principles for Inclusive Development." *At-Taradhi: Jurnal Studi Ekonomi* 16, no.1 (2025): 14-33.

ABSTRACT

The informal sector continues to dominate employment in many developing countries, including Indonesia, providing livelihoods for millions of workers who often lack access to social protection and economic security. This paper examines the origin and development of the informal economy and explores its structural determinants. Additionally, it highlights the role of Islamic economics, particularly the potential of Islamic social finance instruments—zakat, infāq, ṣadaqah, and waqf (ZISWAF)—in supporting inclusive and sustainable development within the informal sector. Employing a descriptive-qualitative approach, this study integrates content analysis, literature review, and critical analysis of both mainstream and Islamic economic perspectives. The conceptual model developed in this paper positions Islamic economic principles such as falah, maslahah, and social justice as key drivers for empowering informal sector workers. By aligning these principles with the objectives of maqāṣid al-sharī'ah, the framework provides strategic directions for capacity building, ethical financing, and inclusive growth. The findings suggest that productive utilization of ZISWAF can facilitate the transition of informal workers toward economic resilience and formal sector integration. This study calls for collaborative engagement among government, private sector, and Islamic philanthropic institutions to ensure the realization of sustainable development goals, underpinned by ethical and spiritual commitments.

Sektor informal terus mendominasi lapangan kerja di banyak negara berkembang, termasuk Indonesia, dengan menyediakan mata pencaharian bagi jutaan pekerja yang sering kali tidak memiliki akses terhadap perlindungan sosial dan jaminan ekonomi. Penelitian ini mengkaji asal-usul dan perkembangan ekonomi informal serta mengeksplorasi faktor-faktor struktural yang menjadi penentunya. Selain itu, penelitian ini menyoroti peran ekonomi Islam, khususnya potensi instrumen keuangan sosial Islam—zakat, infāq, ṣadaqah, dan wakaf (ZISWAF)—dalam mendukung pembangunan yang inklusif dan berkelanjutan di sektor informal. Melalui pendekatan deskriptif-kualitatif, studi ini mengintegrasikan analisis isi, kajian literatur, dan studi kritis terhadap perspektif ekonomi arus utama dan ekonomi Islam. Model konseptual yang dikembangkan dalam penelitian ini menempatkan prinsip-prinsip ekonomi Islam seperti falah (kesejahteraan holistik), maslahah (kemaslahatan umum), dan keadilan sosial sebagai pendorong utama dalam memberdayakan pekerja di sektor informal. Dengan menyelaraskan prinsip-prinsip tersebut dengan tujuan maqāṣid al-sharī'ah, kerangka ini memberikan arahan strategis dalam penguatan kapasitas, pembiayaan berbasis etika, dan pertumbuhan yang inklusif. Temuan penelitian ini menunjukkan bahwa pemanfaatan ZISWAF secara produktif berpotensi memfasilitasi transisi

pekerja informal menuju ketahanan ekonomi dan integrasi ke dalam sektor formal. Studi ini juga mengajak adanya kolaborasi yang sinergis antara pemerintah, sektor swasta, dan lembaga filantropi Islam guna mewujudkan tujuan pembangunan berkelanjutan yang berlandaskan komitmen etis dan spiritual.

DOI: <https://doi.org/10.18592/taradhi.v16i1.16301>

Introduction

For the past few decades, the informal economy has been recognized in the world and mostly dominated compared to formal economy. Many economic and business institutions define informality from any angle hence it comes to conclusion that informal economy is the safety net for people who are having lower education, unemployed, unproductive and having low-skilled labor (Febrianto, 2020). Under this great phenomenon of growing informal, we might encounter these activities in our daily basis without us realizing such as buying food or beverages from street vendors, hiring maid or nanny for taking care our home and children from rural area, hiring handy man who can repair our home, car, electricity for living. This kind of work is far from government attention but their accumulate income growing as unreported income and number of employments are dominating compared to formal sector (Portes & Haller, 2010).

Frequently, the discussion on informal economy strongly related to developing countries that lack authority attention, law enforcement and stakeholders who might bring people in informal sector into formal. In contrast, developed countries experienced different types of informal economy because it also involved technology advancement, globalization, and different economic structures. However, an informal economy always brings to the relation with economic growth. There are two points of view that argue about economic growth and informal economy, namely informal economy is highly correlated to decreasing the growth in a country. Meanwhile, another point view sees the informal economy as the proxy of increasing growth economy (Febrianto, 2020). In Indonesia, informal sector dominates compared to unemployment and formal sector. As can be seen in figure 1, Indonesia has been regulating the policy that might reducing unemployment and informal sector. However, from the figure 1, Indonesia from 2020 to 2024 has been experienced reducing the proportion of informal sector.

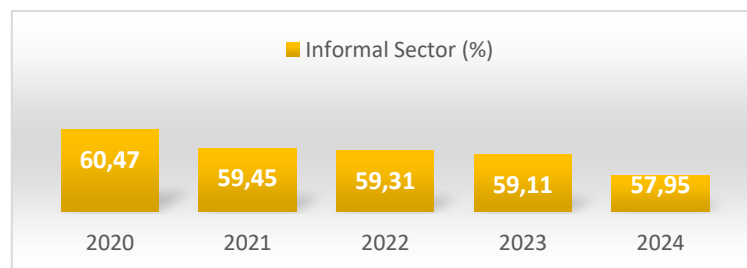


Figure 1. Proportion of Informal Sector in Indonesia

Source: BPS, 2024

Figure 1 illustrates the trend of informal sector employment in Indonesia from 2020 to 2024. The data show a gradual decline in the number of informal workers, from 60.47 percent in 2020 to 57.95 percent in 2024. This reduction, although modest, suggests an ongoing shift toward labor formalization or structural changes within the employment

landscape. However, the persistence of a large informal workforce reflects the continued dominance of informal jobs, particularly in rural areas, agriculture, and low-skilled service sectors, where formal employment opportunities remain limited.

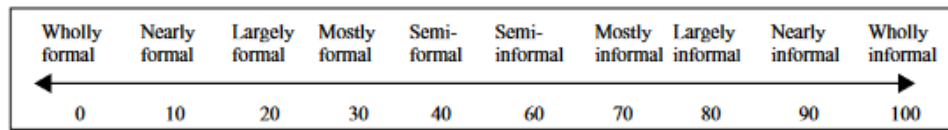


Figure 2. The type of Informal Economy in Term of GDP in Percentage

Source: (Williams, 2014)

According to Williams in figure 2, we can classify informal activity of the country to understand the direction of the policy in a country (Williams, 2014). Figure 2 provides a conceptual framework that maps the spectrum of employment relationships on a continuum from wholly formal (0) to wholly informal (100). Rather than treating formality and informality as binary categories, this model introduces gradations such as nearly formal, largely formal, mostly formal, semi-formal, semi-informal, mostly informal, largely informal, and nearly informal. This continuum allows for a more nuanced understanding of employment conditions, recognizing that many jobs exist between the two extremes. For example, workers with partial social protections or informal agreements may be classified as semi-formal, while self-employed individuals operating unregistered micro-businesses may fall into the category of mostly informal. This classification highlights the complexity of labor market dynamics, where workers may not fully transition from informal to formal status directly but instead move gradually along this spectrum.

Taken together, these figures emphasize both the scale of informal employment and the need for nuanced policy responses. The gradual decline in informal sector participation suggests potential for labor market improvement but also points to the importance of facilitating smooth transitions along the formality spectrum. Strategies such as expanding social protection coverage, simplifying business registration, and enhancing skills training are critical to support informal workers, particularly those in semi-formal or semi-informal arrangements, toward achieving more secure and regulated employment. However, the government should consider the existence of informal sectors for a short time or to be reduced in a longer period to achieve economic growth and sustainability (Sultana et al., 2022). This is strongly related to taxation policy, higher level social protection, and effective redistribution via social transfer.

While extensive studies on the informal economy have been conducted, particularly in the context of developing countries like Indonesia, much of the existing literature tends to focus on structural issues, labor informality dynamics, and regulatory challenges. However, there remains a limited exploration of the potential contribution of Islamic economic principles in addressing the complexities of informality, particularly in empowering informal sector workers through ethical financing and social justice mechanisms. This research offers a distinct contribution by integrating the perspective of Islamic economics—especially through instruments such as *zakat*, *infāq*, *ṣadaqah*, and *waqf* (ZISWAF)—as strategic tools to enhance the welfare and capacity of informal workers. By aligning the objectives of informal sector development with the foundational principles of the goals of Islamic law (*maqāṣid al-sharī'ah*) such as social justice (*‘adl*), public benefit (*maslahah*), and human well-being (*ḥalab*), this study introduces an alternative policy approach that complements conventional development strategies. Furthermore, unlike previous studies

that predominantly examine informality from labor market or fiscal perspectives, this paper provides a conceptual framework that situates the informal economy within the broader discourse of inclusive and sustainable development under Islamic economics. This approach not only fills a gap in the current body of knowledge but also offers actionable insights for policymakers, religious institutions, and philanthropic organizations seeking to foster productive empowerment and social protection for informal sector workers in Indonesia.

This paper contributes to literature in two main ways. First, unlike many literatures that explain informality that face in Indonesia and second, this paper provides at bringing together and analyzing the Islamic economic role to the literature on the informal sector.

This paper is to set out the following objectives: (1) To identify the origin and development of the informal economy; (2) To explain factor determinations of informal economy; (3) To determine the Islamic economic roles in the informal economy.

The organization of this paper is as follows: this paper focuses on background and development of informal economy in Indonesia. Then, we deal with the problem that exists in informal economy and the implication for the development and sustainable economy. The discussion will continue to the next section with explaining the roles and responsibilities of Islamic Economic to this sector. In the end of this, concluding remark and recommendation will be given.

Literature Review

A. The Origin and Development of The Informal Economy in Indonesia

Initially, the concept of informal economy has been conducted by a social anthropologist named Keith Hart in 1971. At the beginning he introduced informal sectors which describe the group of people who work outside the formal labor market. Therefore, developers become informal economy which has broader definition rather than just referring to the ways of making a living outside the formal wage economy term (Coletto, 2019; Gerxhani, 2004).

According to UN International Labor Organization (ILO), the definition of informal economy is the activities that are not counted as formal arrangement based on law (Sillah, 2019). Hart distinguishes informal economy into two types based on large sets of activities which are legitimate and illegitimate. It all encompasses to the activities such as tax evasion, black market activities, drug cartel, human trafficking, petty theft, gambling, etc. on the other hand, the main legitimate informal activities come from primary and secondary activities such as farming, market gardening, constructions, petty trader, musicians, barbers, shoecleaning, etc (Coletto, 2019; Rothenberg et al., 2016).

According to the ILO, the informal economy has a greater share compared to formal economy, especially in developing countries. Which also strongly related to low productivity, limited fiscal resources, poverty and income inequality (Özgür et al., 2021). The ILO also defines someone who is self-employed in informal enterprises whether in small firm or unregistered company and wage employment in informal job with working benefits, secure contract, and social protection are under informal categorize (Mukherjee, 2016). In addition, Informal economy has been labelled with many names such as shadow economy, underground economy, hidden economy, and the black economy (Malek & Arshad, 2017). However, informal economy defines so

many names, but it is based on three main economic schools of thought since more than four decades ago.

Table 1. Economic school of thought on informal economy

The Dualist School	The International Labor Organization (1970s)	<ul style="list-style-type: none"> • Informal sector has its own activities that is not related to its counter sector and separated from informal economy • Slow rate economic growth and faster rate population growth are very impactful toward absorbing surplus labor in labor market
The Structuralist School	Caroline Moser & Alejandro Portes (1970s & 1980s)	<ul style="list-style-type: none"> • Informal economy is the subordinated economic units consider micro firm exist and the purpose of worker is reducing input and labor cost. • the persistence of informal activities and growth of informal production relationship due to the nature of capitalist development
The Legalist School	Hernando de Soto (1980s & 1990s)	<ul style="list-style-type: none"> • informal sector is the place microentrepreneurs that choose to operate their firm informally to avoid costs, time, and effort of formal registration. • Unreasonable government rules and regulations will make the microentrepreneurs stay in the informal sector.

Source: (Chen, 2005)

From table 1, it explained There are different ways to understand the informal sector based on several major theories. The Dualist School, supported by the International Labor Organization (ILO) in the 1970s, explains that informal activities are separate from the formal economy and mostly appear because slow economic growth and fast population growth make it hard to absorb all workers into formal jobs. The Structuralist School, developed by Caroline Moser and Alejandro Portes in the 1970s and 1980s, sees the informal sector as connected to the formal economy, where small and micro businesses help reduce production and labor costs, and exist because of how capitalism grows and changes. Meanwhile, the Legalist School, led by Hernando de Soto in the 1980s and 1990s, believes that many microentrepreneurs stay informal because government rules are too complicated, expensive, and time-consuming, so it's easier for them to run their businesses outside the formal system.

Understanding the different perspectives on the informal sector is crucial, especially when analyzing real-world labor market data. Figure 3 illustrates the composition of Indonesia's labor force in 2024, showing a striking reality that the informal sector continues to dominate employment, with 83.83 million people compared to 60.81 million in the formal sector, and 7.47 million unemployed. These numbers align with the earlier theories particularly the Dualist and Structuralist views which suggest that informal employment arises due to limited formal job opportunities and cost-reduction strategies in a capitalist economy. Moreover, the Legalist perspective helps explain why so many microentrepreneurs remain in the informal sector and choosing flexibility over burdensome regulations. Together, these theories provide valuable insight into why informal employment remains a key feature of Indonesia's labor market.

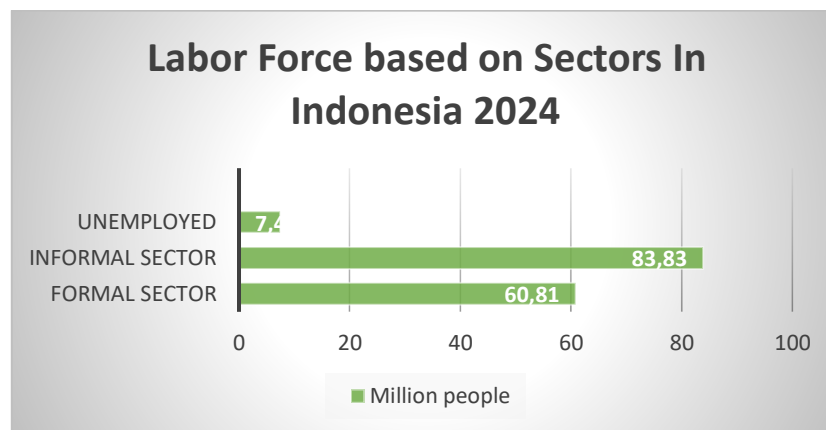


Figure 3. Labor Force in Indonesia Based on Sector

Source: BPS, 2025

Indonesia's labor market in 2024 is characterized by a predominantly informal workforce alongside a substantial formal sector and a smaller unemployed segment. Figure 3 represents the number of people working under the informal sector is 82,67 million people or 55,9% from total of national labor force, while people working under formal sector are 57,18 million people, that is only 38,7% and 7,8 million are unemployed. In other words, informal employment accounts for the largest share of workers. This prominence of the informal sector underscores a critical aspect of Indonesia's economy, with important implications for social protection and economic policy.

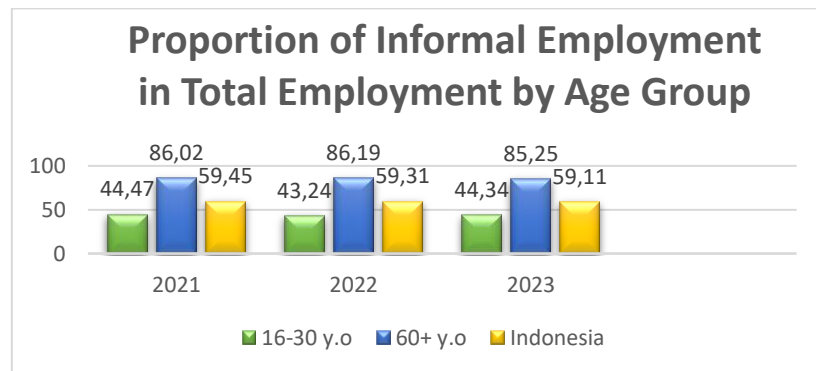
While the overall size of the informal sector in Indonesia is substantial, it is also important to look deeper into how participation is distributed across different groups by gender and age. The next graph highlights the proportion of informal sector workers based on gender and age from 2021 to 2023. It shows that male workers consistently dominate the informal sector compared to female workers, although both genders have significant representation. This gender disparity may reflect broader structural issues, including differences in access to education, job opportunities, and societal expectations. Furthermore, the age-based analysis highlights that the older age group (60+) consistently dominates informal employment at around 85–86%, compared to youth (16–30 years old) whose share hovers around 43–44%. This suggests that informal work serves as a safety net for older workers who may be excluded from formal opportunities, while younger individuals, despite entering the workforce, still face barriers to secure formal jobs.

Table 2. Proportion of Informal Sector Based on Gender

	Male	Female
2021	56,61%	63,8%
2022	56,03%	64,43%
2023	55,81%	64,25%

Source: BPS, 2025

A notable aspect of Indonesia's informal employment is its demographic composition, particularly regarding gender and age. Analysis of recent labor force data reveals that informal sector employment is disproportionately dominated by women and older individuals. Table 2, in fact, between 2021 and 2023, women have consistently made up a higher percentage of informal sector workers compared to men. This means that a greater share of working women is in informal jobs, and women constitute a larger proportion of the informal labor pool than their male counterparts during those years. This gender disparity aligns with broader patterns observed in developing economies, where women are often more concentrated in informal and vulnerable employment (Mohapatra, 2012). Socio-cultural factors and job opportunities available to women contribute to this trend for instance, women more frequently engage in non-standard work (part-time, home-based, or family work) which tends to be informal (Rahayuwati et al., 2024). As a result, women workers in Indonesia face higher likelihood of lacking job security and social protection, since a significant number are in the informal sector.

**Figure 4.** Age Patterns in the Informal Workforce

Source: BPS, 2025

Age distribution further skews the profile of informal employment. Older workers, especially those aged 60 and above, are heavily represented in the informal sector. Many individuals past the typical retirement age remain economically active through informal work, as formal sector opportunities for seniors are limited. The data from figure 4 indicates that the elderly (60+ years) form a substantial portion of informal workers, far more so than in the formal sector. One reason is that upon reaching retirement age or exiting formal employment, many seniors turn to informal jobs (such as farming, running a small business, or casual labor) to sustain their livelihood. Studies have found that in Southeast Asia, the rate of informality is highest among older workers, and Indonesia is no exception (Rahayuwati et al., 2024). For example, elderly

women in Indonesia are significantly more likely to be working informally than elderly men, reflecting both the gender and age dimensions of informality. Overall, the prevalence of older individuals in informal work is a consequence of limited pension coverage and the need for income beyond retirement, coupled with the flexible, accessible nature of informal jobs that often do not enforce age limits.

The labor force composition in Indonesia with 83.8 million informal workers versus 60.8 million formal workers (2024) underscores the dualistic nature of the economy. The formal sector provides more secure employment for millions, yet the informal sector remains the backbone for an even larger segment of the population. This reality has important policy implications. A workforce dominated by informal employment presents challenges for workers' welfare and government policy. Workers in informal jobs typically lack social protections, such as health insurance or retirement benefits, and often have lower and more volatile incomes (Ceni, 2017). From a policy perspective, the government faces a reduced tax base and difficulties in extending labor regulations or social security to a majority of workers, given the sheer size of the informal economy (Larasati, 2023).

On the positive side, the informal sector's capacity to absorb a large number of workers including women with family responsibilities and the elderly who need continued income serves as a cushion against unemployment. With 7.47 million unemployed in 2024, policies that improve the conditions of informal work or facilitate transitions to formal employment could greatly enhance livelihoods. Strengthening vocational training, simplifying business registration, and expanding social insurance coverage to informal workers are frequently cited strategies to bridge the gap between the sectors (Fourie, 2018; Palmer, 2020; Winkler et al., 2017). In summary, Indonesia's 2024 labor force data highlight a pressing need to address the vulnerabilities associated with informal employment while harnessing its role in providing jobs, especially for women and older citizens, in an effort to achieve more inclusive and secure economic growth.

B. Issues in The Informal Sector and Its Implications for The Development and Sustainable Economy.

In the economy, an informal economy brings positive and negative impact for the firms and workers. In the positive side, flexibility to choose economic decision, location, resource management and market competition was the main factor of avoiding the regulation and taxation. On the other hand, in production side most of the time the firm suffers from higher cost and risk, the state can protect them from any kind of misconduct of business contract, having limited access to banking services, if the firm or individual is involved in illegitimate, they need more resources to cover up the activities (Loayza, 2018). The proportion of informal economy is getting bigger compared to formal economy as initially people in the formal sector are volunteering rather than exclusion from formal economic. There are three reasons why this sector is hidden from formal authority, namely monetary, regulatory, institutional reasons. Monetary reason means people who are in informal economy are trying to avoid paying taxes and all kinds of social security contributions. It means people who are in informal sectors using public infrastructure without contributing necessary tax revenue to fund it (Loayza, 2018; Wu & Schneider, 2021). While regulatory reasons include avoiding governmental bureaucracy or burden of regulatory framework. The last is institutional reason where it has weak rule of law, corruption law, the quality of political institutions (Wu & Schneider, 2021). In addition, the regulation toward labor market such as

getting tighter, cutting of the working time per week, early retirement, declining tax morale are the various reasons shifting formal economy into informal economy (Schneider & Enste, 2000)

Many economists, even the government, believe that informal sectors can disappear overtime as formal manufacturing creates products and services sector grow and create job opportunities for people who join in informal sector (Farrel, 2004). However, even the informal sector is considered as a safety net for some group of people. If they faced crisis, it still having huge impact to this sector because it consists of vulnerable groups which they have unstable income, did not have financial guarantees, and uncertainty contracts (Pitoyo et al., 2020). Therefore, there are two types of how people in informal economy respond to stay during crisis. It will explain in table 2.

Table 3. The Ability Informal Economy to Survive during Crisis

Optimistic View	Pessimistic View
Point of View: informal economy as economic activity	Point of View: focusing on labor force of informal economy
<ol style="list-style-type: none"> 1. Having flexibility to absorb labor without asking for certain requirements 2. To start business in formal economy didn't have to have large financial capital 3. This sector might the only one sector that can absorb the unemployment worker from lay off 4. Informal sector activities are easier to carry out during a crisis 	<ol style="list-style-type: none"> 1. Informal economy belongs to vulnerable groups such as women worker, unskilled labor, underage labor, etc. 2. There is uncertainty about guarantee of employment, social security about insurance etc. 3. The impact, somehow, is similar as the formal sector or worse. 4. With income uncertainty, the crisis makes it worse.

Source: (Pitoyo et al., 2020)

To have sustainable development and providing decent economic opportunities for everyone, it requires reducing proportion of informal economy. The larger informal economic size might cause GDP per capita to get lower and poverty level is getting higher. Moreover, informal sectors lead to labor right abuses such as underpaid, working overtime, and insufficient coverage for their health insurance. In addition, from environmental issue, it strongly associated in environmental degradation namely air pollution due to higher mortality or the enforcement are unable to control environmental issue especially in rules and regulations (Özgür et al., 2021; Sultana et al., 2022). Thus, this might take long time to reach everyone going back to formal sector because the informal economy is currently the only viable income sources for many people (Delechat & Medina, 2021). Therefore, the relationship between economic development and informal economy is like two-side. On the one hand, higher levels of human capital and technological advancement will help people to improve their quality of life. This is because they are in their comfort zone where they are not under pressure about work, having flexible time and a reliable payment system.

However, economic development can bring people from informal sector to formal sector back. Strong institutional capacity and better social infrastructure are the signs of advanced economic development. The choice that people will take whether to join or switch formal sector will depend on how much they enjoy the benefit of economic growth. This leads to shrinking of informal economy (Wu & Schneider, 2021). For those dualists who believe that informal economies and formal economies are separate and independent sectors, economic growth is strongly related to eradicating informal economy (Sillah, 2019).

Another way to reduce the proportion of the informal economy sector is taxing. The potential taxpayers from the informal economy are difficult to detect due to small scale enterprises. Although, some firms or enterprises in the informal sector are having a lower rate of return and their taxable income is quite low (Kundt, 2017). Government believes that if they are forgiving past tax debts of the company it can make the companies pay their tax on time. However, the companies will be playing tricks for waiting for the tax amnesties program every year (Farrel, 2004). In order to change that system, the government should charge the tax invaders with high penalties at certain times every year and also use sophisticated digital system to make taxpayers easier to pay and easier to track. In addition, the dynamic relationship between tax and informal sectors is the result of poor institutional factors such as corruption, bureaucratic quality, and weaker legal environment (Mitra, 2017).

Research Methodology

This study adopts a descriptive-qualitative research design to explore and conceptualize the potential role of Islamic social finance in empowering the informal sector. This approach is particularly suitable given the normative, philosophical, and policy-oriented nature of Islamic economics and its intersection with informal economy structures (Creswell & Poth, 2018). The research does not aim to test a hypothesis but rather to construct a comprehensive analytical framework through the interpretation of textual sources, empirical evidence, and policy analysis.

The methodology consists of three interrelated methods: (1) Literature Review. A systematic review of existing literature was conducted to establish the conceptual boundaries of both informal economy and Islamic social finance. Sources include peer-reviewed journal articles, government reports (e.g., BPS, Baznas), international organization publications (ILO, IMF), and classical and contemporary Islamic economics literature (Malek & Arshad, 2017; Samad & Sugeng, 2022). This review helped to identify key variables, concepts, and patterns relevant to informal sector empowerment and Islamic development principles; (2) Content Analysis. To extract themes and recurring principles, the study employs qualitative content analysis (QCA) on key policy documents, such as Indonesia's poverty alleviation plans (RPJMN), Islamic philanthropic reports, and SDG-aligned frameworks. This method was used to map how Islamic social finance instruments (ZISWAF) are being operationalized and perceived in relation to the informal sector (Ascarya & Sakti, 2021); (3) Critical Analysis and Conceptual Modeling. A normative-analytical lens was applied to develop a conceptual model that integrates Islamic values (*falah*, *maslahah*, *adl*) with structural challenges of the informal economy. The model was built through comparative synthesis, bridging conventional economic analysis with *maqāṣid al-sharī'ah* (Syahrani et al., 2023; Yasmeen et al., 2024). This method allows for the construction of a spiritually grounded yet policy-relevant development strategy.

The integration of these qualitative methods ensures the depth of understanding required for proposing a model that is both philosophically sound and empirically grounded. Moreover, triangulation through multiple data sources (statistics, reports, theoretical texts) enhances the reliability and validity of the findings.

Results & Discussion

A. The Roles and Responsibilities of Islamic Economic to Informal Economy

Islamic economics provides a holistic conceptual framework for development (Samad & Sugeng, 2022). The goal is achieving *al-falah* (holistic prosperity in this world and the hereafter), measured not only by economic growth but also by social welfare and ethical integrity. The principle of *maslahah* ensures that economic activities promote collective benefit and prevent harm. Social justice (*al-'adl*) is central to Islamic economic thought, requiring fair distribution of income, reduction of inequality, and equal opportunities for all individuals to thrive (Syahriani et al., 2023). This framework aligns well with the Sustainable Development Goals (SDGs), but with the added dimensions of ethical and spiritual accountability. Thus, the model integrates *maqāṣid al-sharī'ah* (the objectives of Islamic law)—preservation of religion, life, intellect, lineage, and wealth—into development strategies. Thus, empowerment of informal workers through skills enhancement (*preservation of intellect*), social protection (*preservation of life*), and ethical financing (*preservation of wealth*) becomes a pathway to achieving both *falah* and sustainable development.

Islam has its own uniqueness perspective related to economic growth and sustainability development. It is believed that these elements namely social responsibility (*faradl*), empowerment (*shura*), social equilibrium (*al 'adl wal ihsan*), social cohesion (*ummah*), endowment (*waqf*), and almsgiving (*zakat*) are the connection between Islamic viewpoint and contemporary sustainable development. Therefore, poverty alleviation, decreasing inequality, and promoting prosperity are the results from that connection.

Social responsibility has been carefully defined from Islamic economists as its strongly related to characteristic human as in the micro-foundation of Islamic economics. In order to achieving *falah*, Individuals should sacrifice their economic interest to establish justice in society. It means in the way to reach *falah*, all of the behavior of individuals should establish the concept of *maslahah* and justice. Thus, social responsibilities involve all the individuals in formal sectors to be less self-interest to reach out people in the informal sectors (Barom, 2018). People in informal sectors tend to be financially in need, having family responsibilities and having human capital constraints. Integrating Islamic social responsibilities to informal sectors lead to reaching social equilibrium (leaving self-interest behavior and fulfilling justice then achieving (*falah*)). In addition, fulfilling Islamic social responsibilities to this community might be establishing social cohesion. It means when the individual brings out their less self-interest to the community and helps people who are in need it means that community are enhancing societal well-being and prevents all potential harm for *ummah* in the context of economic development (Majeed, 2019). From Islamic financial institutions (IFIs) point of view, the IFIs are responsible for mobilizing investment fund from permissible and recommended sources to the people are having permissible and recommended project. IFIs should lower their requirements of capital of borrower and state the rights and conditions of the client prior to settlement of any contract in order to leading of transparency and fairness for both party (Farook, 2008).

This interconnection between individual ethics and collective well-being underscores the unique contribution of Islamic economics to development discourse. Rather than separating material progress from moral responsibility, Islamic thought integrates both dimensions, positioning social responsibility as a central pillar in achieving holistic prosperity (*falah*). This perspective naturally aligns with broader development agendas, particularly when addressing marginalized communities like those in the informal sector. By embedding ethical obligations within economic action, both at the individual and institutional levels, Islamic economics provides a cohesive framework where social cohesion, justice, and sustainability are not just outcomes, but inherent processes in economic life (Yasmeen et al., 2024).

Thus, sustainability means we are practicing our religious knowledge, commitment to societal role, and responsible to our religion and civic institutions (Ismail & Mohd Rasid, 2022). The aims of Sustainable Development Goals (SDGs) are overlapping with the aims of Islamic finance itself (Mohamad & Borhan, 2017). In addition, achieving sustainable development from Islamic point of view already mentioned in Qur'an and Sunnah. As the unique foundation that involving ethical and Islamic principle, Islamic economic propose instrument that can reduce financial disparity between the rich and the poor. Islamic economics has been emphasized that income redistribution can solve poverty, unemployment, and social exclusion by social welfare program such as Zakat, Infaq, shadaqah, and waqf (ZISWAF)

B. The Strategic Role of ZISWAF in Supporting the Informal Sector

The ZISWAF instruments (Zakat, Infāq, Şadaqah, and Waqf) are core mechanisms within Islamic social finance. Their strategic deployment offers significant potential to uplift the informal sector: first,

1. Zakat

Zakat serves not only as an immediate social safety net but also as productive capital to foster self-reliance. Productive zakat involves providing business capital, tools, and training to eligible recipients (*mustahik*). Recent studies show that productive zakat has successfully increased micro-enterprise incomes and helped beneficiaries transition toward financial independence. It involves not just cash transfers, but also provision of tools, training, and business capital. Some studies found that productive zakat combined with training significantly increased micro-enterprise income and helped recipients improve their business performance by skill development and also providing guidance in term spiritual side (Khatimah et al., 2024; Perdana et al., 2023; Wibowo & Restuningsih, 2019). Mahmudin's Story (BAZNAS Productive Zakat Program) A motorcycle mechanic in Jakarta who received equipment and business training through the BAZNAS Z-Auto program. His income increased from IDR 3 million to over IDR 7 million per month, allowing him to transition from *mustahik* to *muzakki* (zakat payer) (Baznas, 2025)

2. Infāq and Şadaqah (Voluntary Charity)

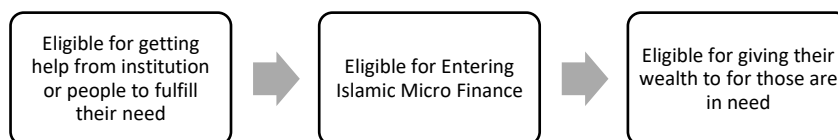
These voluntary contributions allow flexible allocation beyond the eight zakat recipient categories. Infāq and şadaqah are often used to fund entrepreneurship training, provide business equipment, and support informal workers not eligible for zakat. Programs like Dompot Dhuafa's "UMKM Naik Kelas" exemplify how charity can elevate micro-entrepreneurs to higher business levels. Research by (Adiwijaya et al., 2023; El Ayyubi

& Eka Saputri, 2018) found that ZIS (Zakat, Infaq, Sadaqah) distributions significantly contributed to poverty reduction when linked to entrepreneurship training, equipment provision, and business mentoring.

3. Waqf (Endowment)

Waqf, especially productive waqf, supports sustainable empowerment through asset management. Examples include leasing waqf-owned market stalls to informal vendors at low cost or funding microfinance for small entrepreneurs through Cash Waqf Linked Deposit (CWLD) schemes. Initiatives like the “Gerobak Berkah” program demonstrate how waqf can provide business assets (e.g., food carts) and business coaching for informal entrepreneurs. Funded through CWLD, this initiative enables informal workers to operate with better business equipment and hygiene standards, increasing competitiveness and income (Wakaf Warrior, 2025). Another example, Bank Wakaf Mikro (Microfinance Model) that is operating near Islamic boarding schools (pesantren), BWM provides interest-free micro-loans to informal businesses, improving access to capital without *riba*-based financing especially for small-medium enterprises (Aransyah et al., 2022; Rizki et al., 2022).

There are many *qur’anic* verses that related to sustainable development goals such as dealing with poverty and distress (Al Baqarah (2) verse 271, ordering Muslim regarding to feed the hunger in Al Insan (76) verse 8, social justice (4) verse 58, equality Al hujurat (49) verse 10, and also *Qur’an* promote to strengthen the sense of family and neighborhood & community Ar Rum (30) verse 21 and An Nisa (4) verse 36 respectively. Understand that Islam has involved in every aspect of life including the sustainability development means that we are involving in spiritual and emotional commitment as a Muslim and contribute to global human welfare (Ismail & Mohd Rasid, 2022).



Source: (Ascarya & Sakti, 2021)

Figure 5. The Process of from Mustahiq to Muzakki

From the figure 5 it is clear that if people are poor (*mustahiq*), it means they are limited from entering micro finance institution due to disqualified from the requirement. It is at its best because in order to alleviate poverty they have to avoid debt and receive charity which is *zakat*. From receiving *zakat*, it is expected to help *mustahiq* to improve their skill and joining technical assistance. When they are having enough skill and creating their own business. They can propose to get loan from Islamic Micro Finance Institution.

Zakat as the faith-based charity instrument has significant impact for people who are in need (Malihah et al., 2022). Zakat can be maximized to increase productivity if only *muzakki* pay their *zakah* in the zakat institution such as Badan Amil Zakat Nasional (Baznas), Dompot Dhuafa, LazisMu and any other institution that have been legally approved by government. Some research showed that Zakat considers as financial assistance for the needy person and at the same time it can alleviate poverty (Arif, 2017; Aziz et al., 2020; Herianingrum et al., 2024; Iddy et al., 2022a, 2022b).

4. Policy Recommendations Based on Islamic Economic Principles
 - a. Scaling Productive ZISWAF Programs: Government agencies should synergize with ZISWAF institutions to expand productive zakat and waqf-based financing for micro-entrepreneurs. Tax incentives for CSR linked to ZISWAF can enhance the sustainability of these programs (Firmansyah, 2024; Halim et al., 2025).
 - b. Standardization and Business Quality Improvement. Support informal entrepreneurs to formalize their businesses through legal registration, halal certification, and financial literacy, preparing them for broader market access (Abdullah & Rusdiana, 2024; Firmansyah & Adji, 2023).
 - c. Data Integration for Accurate Targeting. Establish a shared database between government social registries (DTKS) and ZISWAF institutions to improve beneficiary identification and track empowerment outcomes (Amrial, 2021; Johari & Pratama, 2022).
 - d. Strengthening Islamic Microfinance Networks. Expand the reach of Islamic microfinance institutions (BMTs, BWM) with regulatory support and capacity building, focusing on underserved informal entrepreneurs (Aransyah et al., 2022; Rizki et al., 2022; Solekha et al., 2021).
 - e. Promoting Islamic Economic Literacy. Deliver widespread education on Islamic business ethics, financial management, and the role of ZISWAF in poverty alleviation and empowerment (Natalia, 2022; Susanti, 2022).
 - f. Mainstreaming Islamic Social Finance into National Development. Integrate Islamic economic strategies into national poverty alleviation programs, including RPJMN/RPJMD, aligning with SDGs but with enhanced ethical accountability (Aldi et al., 2020; DPR RI, 2024).

Conclusion

The informal sector remains a vital yet vulnerable component of Indonesia's economy, employing the majority of the labor force, particularly women, the elderly, and low-skilled workers. Despite its role as a safety net, this sector is often excluded from legal protection, stable income, and access to financial services. The persistence of informality poses structural challenges to achieving inclusive and sustainable development. This study highlights how the informal economy is shaped by various economic theories and demographic factors, underscoring the urgent need for more inclusive, well-targeted policy interventions.

Islamic economics offers a unique and holistic framework to address these challenges, emphasizing principles such as *falāḥ* (prosperity), *maṣlaḥah* (public interest), and *ʿadl* (justice). Through ZISWAF (zakat, infāq, ṣadaqah, waqf), Islamic social finance presents practical instruments to empower informal workers—not only as a form of charity but as sustainable capital for entrepreneurship, skills training, and access to microfinance. Programs like productive zakat and waqf-based business assistance have shown success in helping beneficiaries move from being recipients (*mustahiq*) to contributors (*muzakki*), demonstrating the potential of ethical and faith-based finance in promoting long-term economic resilience.

To realize this potential, strategic collaboration between the government, Islamic philanthropic institutions, and civil society is essential. Policy support should focus on integrating Islamic social finance into national development agendas, expanding microfinance access, and promoting formalization through legal recognition and training. Ultimately, by aligning the empowerment of informal workers with Islamic economic principles and the goals of *maqāṣid al-sharī'ah*, this model provides a spiritually rooted pathway toward inclusive growth, justice, and sustainability.

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