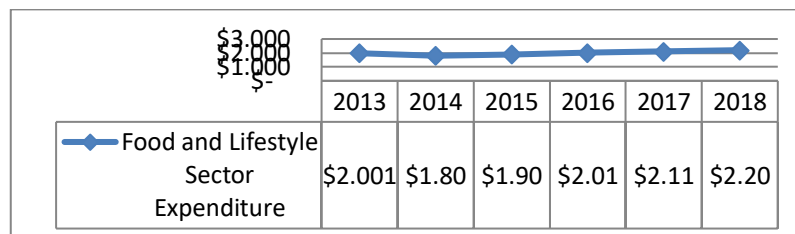


# CHAPTER I

## INTRODUCTION

### A. Background

The industrial sector is one of the economic sources which currently cannot be separated from economic life. Along with the times, industrial development has begun to change from a simple stage to the present the halal industry in the industrial era 4.0, whose development has greatly increased in the world in recent years. The global halal industry can be said to be one of the sectors capable of increasing economic growth. This is evidenced by the State of Global Islamic Economic 2019, global halal industry is estimated to reach around USD 2.2 trillion (excluding the Islamic financial sector). The global halal industry is estimated to increase at an annual rate of 5.2 percent, so that this industry is predicted to be worth USD 3.2 trillion in 2024. In addition, Islamic financial assets were recorded to have reached USD 2.5 trillion in 2018. Based on the State of Global Islamic Economy Report, there is an increase in spending in the food sector and lifestyle in the development of the halal industry every year. Thus, the halal industry has become one of the fastest-growing consumer sectors.



Source: State of Global Islamic Economy Report

**Figure 1. 1**  
**Food and Lifestyle Sector Expenditure (Trillion)**

The global halal industry is not only limited to the food sector but includes the sectors of medicine, cosmetics, health products, toiletries and medical devices as well as service sector components such as logistics, marketing, print, and electronic media, packaging, branding, and financing (Majlis, 2011, Dar, Azmi, et al., 2013). Based on reports from the State of Global Islamic Economy in 2019 and 2020, total revenue in 2018 and estimated revenue in 2024 for each sector are available in table 1. 1 below.

**Table 1. 1**  
**Total Revenue (2018) and Estimated Income (2024)**  
**Each Halal Industry Sector**

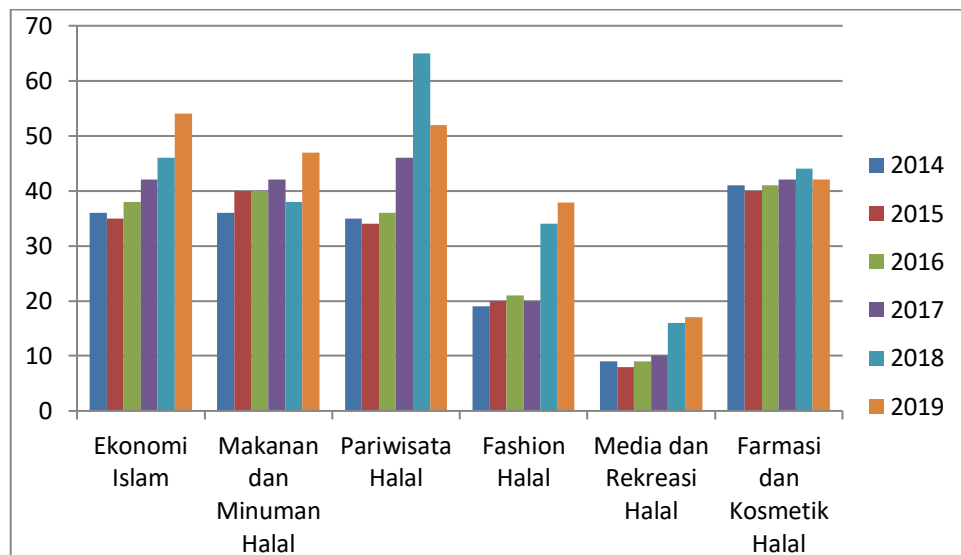
Sector	Total Revenue in 2018 (\$)	Estimated Income in 2024 (\$)
Halal Food	1.369 Billion	1.972 Billion
Modest Fashion	283 Billion	402 Billion
Media & Recreation	220 Billion	309 Billion
Muslim-Friendly Travel	189 Billion	274 Billion
Halal Pharmaceuticals	92 Billion	134 Billion
Halal Cosmetics	64 Billion	95 Billion
Islamic Finance (Assets)	2.524 Billion	3.472 Billion
Islamic Finance (Assets)	2.524 Billion	3.472 Billion

Source: State of Global Islamic Economy Report 2019-2020

Table 1.1 is the result of a survey conducted in 73 countries consisting of 57 member countries of the OIC (Organization of Islamic Cooperation), mostly Muslim-majority countries and 16 non-OIC countries. From the results of the data above, the Islamic finance sector and the halal food sector have the largest income among other sectors.

Indonesia is one country that has a large market potential for the development of the halal industry. From the research results, there is a development in the halal industry market, as evidenced by Indonesia's current

position in the 5th position according to the Global Islamic Economy (GIE) Index ranking in all sectors. In Indonesia, the consumption of the halal industry in 2017 reached more than USD 200 billion or more than 36 percent of total household consumers and non-profit institutions serving households. This figure reaches more than 20 percent of Indonesia's total GDP. From the achievements in 2017 of USD 200 billion contributed by the consumption of the halal industry, as much as USD 169.7 billion or 984.85 percent came from the consumption of halal food.



Source: Global Islamic Economy Gateway (2019)

**Figure 1. 2**  
**Comparison of Halal Inter-Sector Scores in Indonesia**

Based on figure 1.2, there is an increase in each sector each year, which shows progress in the development of the halal industry. However, the halal condition of the industry shows that most of the consumption of products that are in accordance with Sharia or halal is still supplied by imported products, one of which is from the halal food sector. Based on the State of Global

Islamic Economy 2019, Indonesia is a country with a top position that influences the high level of consumption in the halal food sector. For example, in the halal food sector, Indonesia still supplies halal products from other countries and has not yet exported to other countries.

**Table 1. 2**  
**Total Spending and Exporting in the Halal Food Sector 2019**

<b>Rank</b>	<b>Country</b>	<b>Spending (\$)</b>	<b>Exporting (\$)</b>
1	Indonesia	173 Billion	-
2	Turkey	135 Billion	548 Million
3	Pakistan	119 Billion	-
4	Egypt	89 Billion	-
5	Bangladesh	82 Billion	-
6	Iran Islamic Rep.	63 Billion	-
7	Saudi Arabia	57 Billion	-
8	Nigeria	52 Billion	-
9	Russia	45 Billion	-
10	India	41 Billion	1.7 Billion

Source: State of Global Islamic Economy 2019

Based on table 1.2, Indonesia is the highest country in consuming halal food in 2019. However, Indonesia has not been able to play an active role as a producer in producing food products that comply with Sharia or halal standards. Every Muslim has to make sure the source of the food they get is really halal or not. This means not only checking the ingredients of each product but also ensuring that all processes in its manufacture are based on the basis of Shari'ah (Zakaria, 2008).

In addition to the food sector, the growth of the halal industry in Indonesia, especially in the Muslim-friendly travel and modest fashion sectors, has increased its development. This is evidenced in the State of Global Islamic Economy Report 2019, Indonesia was ranked 4th in the Muslim-friendly travel sector and 3rd in the modest fashion sector. The fashion

industry in Indonesia contributes to the national GDP by 3.76 percent, with export value in 2017, reaching USD 13.29 billion. Meanwhile, in 2019, according to the State of Global Islamic Economy Report 2019, the Muslim-friendly travel sector has the potential to reach USD 243 trillion. This proves the public's interest in choosing halal products as a lifestyle.

In another case, the concept of Halal has been explained in the Quran, which explains what to do and what to leave behind. It is found in Al-Quran surah Al-Baqarah verses 168 and 172-173 and surah Al-Maidah verse 87:

يَا أَيُّهَا النَّاسُ كُلُوا مِمَّا فِي الْأَرْضِ حَلَالًا طَيِّبًا وَلَا تَتَّبِعُوا خُطَوَاتِ الشَّيْطَانِ إِنَّهُ لَكُمْ عَدُوٌّ مُبِينٌ (168)

*“O mankind, eat from whatever is on earth that is lawful and good and do not follow the footsteps of Satan. Indeed, he is to you a clear enemy.” (Al-Baqarah : 168)*

يَتَأَيُّهَا الَّذِينَ ءَامَنُوا كُلُوا مِن طَيِّبَاتِ مَا رَزَقْنَاكُمْ وَاشْكُرُوا لِلَّهِ إِن كُنتُمْ إِيَّاهُ تَعْبُدُونَ ﴿١٧٢﴾ إِنَّمَا حَرَّمَ عَلَيْكُمُ الْمَيْتَةَ وَالدَّمَ وَلَحْمَ الْخَيْزِيرِ وَمَا أُهْلَ بِهِ لِغَيْرِ اللَّهِ فَمَن اضْطُرَّ غَيْرَ بَاغٍ وَلَا عَادٍ فَلَا إِثْمَ عَلَيْهِ إِنَّ اللَّهَ غَفُورٌ رَّحِيمٌ ﴿١٧٣﴾

*“O you who have believed, eat from the good things which We have provided for you and be grateful to Allah if it is indeed Him that you worship (172). He has only forbidden to you dead animals, blood, the flesh of swine, and that which has been dedicated to other than Allah. But whoever, is forced by necessity, neither desiring it nor transgressing its limit, there is no sin upon him. Indeed, Allah is Forgiving and Merciful (173).” (Al-Baqarah : 172-173)*

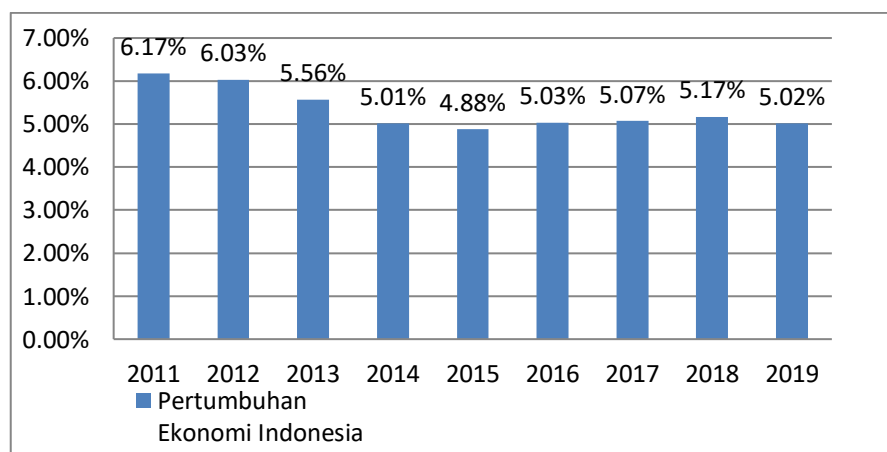
يَا أَيُّهَا الَّذِينَ ءَامَنُوا لَا تَحْرِمُوا طَيِّبَاتِ مَا أَحَلَّ اللَّهُ لَكُمْ وَلَا تَعْتَدُوا إِنَّ اللَّهَ لَا يُحِبُّ الْمُعْتَدِينَ

*“O you who have believed, do not prohibit the good things which Allah has made lawful to you and do not transgress. Indeed, Allah does not like transgressors.” (Al-Maidah : 87)*

Based on the Shari'ah, all activities related to Halal and Haram must be based on the Qur'an and Sunnah. Halal and Haram are general terms used as

guidelines for human life in carrying out worship. With this belief, Muslims always uphold Islamic law in carrying out every activity. This is very important for the world community to recognize the new potential that exists in today's industry.

Indonesia is a country with a Muslim population reaching 87.18 percent of a population of 232.5 million. Due to the high population of Muslims in Indonesia, the level of demand for halal products should be even higher. This can be one of the important points in the development of the halal industry in increasing economic growth in Indonesia. However, Indonesia with the largest Muslim majority population scale has not succeeded in becoming a supporter in the development of the halal industry. During the last five years, Indonesia's economic growth was in the range of 5 percent. Based on expenditure, national income is still supported by public consumption, which in 2017 contributed 56.13 percent of GDP. However, this level of consumption growth is at a level of economic growth of around 4.95 percent (yoy).



Source: BPS, 2019

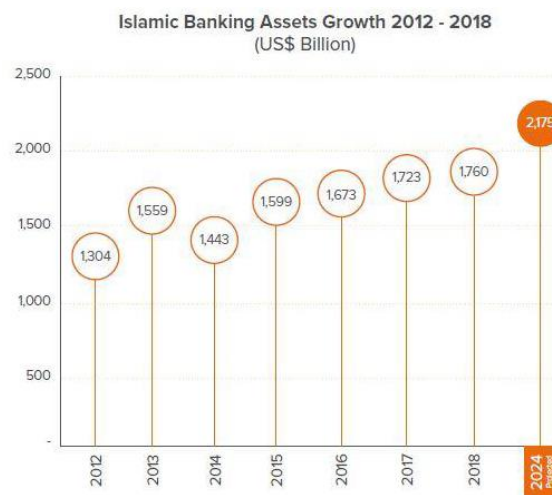
**Figure 1. 3**  
**Indonesia's Economic Growth (2011-2019)**

In terms of business fields, the food and beverage industry sector in the last three years has experienced a decline. In 2017 the level of the food and beverage industry was 9.23 percent and decreased in 2019 by 7.78 percent (coc). Economic growth has been accompanied by a stable inflation rate in recent years. Volatile price inflation has been increasingly suppressed. It then generates a general inflation rate in the government's target range. Meanwhile, according to the expenditure group, inflation for foodstuffs and processed food, beverages, cigarettes, and tobacco is experiencing a downward trend. Meanwhile, the clothing expenditure group tends to increase. According to Fahrudin (2009), inflation has an influence on Islamic financing. In line with research conducted by Khairin (2012), it is said that the inflation rate has an effect on *mudharabah* financing. This can be an indicator of influence on the development of the halal industry in Indonesia. In addition, according to Rama (2013), there is a two-way relationship between economic growth and Islamic financing that occurs. This can be used as a reference where economic growth is able to encourage the development of the halal industry in Indonesia.

In addition, the development of the Sharia economy in Indonesia affects the level of demand for Sharia products. The global market in the halal industrial sector is very high. The opportunities for developing the halal food industry in Indonesia are very high. For example, West Sumatra, most of the population is Muslim (98 percent based on West Sumatra BPS data). Public awareness of using halal products is also high. Not long ago, the province won an award as the best halal culinary destination in the 2016 World Halal

Tourism Award (WHTA) competition in Abu Dhabi, United Arab Emirates (UAE). According to Hussein Elasrag (2016), the increasing awareness of Muslim consumers about their religious obligations has also contributed to the increasing demand for halal products and services.

The Islamic finance industry is a high growth industry that is maturing although with substantial opportunities remaining for investors, governments and businesses to better address the faith-inspired ethical needs of business and retail consumers. With Islamic finance assets projected to grow by 5.5% per annum to reach USD 3.5 trillion by 2024, there are substantial opportunities, with strategic imperative by stakeholders group highlighted below, together with top opportunities. There is the Islamic commercial banking dominates assets distribution is Islamic banking with 70% of assets, Islamic funds with 4%, Islamic Sukuk with 4% of assets and other 7% so that Islamic bank has a important role in developing halal industry.



Source: Islamic Microfinance News

**Figure 1.4**  
**Islamic Banking Assets Growth 2012-2018**



Islamic banks play an important role in developing Micro, Small & Medium Enterprises (Gilani et al., 2016). Sharia banks can provide Sharia financing products that are suitable for their needs, competitive, and easily accessible to Micro, Small & Medium Enterprises players engaged in the halal food industry. The development and improvement of the halal food industry cannot be separated from the important roles that are interrelated with one another. Therefore, there is a need for the integrity of the government, society, and Islamic financial institutions to increase the competitiveness of Micro, Small & Medium Enterprises in the halal food industry sector in order to increase economic growth in Indonesia.

The financial sector is believed to be one of the most important sectors in supporting economic growth. This is based on Schumpeter (1911), which states that the development of the financial sector has an important role in economic growth. In addition, according to Bencivengan and Smith (1991), which strengthens the statement, it states that the development of the financial sector is a strategic factor (one of the influencing factors) that can encourage economic growth in the long term. This is because the development of the financial sector with its progress can assist small businesses in developing existing businesses so as to move the microeconomic sector within the trade circle.

Based on the description above, the researcher argues that the inflation rate, Indonesian economic growth and world economic growth have great potential for Islamic financing, which is Islamic financing as a proxy to

measure the development of the halal industry in Indonesia. In addition, the majority of Indonesia's population is Muslim; logically, the development of the halal industry will be even greater in Indonesia compared to other countries. Many authors and researchers who have studied the effects of the inflation rate, economic growth, and Islamic financing, and said that :

Economic growth has a positive and significant impact on Islamic finance in the short and long term (Farahani and Sadr, 2012). In addition, in a research journal conducted by Furqani and Mulyany (2009), it is said that economic growth (GDP) has a positive and significant effect on Islamic financing in the long term. Also, there is a significant relationship between economic growth and the development of Islamic finance in the short and long term (Abduh and Omar, 2012).

In the research journal Andres, Hernando, and Salido (2002), say that there is an effect of inflation on economic growth through interactions with financial markets. However, from the results of research conducted by Iqbal and Nawaz (2010), it is said that high inflation will harm economic growth. This makes researchers interested in adding the inflation variable to the study. In addition, in the research journal Majid (2007), it does not say anything related to inflation, but researchers use this variable because in theory, inflation can increase economic growth through interaction with financial markets.

Based on several theories found by researchers in previous studies, which will have a good impact on the development of the halal industry by using

proxies for Islamic financing, the researchers want to try to analyze the factors that affect the growth of the Halal Industry in Indonesia.

Therefore, the researcher is interested in conducting research on the topic "The Analysis of Factors Affecting the Development of Halal Industry in Indonesia".

### **B. Limitation of Research**

Based on the background that has been described above, it is necessary to limit the problem so that later the scope of the research becomes clearer and more detailed. In this case, the researcher limits the problem to:

1. The data used in the study, namely the period of January 2004 - December 2019.
2. The place of research in Indonesia.
3. The research object is data on Islamic financing, inflation data, real GDP data for Indonesia, and real GDP world data.
4. The research was conducted using the VECM (Vector Error Correction Model) method with the help of Eviews 9 software.

### **C. Formulation of Problem**

Based on the background description above, the following problem formulations will be proposed in this study:

1. How does inflation affect the development of the halal industry in Indonesia in the short term and long term?
2. How does Indonesia's economic growth affect the development of the halal industry in Indonesia in the short term and long term?
3. How does the world's economic growth affect the development of the halal industry in Indonesia in the short term and long term?

### **D. Research Objective**

Based on the problem formulation that has been described above, the objectives of this study are:

1. To analyze the influence of the inflation variable on the short-term and long-term Sharia financing variables in the development of the halal industry in Indonesia.
2. To analyze the influence of Indonesia's national income variables on the short-term and long-term Sharia financing variables in the development of the halal industry in Indonesia.
3. To analyze the influence of world national income variables on short-term and long-term Sharia financing variables in the development of the halal industry in Indonesia.

## **E. Research Benefit**

### 1. Theoretical Benefit

This research is able to contribute to the development of science, especially in the fields of Islamic Economics and Halal Lifestyle, and also become a treasure trove of knowledge for academics in general.

### 2. Practical Benefit

It is hoped that the Government can strengthen regulations in the halal industry and increase public awareness in the selection of halal products in Indonesia.