

The Influence of Msmes, Inflation, and Sharia Bank Finance on Economic Growth

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Abstract

Economic expansion is significant to study considering that each region will always try to increase its economic target. This study aims to analyse domestic economic development in West Java with the predictor variables of the number of MSMEs, inflation, and Islamic bank financing. Using secondary data for the 2016–2021 period obtained from the Central Bureau of Statistics, the Services and Finance Authority, and the Office of Cooperatives and UMKM of West Java Province, using seven cities in West Java as a sample in the study and multiple linear regression as an analytical tool The findings revealed that, for the 2016–2021 period, the number of MSMEs, inflation, and Islamic bank financing had a significant positive effect on West Java regional economic development. Furthermore, simultaneously, the three independent variables significantly affect the regional economic development of West Java. West Java's regional economic growth variable of 95.28% is influenced by the independent variables of the number of MSMEs, inflation, and Islamic bank financing, while 4.72% is influenced by other variables. In order to increase economic growth, the government's role is very important in empowering MSMEs, maintaining inflation rate stability, and increasing the portion of sharia financing by Islamic banks.

Keywords : MSMEs, Economic Growth, Inflation, Islamic Banks

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1. INTRODUCTION

1.1. Research Background

Economic growth is important in the country's development, specifically for Indonesia, which is categorized as a developing country. Economic development is carried out to achieve increased economic growth and employment, advancing the technology sector, equal income distribution, and improving education quality. Economic progress serves as a measure of the effectiveness of economic achievement, namely when economic development impacts changes in the economic sector, such as the strengthening of new industries and increased export-import activities carried out by industries in an area that can affect changes in the industrial and trade sectors (Daniel, 2018).

Economic growth is becoming increasingly crucial to study because each country will always try to increase its economic targets (Sari & Kaluge, 2018).

An increase in economic growth would represent a country's economic status and is considered to expand if the country's real Gross Domestic Product (GDP) increases (Kala et al., 2018). Several factors can increase the GDP figure, including the growth of MSMEs. The amount of business units and entrepreneurs, the quantity of cash they earn, and the jobs they create demonstrate how MSME firms contribute to economic development (Mashita et al., 2020). In addition to GDP, one of the crucial indicators in knowing the economy's condition regarding to Gross Regional Domestic Product (GRDP). However, GRDP only focuses on calculating economic growth in a region or area.

The development of the role of MSMEs is an important part inseparable from a region. MSMEs play a significant part in contributing to the Indonesian economy because they can absorb around 97% of the national workforce for the productive-age population

and provide around 57% of the GDP (Muliadi dkk., 2020). Economic improvement can be developed through the principles of good governance that support business competition, develop product standardization, develop technology, grow and improve business capabilities, expand employment opportunities, increase exports, equalize income, make it easier for MSMEs to access capital from financial institutions, and facilitate MSME licensing in carrying out their business (Sumardi & Zulpahmi, 2020).

Empowerment of MSME cannot be separated from inflation because it is related to the supply of raw materials, manufacturing processes, tools used, transportation costs, output, and selling prices. Inflation is used to assess economic growth, unemployment, poverty, and export-import relations. Likewise, inflation is a significant problem in the economies of all countries, including Indonesia (Mulyani, 2020). Changes in this indicator will significantly impact the economic growth dynamics. According to Daniel (2018), inflation is when the economy shows a upward trajectory of prices for goods in general and continuous. This is because the flow of goods and money are not balanced and are caused by various factors. Inflation impacts economic growth, causing people's income to shrink and lowering their standard of living. Inflation that is not regulated effectively will complicate public assessments of consumption, investment, and production and slows down economic growth.

The banking industry is considered to have the power to stimulate economic growth, making it equally crucial to MSMEs and inflation (Widiaty & Nugroho, 2020). One of the financial organizations' fastest-growing divisions is Islamic banking. The Muslim community, predicted to represent in excess of a quarter of the world's population by 2030, promotes the growth of Islamic banks. As a result, the Muslim community has made substantial contributions to expanding Islamic financial institutions.

According to Iryanto et al., (2020), economists generally think that the role of a bank intermediary is analogous to that of a heart, whose function is to pump blood throughout the body. When the banking industry is strong, the movement of cash to the real sector will support the development of permanent investment, one of the key conditions for economic development. Islamic banks have a positive

intermediary role and can also be a marker of good performance so that it can be seen that Islamic banks can reach the goals set by sharia principles (Zulpahmi et al., 2018). Islamic banking institutions provide a greater emphasis on productivity, which benefits the real sector and the economy (Deti et al., 2017).

Empirical evidence regarding the impact of MSMEs on the growth of the economy has been carried out in research by Bosma (2018), Dyahrini & Wiludjeng (2020), Sari & Saputra (2020), Suhaili & Sugiharsono (2019) dan Tahir et al. (2018), showing that MSMEs have a significant influence on economic development. However, conversely, research by Halim (2020), Rohadin & Yanah (2019), and Adeosun & Shittu (2021) shows the opposite result that MSMEs do not influence economic growth. Apart from MSMEs, inflation contributes favorable to the development of economy in Phiri (2018), Uddin (2021), and Widiaty & Nugroho (2020). However, according to research by Ardiansyah (2017), Adaramola & Dada (2020), Daniel (2018), and Ngoc (2020), inflation has a negative and quite large impact on economic growth in Indonesia. Even so, research by Widiaty & Nugroho (2020) explains that inflation can have a positive effect in a short period. However, over an extended duration, inflation can have an adverse impact on the economy of Indonesia.

The Islamic banking industry in Indonesia shows strong growth in the distribution of financing provided to the public and business actors. Studies from Iryanto et al. (2020), Anwar et al. (2020), Prastowo (2018), Terminanto & Rama (2017), Yolanda et al. (2021), Zirek et al. (2016), and Bsoukhatem & Ben Moussa (2018) reveal that Islamic banking institutions and economic development have a favorable and noteworthy correlation. The increase in assets, external source of funds, investment, and funding through sharia-compliant banks has encouraged the achievement of economic growth.

The results of previous research are less convincing because there is still controversy over the real impact of the research. Some authors state that the variables studied positively influence economic growth. In contrast, other studies reveal a negative or no effect on economic growth. Therefore, this research was conducted to complement previous research by contributing to the economic literature and providing insight and updated data to understand the impact of the quantity of MSMEs, inflation, and Islamic bank financing on development in the

economy landscape in the West Java region between 2016 - 2021. To fill gaps in the existing literature. This study differs from past research in that it incorporates three macroeconomic factors: MSMEs, inflation, and financing through Islamic banking. In contrast, earlier studies did not combine these three variables for research. This study also focuses on the West Java region of Indonesia, the selection of cities in West Java as a sample, and the different periods studied. In general, the objective of this research is to ascertain the impact of the number of MSMEs, inflation, and Islamic bank financing on regional economic growth in West Java partially and simultaneously.

1.2. Literature Review

Theory of Economic Growth

Classical theory

In his book "An Inquiry into the nature and Causes of Wealth of the Nation," Adam Smith suggests the factors that have increased economic development. The increase in population will expand the market, and the consequences of market expansion will encourage economic activity, thereby accelerating economic development. Then, according to classical philosophy, economic growth is caused by the progress of society and technological evolution (Suryana, 2000: 53).

According to Adam Smith, economic growth will occur if there is an increase in performance so that it will increase the attractiveness of investors, encourage the advancement of technology, and expand the market. Limitations that make the process of economic growth are natural resources and human constraints. If the carrying capacity of natural resources and humans cannot balance ongoing economic activity, it will impact slowing economic growth (Chalid, 2015: 11).

Neoclassical theory

Robert Solow and Trevor Swan are two economists who pioneered this hypothesis. According to neoclassical theory, the amount of labor and capital accumulation are elements of creation that significantly impact growth. In addition to the ideas put forward by Robert Solow and Trevor Swan, Schumpeter was also a proponent of neoclassical economic theory. According to him, one of the elements driving economic growth is the existence of intermediation by Islamic financial institutions. MSMEs can get cash to increase their output thanks to the availability of Islamic banking. Increased

productivity leads to increase per capita income, which leads to increased economic growth.

Apart from banking intermediation, Joseph Schumpeter also revealed that economic progress occurs when entrepreneurs innovate. In this context, innovation refers to using the latest knowledge and technology in the commercial sector. According to Schumpeter, economic development is primarily determined by entrepreneurial initiatives, namely, people with ideas for increasing production factors to produce the goods society needs. Entrepreneurs are people who can produce innovation or renewal in the economy.

Keynesian Theory

The Keynesian theories explain the causal linkage between inflation and economic advancement. Keynes emphasized that its structure of inflation is caused by people planning to live beyond their economic capacity. In an extended period, when inflation soars, economic growth will shrink. Empirical facts from some research that justify this condition are that high inflation causes economic growth to fall (Lubis, 2014). Contrary to Mundell's theory, Mundell emphasized that inflation reduces a person's wealth or lowers the interest rate on money (after it is spent). Thus, people save money in the form of interest-bearing money assets. The amount of savings increases capital accumulation and accelerates economic growth.

Harrod-Domar Theory

Harrod-Domar says an essential investment element exists in the country's economic growth process. Investment has a role in increasing income and capital stock, which increases the production capacity of a region's economy. In the long run, investment can affect aggregate supply through changes in production capacity. According to Harrod-Domar, an increase in total aggregate spending is required in the long run to achieve economic growth., and stable economic growth can be achieved if $C + I + G + (X-M)$ continues to increase.

Economic Growth from Islamic Perspective

According to many Islamic economic texts, economic growth is a component of economic development. Economic growth in Islam is described as "continuous improvement of factors of production capable of contributing to the welfare of mankind" (Widiaty & Nugroho, 2020). From an Islamic perspective, according to Ahmad in (Naf'an, 2014)

revealed that economic growth from an Islamic perspective is not only realized to meet materialistic needs but also to fulfill needs and prepare for the afterlife. Islamic economics considers the capacity of commodities and services to be produced and the ongoing changes in religious, social, and societal factors. It is impossible to say that the economy is growing if societal distortion or rejection exists. Economic expansion can bring about a distributive balance because it creates new jobs. The creation of new jobs increases people's actual income, which is one of the benchmarks of the achievement of the Islamic economy.

In Islamic economics, money is considered a public good, but capital is considered an individual good. Money is public property, so anyone hoarding money (making passive money) reduces the money supply, slowing down the economy. Capital, a personal item, should not be left unproductive because it will decrease in value due to the inflation rate. If you do not want it to be productive, existing capital can become one of the objects of zakat. Islam provides an alternative by using this capital for productive activities, such as providing capital to Islamic financial institutions through Islamic contracts to be channeled through mudharabah, musyarakat, and murabaha financing.

According to Q.S Hud (11) verse 61, humanity was created in the Quran to provide wealth to this earth and the ability to build shelter and produce food. God formed man from the ground and encouraged him to help the world grow by growing crops and preparing provisions for a living. Man can build a place to live in his vast land, enjoy the food he gets, and spend his wealth in the way of Allah.

The goals and tools to achieve economic growth must comply with sharia principles based on the Al-Quran and hadith. This does not eliminate the scheme from the conventional system as long as it does not violate Sharia principles. In Q.S Al – A'raf (7), verse 96):

وَلَوْ أَنَّ أَهْلَ الْقُرَىٰ ءَامَنُوا وَأَتَّقُوا لَفَتَحْنَا عَلَيْهِم بَرَكَاتٍ مِّنَ السَّمَاءِ وَالْأَرْضِ وَلَٰكِن كَذَّبُوا فَأَخَذْنَاهُم بِمَا كَانُوا يَكْسِبُونَ

Meaning: *And if the people of the towns had believed and guarded (against evil) We would certainly have opened up for them blessings from the heaven and the earth, but they rejected, so We overtook them for what they had earned.*

This verse shows that faith and piety toward the commands of Allah SWT are the most critical factors in providing sustenance and economic prosperity. On the other hand, disobedience leads to a loss of calm and tranquility. That does not exclude non-Muslims from experiencing economic growth. They can still reach it if they stay on the straight and narrow path and Allah has mercy on them.

Micro, Small and Medium Enterprises (MSMEs)

MSMEs are an important business sector in the development of the Indonesian economy. According to Law Number 20 of 2008 regulating Micro, Small, and Medium Companies (MSMEs), the business world in Indonesia is categorized into micro, small, medium, and large businesses. This is evident from the number of firms established and the number of employment produced. According to Abduh (2017: 11), several indicators of MSMEs are as follows:

- a. Sales Growth,
- b. Capital Growth,
- c. Growth in the Number of MSMEs,
- d. The addition of manpower every year,
- e. Market and Marketing Growth,
- f. Profit Growth / Operating Profit.

MSMEs are productive businesses that impact employment, increase people's income, and increase economic growth. The expansion carried out by MSMEs in Indonesia positively impacts economic growth. According to Siti (2011: 46), the function of MSMEs in the national economy is as follows:

- a. The central function in economic activity.
- b. The most effective job originator.
- c. Crucial components to community empowerment and local economic growth.
- d. The establishment of new markets and the roots of innovation.
- e. Involvement in the balance of payments.

Empirical facts from various countries and research dealing with SMEs have convinced that SMEs are the heart of the economy. They have contributed significantly to driving economic growth by providing the latest career opportunities and as a source of business innovation. MSMEs are often the economy's largest business actors and are sometimes called people's economic actors (Azis & Rusland, 2009: 5).

Therefore, the presence and role of MSMEs must be protected and preserved to build a sustainable economy. in a period of shifting global economic

conditions, free trade, and information and communication technology development. MSMEs are playing a new and increasingly important role in the economy. As a pillar of non-oil and gas export growth and a significant industrial sector business unit by supplying unique materials such as components and spare parts throughout the production process chain, including the subcontract system (Azis & Rusland, 2009: 5).

Several research studies indicate the influence of micro, small, and medium enterprises (MSMEs) on economic growth. For instance, Tahir et al. (2018) explored the contribution of MSMEs to Malaysia's economic growth between 2005 and 2016, revealing a strong and statistically significant correlation between MSMEs and economic growth. Research by Bosma et al. (2018) also states that productive entrepreneurship carried out by MSMEs positively contributes to economic growth. In addition to forming productive entrepreneurs, proxies are needed for institutional quality, financial stability, small government, and start-up skills. Research by Dyahrini & Wiludjeng (2020) analyzing the contribution of MSMEs in the Greater Bandung area shows that MSMEs influence 30.26% of the Greater Bandung regional economic growth. Research by Suhaili & Sugiharsono (2019) shows a more significant contribution, namely 59.74% of MSMEs contributing to economic growth. The positive contribution of the impact of MSMEs on economic growth is also supported by research by Sari & Saputra (2020), which was conducted in the Batam City area. However, on the other hand, research by Adeosun & Shittu (2021), Halim (2020), and Rohadin & Yanah (2019) shows the opposite result that MSMEs do not influence economic growth.

Inflation

inflation refers to a rise in the aggregate price level of commodities and services within a specified timeframe. (Aziz et al., 2016). Depending on the level, inflation can have beneficial or negative effects on economic growth. Mild inflation has a good effect if it pushes the economy in a better direction, as seen from the increase in national income, which benefits investment and savings among the population. Conversely, hyperinflation will negatively impact if inflation is uncontrolled or excessive. This type of inflation causes rapid price increases, a decrease in people's purchasing power, a decrease in investment, and a slowdown in economic growth (Badan Pusat Statistik, 2018).

Economists generally conclude that inflation is a source of the loss of money's purchasing power in the price of goods and services. The elasticity of demand for and supply of goods and services causes depreciation. Other variables that affect price changes include government programs such as price limits, subsidies, etc. The occurrence of inflation is based on two types, namely, internal and external factors that cause an increase in the price of goods. Regarding internal factors, the cause of the inflation problem comes from within the country due to pressure from one of the macro- and microeconomic variables. While external factors that cause problems from inflation come from abroad, their influence or impact can be felt domestically because they have a close relationship so that the prices of imported goods also increase.

According to Raharja & Manurung (2011) an economy is defined as describing inflation if the following three characteristics are met:

- a. There is an increase in prices,
- b. Price increases are general in nature,
- c. Takes place continuously.

Islam believes the economy has no inflation since its currency because dinars and dirhams are stable. Dinars and dirhams were the currencies used during the Prophet's time. They were in accordance with Islamic teachings since the Prophet established that gold and silver were unchangeable, standard, and had the same value worldwide (Aji & Mukri, 2020).

Inflation is a result of a monetary phenomenon that arises due to a decrease in the purchasing power of currencies in comparison to commodities. According to Adiwarmar Karim's definition, inflation refers to the rise in the overall price level of commodities and services within a particular period of time (Karim, 2004: 424). According to Adiwarmar Karim (2007: 138), inflation can be categorized based on its causes, which are as follows:

- a. Natural Inflation and Human Error Inflation

Natural Inflation is caused due to natural factors that humans do not have the power to prevent such as earthquakes, tsunamis, volcanic eruptions, etc. While Human Error Inflation occurs because of errors resulting from human negligence in making economic policies. This is also found in the Al-Qur'an letter Ar-Rum verse 41.

- b. Expected Inflation and Unexpected Inflation

In the context of expected inflation, the nominal loan interest rate equals the real loan interest rate minus inflation. However, the nominal loan interest rate does not include inflation-related losses from Unexpected Inflation.

c. Demand Pull and Cost Push Inflation

Demand-pull Increased overall demand for goods and services while production is at or close to capacity drives inflation in an economy. Cost-push Changes in the total supply of goods and services in an economy lead to inflation. Price increases accompanied by a decrease in output are what constitutes inflation. Due to rising production costs, this is typically followed by a decrease in the total supply (aggregate supply). As a result, inflation is accompanied by a recession.

d. Spiralling Inflation

This type of inflation is the result of earlier inflation, which was brought on by earlier inflation, and so forth.

e. Imported Inflation and Domestic Inflation

Import inflation can be interpreted as the inflation from other countries, and the country concerned must become a price taker in the global exchange market. Domestic inflation occurs only in one country and has little impact on other countries.

Many studies investigations have illustrated the effects of inflation on economic growth, with varying outcomes, as exemplified by Phiri (2018) research on the influence of inflation on economic growth in the South African locality. The threshold of 5.30% is supported by empirical research findings. Inflation exerts a positive impact on economic growth when it remains below a certain threshold. However, economic growth experiences adverse effects once inflation surpasses the 5.30% barrier. The study conducted by Uddin (2021) to investigate the correlation between GDP growth and inflation in Pakistan. The findings indicate a positive and statistically significant association between GDP growth and inflation in the country. As per the findings of Adaramola & Dada (2020), Ardiansyah (2017), Daniel (2018), and Ngoc (2020), it can be inferred that the phenomenon of inflation in Indonesia has been observed to exert a significant and adverse influence on the country's economic growth. In contradistinction to the study conducted by Widiaty &

Nugroho (2020), which investigates the impact of inflation on the economic growth of Indonesia through the lens of Islamic economics. As per the research results, inflation exerts an adverse impact on the economic growth while exhibiting a favorable short-term influence on the same.

Islamic Bank Financing

Banks are financial entities that take money from the public, reinvest it in the community, and provide other financial services. In Indonesia, banks are classified as conventional or sharia. Islamic banks apply syar'i principles in Islam in carrying out their operational activities. Syar'i requires that Islamic banks comply with Islamic law when providing money to consumers (among other things, they must not contain elements of maisyir, gharar, or usury, and their line of business must be halal). In addition to sharia issues, Islamic banks are constantly looking for ways to make money for themselves and those who use them (Astuty, 2015). In general, the above literature shows that the intermediation function of banks is indeed the basis of economic activity.

Financing is one of the facilities offered by Islamic banks. The primary obligation of the bank is to provide a guaranteed place to put money and provide means of payment for the purchase of goods and services. Where excess public money will be channeled to people who want money. The financing channeled through Islamic banking intends to increase the application of Islamic principles to the financial sector. The sharia principles applied in the operational activities of sharia financial institutions are based on justice, balance, benefit, and universality (rahmatan lil' alamin).

In its operational activities, Islamic banks use three financing contract models, namely:

a. The profit-sharing financing model for Islamic banks is represented by Mudharabah and Musyarakah financing. Mudharabah financing represents a collaborative arrangement between multiple parties, wherein the capital owner and the manager (mudharib) enter into a profit-sharing agreement. This document serves as verification of the partnership between Shahib al-Maal, who has provided full capital funding, and Mudharib, who has contributed their expertise. Musyarakah financing refers to a collaborative arrangement between a financial institution and its clients, wherein the terms of profit and risk distribution

are determined by mutual agreement. The distinction between musyarakah and mudharabah is based on the managerial and financial contribution level or a combination of both. Capital comes from one party in mudharabah, while capital comes from two or more parties in musyarakah.

- b. Murabahah, istishna, and salam are the three types of financing available through the buying and selling paradigm. Murabaha financing is a contract of sale and purchase of certain commodities where the seller informs the buyer of the purchase price and then sells the goods to the buyer on the condition that both parties agree upon the projected profit. In a murabaha contract, the seller sells goods higher than the purchase price. The profit margin is the difference between the selling price of the goods. Murabahah financing involves at least two parties: Islamic banks as sellers and customers as product consumers. Simultaneously, istishna financing is a contract between two parties based on an order from a third party. The requested goods are made according to agreed-upon specifications and sold at an agreed-upon price and payment method. Salam financing is a contract between a customer and a seller for requested goods where payment is made in advance and the goods are delivered after the contract ends.
- c. The pattern of ujroh financing comprises of ijarah and ijarah al-muntahiya bit-tamlik. Ijarah transfers usufructuary rights to an asset by paying the rental fee without transferring ownership. Meanwhile, ijarah al-muntahiya bit-tamlik is a rental agreement between the owner of the rented object and the lessee to earn compensation for the thing being leased with the option of transferring ownership of the item within a set period according to the contract.

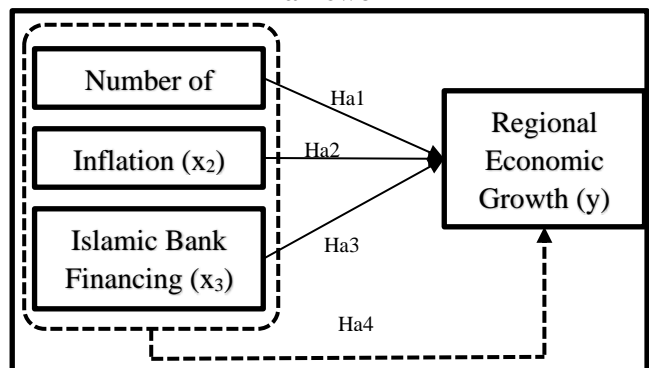
Islamic bank financing is used to answer the needs of society while developing their business. Individuals, entrepreneurs, institutions, business entities and others who want a budget. Financing has a role, among others:

- a. Can increase the flow of exchange of goods and services.
- b. Is a tool that is used to take advantage of idle funds.
- c. As price controller.

- d. Can increase existing economic benefits.

Every country has a way of increasing its country's economic growth. Applying existing macroeconomic policies in developed countries will undoubtedly differ from that in developing countries. Regional economic growth can be influenced by various macroeconomic factors such as inflation rate, unemployment rate, money supply, production of goods and services by MSMEs, number of MSMEs, investment level, and financing distribution from both Islamic and conventional banking. Drawing from the aforementioned description, it is possible to construct a theoretical framework that elucidates the impact of macroeconomic factors on the quantity of Micro, Small, and Medium Enterprises (MSMEs), the rate of inflation, and the allocation of financing from Islamic banks. Then the following is the theoretical framework of this study:

Figure 1. Chart of Theoretical Thinking Framework



Based on the figure above, the authors formulate a hypothesis which is a temporary conclusion from the study as follows:

- Ha1* = The variable number of umkm partially influences the regional economic growth of West Java.
- Ha2* = The inflation variable partially influences the regional economic growth of West Java.
- Ha3* = Islamic bank financing variables partially affect the regional economic growth of West Java.
- Ha4* = The variable number of MSMEs, inflation, Islamic bank financing simultaneously influences the regional economic growth of West Java.

2. METHOD

This research is quantitative because it involves numerical data that is processed through systematic

calculations to find the linkage of data and has the aim of proving whether there is an influence between the variables of the number of MSMEs, inflation, and Islamic bank financing on economic growth in 7 cities in the West Java region (the cities of Bogor, Bekasi, Bandung, Cirebon, Sukabumi, Depok and Tasikmalaya.). The data taken in this study is actual and is listed on the websites of the West Java Cooperative and MSME Office, the West Java BPS, and the Financial Services Authority (OJK). The independent variable data is the number of MSMEs, inflation, and Islamic bank financing (BUS & UUS) during 2016–2021. At the same time, the dependent variable is regional economic growth (ADHK GRDP in rupiah), with all data taken in the form of annual time series data and cross-sectional data across cities in West Java province.

The sampling technique used in this study is a purposive sampling technique, in which the sample is determined based on the researcher's considerations regarding the most appropriate, helpful, and representative sample of a population, namely (1) the area of the city or district in West Java that has published data on the number of MSMEs, inflation rates, Islamic bank financing, and regional economic growth (PDRB ADHK). (2) A dataset on the number of MSMEs, inflation rates, Islamic bank financing, and regional economic growth (PDRB ADHK) in cities or districts in West Java is available for 2016–2021. Based on the above criteria, it was found that the number of samples in this study amounted to 42 data obtained based on seven cities as research samples.

Multiple linear regression was conducted as a method of data analysis in order to test the research hypothesis. The present study utilized Eviews 12 software for conducting the analysis. Prior to conducting the multiple linear regression analysis, it is imperative to assess the quality of the data in order to obtain a robust regression equation. This is achieved through the implementation of the classic assumption test, which encompasses a normality test, autocorrelation test, multicollinearity test, and heteroscedasticity test. Once the data has been deemed reasonable and feasible, a multiple linear regression analysis is conducted to ascertain the correlation between the independent and dependent variables. Finally, the process of hypothesis testing was conducted in this study utilizing both a partial test (t-

test) and a simultaneous test (f-test) to determine the acceptance or rejection of the proposed hypothesis.

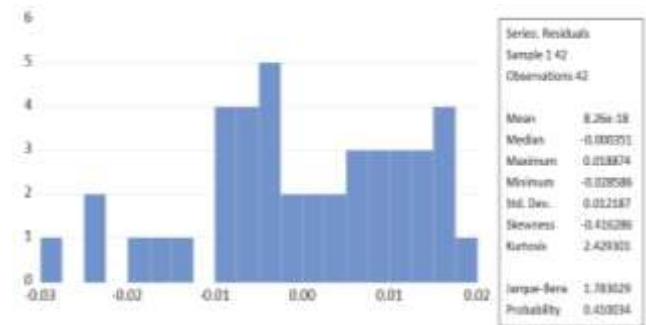
3. RESULTS AND DISCUSSION

3.1. Result

Classic assumption test

A normality test should be performed when testing the first classical assumption. The Jarque-Bera probability can guide decision making: if the probability is greater than 0.05, the population distribution is normal, if the probability is less than 0.05, the population distribution is not normal.

Figure 2. Normality Test



Source: Eviews 12 (Data processed by researchers, 2023)

Based on the results of the above analysis, the normality histogram has a Jarque-Bera value of 1.78 and a probability value of 0.41, indicating that the resulting probability value is greater than $\alpha > 0.05$. This leads to the conclusion that the residuals are normally distributed, implying that the classical normality assumption is met.

Furthermore, the autocorrelation test is used to determine whether there is a relationship between confusion errors in the t time range and interference errors in the t-1 (previous) time range in the linear regression model. The Durbin Watson test was used in this investigation for autocorrelation.

Table 1. Autocorrelation Test

Log likelihood	126.0212	Hannan-Quinn criter.	-5.749875
F-statistic	276.9928	Durbin-Watson stat	0.533326

Source: Eviews 12 (Data processed by researchers, 2023)

The results of the analysis showed that the resulting Durbin-Watson value was 0.5333. This value is within the criteria between -2 to +2. Then, based on these criteria, it can be said that the regression model has no autocorrelation problems.

Next, a multicollinearity test was carried out to overcome the problem of multicollinearity between

variables using the VIF (Variance Inflation Factor) method. As for how to see the occurrence of multicollinearity problems with VIF values. If the VIF value is less than 10, there is no multicollinearity problem.

Table 2. Multicollinearity Test

Variance Inflation Factors

Included observations: 42

Variable	Coefficient Variance	Centered VIF
C	4.36E-05	NA
UMKM	0.000595	2.230253
INFLASI	0.045415	1.044612
PBS	3.42E-09	2.260364

Source: *Eviews 12 (Data processed by researchers, 2023)*

The results of the multicollinearity test showed that the VIF values for the MSME variables were 2.23, INFLATION 1.04 and PBS 2.26. Because the VIF values of all variables do not exceed 10, it can be said that multicollinearity does not occur in the three independent variables.

At last, the heteroscedasticity test is conducted to examine whether the residual variance exhibits homogeneity or heterogeneity. The White test is employed to identify potential issues of heteroscedasticity. According to Winarno (2015), the White test involves the squared residual as the dependent variable and the independent variables comprising the existing independent variables and their corresponding squares. One can examine the chi-squared probability value to identify potential issues with heteroscedasticity. In order to prevent heteroscedasticity issues, it is necessary for the probability value to exceed the threshold of alpha 0.05. The statistical analysis of the white test results indicates a p-value of 0.0657, which exceeds the predetermined level of significance, α (0.05). Therefore, it can be inferred that the variances exhibit homogeneity or the absence of heteroscedasticity.

Table 3. Heteroskedasticity Test

Heteroskedasticity Test: White

Null hypothesis: Homoskedasticity

	Prob. Chi-Square(9)	
Obs*R-squared	16.05707	0.0657
Scaled explained SS	9.393530	0.4018

Source: *Eviews 12 (Data processed by researchers, 2023)*

Multiple Linear Regression Analysis

Table 4. Multiple Linear Regression Test

Dependent Variable: PDRB

Included observations: 42

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.036515	0.006600	-5.532810	0.0000
UMKM	0.348734	0.024386	14.30043	0.0000
INFLASI	0.481974	0.213108	2.261640	0.0295
PBS	0.000357	5.85E-05	6.104565	0.0000

Source: *Eviews 12 (Data processed by researchers, 2023)*

Based on the regression results in the table above, the regression equation can be formulated as follows:

$$y = -0.0365 + 0.3487UMKM + 0.4819INFLASI + 0.0003PBS$$

The explanation of the results of the multiple linear regression analysis model can be described as follows:

- Based on the results of the regression equation above, a constant value of -0.0365 is obtained. This indicates that if the conditions of all independent variables are considered constant or do not change ($= 0$), then the economic growth that occurs will experience a decrease of minus 0.0365 trillion rupiah or a decrease of Rp. 36,500,000,000. In this case, it means that the independent variable really has an influence on the regional economy in order to increase West Java's economic growth.
- The resulting MSME coefficient value of 0.3487 indicates that if the number of MSME units increases by 1 million units, the resulting economic growth will increase by IDR 0.3487 trillion and vice versa.
- The resulting inflation coefficient value is 0.4819 indicating that if inflation increases by 1%, economic growth will increase by 0.4189 trillion rupiah and vice versa.
- The value of the Islamic bank financing coefficient of 0.0003 indicates that if Islamic bank financing increases by 1 trillion, it will increase economic growth by 0.0003 trillion rupiah and vice versa.

Table 5. Results of the Coefficient of Determination

R-squared	0.956270
Adjusted R-squared	0.952818

Source: *Eviews 12 (Data processed by researchers, 2023)*

Based on the table above, the value information in the R-Squared column is 0.9562. This indicates that the dependent variable West Java regional economic growth of 95.62% is influenced by the independent variables the number of MSMEs, inflation and Islamic bank financing. Meanwhile, 4.38% of the economic growth generated by West Java is influenced by other variables outside the independent variables in this study. Adjusted R-Square is a more refined R-Square figure that is typically the most accurate. Whenever more than two independent variables are used in the study, the Adjusted R-Square value is more appropriate for determining how the independent variable explains the dependent variable. The Adjusted R-Square score is 0.9528, indicating that the independent variable has a 95.28% effect on the dependent variable.

Hypothesis Testing

Tabel 6. Partial Test Results (Statistical Test T)

Variabel	Prob. t	Sig	t-hitung	t-tabel
UMKM	0.0000	0.05	14.30043	2.02439
INFLASI	0.0295	0.05	2.261640	2.02439
PBS	0.0000	0.05	6.104565	2.02439

Source: Eviews 12 (Data processed by researchers, 2023)

Based on the table above, the t-count value for the MSME variable is 14,300 and the t-table is 2.02439 and the resulting probability is 0.000. Then, it can be stated according to the t test criteria that $t\text{-count} > t\text{-table}$ ($14,300 > 2.02439$) and a significance of $0.000 < 0.05$. Then, that Ha1 is accepted. Then, that the variable number of MSMEs partially has a significant effect on regional economic growth in West Java. The inflation variable has a t-count value of 2.261 and a t-table of 2.02439 and the resulting probability is 0.0295. Then, it can be stated according to the t test criteria that $t\text{-count} > t\text{-table}$ ($2.261 > 2.02439$) and a significance of $0.0295 < 0.05$, it can be stated that Ha2 is accepted. Then, that the inflation variable partially has a significant effect on West Java regional economic growth. Then for Islamic bank financing variables the resulting t-count value is 6.104 and t-table 2.02439 and the resulting probability is 0.000. Then, it can be stated according to the t test criteria that $t\text{-count} > t\text{-table}$ ($6.104 > 2.02439$) and a significance of $0.000 < 0.05$, it can be stated that Ha3 is accepted so that the variable of Islamic bank financing partially has a significant effect on the economic growth of the West Java region.

Table 7. Simultaneous Test (Statistical Test F)

F-statistic	276.9928	Durbin-Watson stat	0.533326
Prob(F-statistic)	0.000000		

Source: Eviews 12 (Data processed by researchers, 2023)

The e-views calculations indicate that the F value is 276,992 and the significance level is 0.000. In comparison, the F value from the table is 3.24. The obtained F count value of 276.992 passes the F table value of 3.24, with a significance level of 0.000, which is less than the predetermined alpha level of 0.05. This result leads to the rejection of Ho4 and the acceptance of Ha4. Therefore, it can be concluded that the combined influence of the number of MSMEs, inflation, and financing of Islamic banks has a statistically significant and positive impact on the economic growth of the West Java region.

3.2. Discussion

The Influence of the Number of MSMEs on Economic Growth in West Java 2016-2021

The results of the study show that the number of MSMEs (X1) significantly influences West Java's regional economic growth for the 2016-2021 period based on GRDP at constant prices. This statement can be proven by looking at the results of Eviews data processing. The t-count of the variable number of SMEs produced is 14,300 with a significance of 0,000 and t-table 2.02439. So it can be stated according to the t-test criteria that $t\text{-count} > t\text{-table}$ ($14,300 > 2.02439$) and a significance of $0.000 < 0.05$, it can be stated that Ha1 is accepted so that the variable number of MSMEs partially has a significant effect on regional economic growth in West Java. This indicates that if there is a change in the number of MSMEs by one business unit, there will be a change in economic growth that will move in a positive direction. The variable number of MSMEs positively contributes to economic growth in the West Java region. This study's results align with research conducted by (Tahir et al., 2018). Tahir's research revealed that MSMEs have an important economic role because 99.2% of the total business is in the MSME industry. MSMEs significantly influence GDP with a contribution of 32% of GDP. The service sector contributes the largest share of the total MSMEs. While mining is a minor sector, which may be due to high competition and requires very high capital. MSMEs in the service sector, such as tourism, education, health services, etc. can be promoted for further develop (Tahir et al., 2018).

Furthermore, this research is consistent with the findings of Dyahrini & Wiludjeng (2020), who found that the MSME sector contributes 30.26% to the GDP. However, during the Covid-19 epidemic, the role of MSMEs in contributing to GRDP declined because sales from MSME players fell dramatically. The advise is that government aid is needed in building business partnerships, particularly money, internet marketing, and other assistance, to strengthen the role of MSMEs in the economy.

Research by Suhaili & Sugiharsono (2019) also states that MSMEs influence GDP with a contribution of Rp. 5,928,934.98 billion, or 59.74%. Microbusinesses contribute 61.50% of total GDP, small businesses 16.20%, and major businesses 22.75%. Furthermore, the findings of this study are consistent with Sari & Saputra (2020) research, which claims that MSMEs have a favorable and significant impact on economic growth. Because UKM is a business that creates goods or services. The regional GDP has also increased with increased production of products and services. In other words, economic growth is also accelerating. SMEs also increase labor income, increasing people's ability to buy goods and services produced by companies. In addition, Bosma et al (2018) research also states that MSMEs positively affect economic growth.

However, it differs from the research results of Halim (2020) and Rohadin & Yanah (2019), which reveal that MSMEs do not significantly influence economic growth. In study Rohadin & Yanah (2019), MSMEs contribute only 12.5% to economic growth, meaning that MSMEs do not significantly influence economic growth in Indonesia. According to him, this may be because MSME owners and MSME workers do not pay taxes to the government. The advice given is that the government needs to facilitate MSMEs so they can gain access to capital from financial institutions and make export licensing easier so that more MSMEs export the results of their business activities and MSMEs also need to increase their business knowledge so that their businesses can have an impact on increasing economic growth. Halim (2020) states that MSMEs have no significant influence on economic growth because, according to him, only MSMEs that have been established for a long time contribute. Apart from Halim and Rohadin, study Adeosun & Shittu (2021) also reveals that MSMEs contribute little to the economy because only

MSMEs have been around for a long time have contributed.

An increase in the number of MSMEs each year can significantly increase the economic growth of the West Java region, which is marked by an increase in ADHK GRDP in the number of billions of rupiah. This contribution is because MSMEs are Indonesia's most dominating industrial sector and absorb the most labor compared to large industries. In addition, MSMEs continue to sell the results of their activities domestically and internationally so that they can increase regional income in the end. MSMEs also have stronger resilience during less stable economic turmoil. It can be seen that in 2020, despite the Covid-19 pandemic, the number of MSMEs continues to grow and continues to innovate to survive the pandemic and increase their business income.

The government provides assistance to the Micro, Small, and Medium Enterprises (MSMEs) sector, with the aim of facilitating their survival and continuity of business operations. The government is currently devising a plan to provide capital assistance to Micro, Small, and Medium Enterprises (MSMEs) that have fulfilled the necessary criteria and submitted an application for capital. Furthermore, the government of West Java has implemented the MSME Champion initiative to support micro, small, and medium enterprises (MSMEs) seeking to enhance their operations and expand their export capabilities. This program also aims to facilitate MSMEs' access to financial institutions for capital and to promote their products in the market.

The Influence of Inflation on Economic Growth in West Java 2016-2021

The study's findings reveal that the inflation rate (X2) considerably impacts West Java's regional economic growth from 2016 to 2021, based on GRDP at constant prices. This statement can be confirmed by looking at the results of Eviews data processing. The calculated t-count is 2.261, the t-table is 2.02439, and the calculated probability is 0.0295. Hence, according to the t-test requirements of $t\text{-count} > t\text{-table}$ ($2.261 > 2.02439$) and a significance of $0.0295 < 0.05$, H_0 is accepted, implying that the inflation variable partially affects West Java regional economic growth. This demonstrates that an increase in inflation will similarly generate changes in economic growth.

The findings of this study are consistent with Uddin (2021), which reveals a strong, positive

significant association between GDP growth and inflation, with a 1 unit increase in the inflation rate causing a 0.27 unit increase in GDP. This research is also backed by the findings of Phiri (2018), which demonstrates that with a threshold result of 5.30%, if inflation is below the threshold, inflation will have a beneficial influence on economic growth. Yet, if inflation rises above the threshold, it will have a detrimental impact on economic growth. It is vital to have an authorisation policy in place in order to establish a more suitable financial climate and support better economic growth. It is important to have an authorization policy to reduce the inflation rate below the 5.30% threshold in order to establish a more congenial financial climate and support stronger economic growth.

Widiaty & Nugroho (2020) found that inflation positively and significantly affects economic growth. According to the findings, inflation can boost economic growth in the short term. The results above show that inflation within certain limits can be used as a reference for assessing the country's economy. Low inflation does not affect consumer purchasing power because goods are reasonably priced. This circumstance can potentially boost the economy (Ardiansyah, 2017). Inflation on the other hand, has a negative impact on economic growth in the long run. This conclusion is consistent with the Keynesian theory, which states that the supply curve tends to move to the right (positive) in the short run while moving to the left (negative) in the long run. As a result, controlling inflation is very important to promote economic growth and ensure the economic stability of each country.

On the other hand, this research is different from research conducted by Adaramola & Dada (2020), Daniel (2018), Ngoc (2020) which states that inflation has a negative effect on economic growth. In addition, Anggraini et al. (2018), and Yolanda et al. (2021) also revealed that inflation does not affect economic growth. According to Adaramola & Dada (2020), inflation can damage economic growth in the long run because it can reduce the purchasing power of money, thus inhibiting investment, which can boost prospects for economic growth. The government must maintain low and stable inflation to achieve high and sustainable growth. High inflation will hamper the community's development and economic activity, slow economic activity, and ultimately reduce economic growth.

Low inflation rates support the positive contribution of inflation to economic growth. During the 2016–2017 period, the highest inflation was in 2017, with an inflation rate of 3.63%, and continued to decline from 2018–2021 to an inflation rate of only 1.69% in 2021. The low inflation rate was caused by the economic turmoil that was still unstable due to the COVID-19 pandemic. The implementation of the mobility restriction policy makes people stay at home more often than carry out their economic activities. As a result, during the COVID-19 period, inflation decreased quite drastically.

The Influence of Islamic Bank Financing on Economic Growth in West Java 2016-2021

The results of the study show that Islamic bank financing (X3) has a significant influence on regional economic growth in West Java for the 2016–2021 period based on GRDP at constant prices. This statement can be proven by looking at the results of Eviews data processing. The resulting t-count value is 6.104 and t-table is 2.02439 and the resulting probability is 0.000. According to the t test criteria that $t\text{-count} > t\text{-table}$ ($6.104 > 2.02439$) and a significance of $0.0295 < 0.05$, it can be stated that H_0 is accepted so that the Islamic bank financing variable partially has a significant effect on West Java regional economic growth.

This study's findings are consistent with those of Afandi & Amin (2019), Boukhatem & Ben Moussa (2018), Iryanto et al. (2020), M. Anwar et al. (2020), Prastowo (2018) Terminanto & Rama (2017) Yolanda et al. (2021) who found that Islamic bank financing boosts economic growth. According to Afandi and Amin (2019) research, Islamic banks have an impact on economic growth. However, the extent of their contribution needs to be further enhanced as the positive effect is observed only in the areas of working capital financing and consumer financing. Nevertheless, investment financing exhibits an adverse impact on the growth of the economy. The aforementioned discovery aligns with the principles of Islamic finance, which assert that Islamic banking serves as an intermediary that facilitates the effective allocation of productive resources to foster economic expansion. Islamic banking enables the transfer of funds to the actual economy..

On the other hand, there is a contradiction with research conducted by (Setiawan, 2021) reveals that financing channeled through Islamic banks does not

positively affect economic growth. Islamic Bank MSME financing, he claims does not promote economic growth. The contribution of MSME financing to economic growth through the role of Islamic banks' profitability (ROA). Islamic banking benefits and economic growth have a symbiotic relationship and mutual effects. Economic growth has a greater impact on Islamic bank income than Islamic bank profits have on economic growth. Banking capital, Islamic monetary policy instruments, and inflation influence Indonesia's economic growth. The role of bank performance in the relationship between financing and economic growth is indirect. Increased bank profits stimulate economic growth by increasing the amount, ratio, and financing quality for MSMEs. To improve performance (profits of Islamic banks) and economic growth in Indonesia, focusing on the quality and quantity of financing for MSMEs is important.

Islamic bank financing in Indonesia has developed, especially *musyarakah* and *mudharabah* financing, which finance products that interest the general public and MSMEs. Islamic banking has channeled 49.56% of total financing to the commercial sector based on the industrial sector. In the Indonesian economy, sharia banking financing in the form of consumption, working capital, and investment play an important role. The funds are used for community activities ranging from providing for basic needs to supporting small and large businesses. With the financing provided to the public by Islamic banking, its operating income has grown, as has economic progress. The principle of profit sharing is used by Islamic banks, especially in the Islamic banking financial system, where the standards for submitting financing are more accessible. This is so consumers are not burdened with high-interest rates.

The Influence of the Number of MSMEs, Inflation, and Islamic Bank Financing on Economic Growth in West Java 2016-2021

The results of this study indicate that simultaneously, the number of MSMEs, inflation, and Islamic bank financing significantly influence West Java's regional economic growth for the 2016-2021 period. Statistical test results F value F table of 3.24. Then the calculated F value $> F$ table ($276,992 > 3.24$) and a significance of $0.000 < 0.05$. With the increasing number of MSMEs in West Java, the workforce will be absorbed, reducing the number of unemployed.

With the presence of MSMEs, more and more products and services are produced by this industrial sector, which, in the end, the resulting output will increase West Java's regional income. In addition to the number of MSMEs, inflation has a role in determining government policies. Inflation as an important macroeconomic factor makes the government must be more careful in determining policies and regulating inflation rates. A low inflation rate will make the economy grow. Islamic bank financing, which is financial inclusion in providing capital to MSMEs, also positively influences economic growth. By increasing capital for MSMEs, MSMEs can carry out their business activities beyond their normal capacity and can expand to increase their business income which will ultimately increase economic growth.

Islamic bank financing in the form of work, investment, and consumption models has proven to affect regional economic growth significantly. This research aligns with Prastowo (2018), and Terminanto & Rama (2017), which state that financing carried out by Islamic banking positively impacts economic growth. In addition, this research is also in line with Suhaili & Sugiharsono (2019), and Tahir et al. (2018), who argue that the number of MSMEs influences economic growth, and research by Phiri (2018), Uddin (2021), and Widiaty & Nugroho (2020), which shows that inflation has a positive impact on the economy in the short term and is still within a controlled threshold.

4. CONCLUSION

The study concludes that one of the three research variables, in this case, the number of MSMEs, inflation, and Islamic bank financing, positively impacts economic growth. This means that increasing the number of MSMEs, inflation, and Islamic bank financing will boost regional economic growth in West Java. Similarly, the simultaneous test shows that all of the variables in the study have a significant positive influence on the economic growth of West Java. The resulting Adjusted Coefficient (R²) value is 0.9528. The dependent variable for West Java's regional economic growth of 95.28 percent is influenced by the independent variables, the number of MSMEs, inflation, and Islamic bank financing. Then, 4.72% of the independent variables are influenced by other variables outside the scope of this study.

As a regulator, the government needs to continue to improve the Champion MSME Empowerment Program as a forum to assist MSMEs so that they can innovate their businesses and upgrade and further improve the quality and quantity of products and services produced. In addition, MSMEs must be more creative and innovative and be able to take advantage of the latest technology for their business. The local government must make regulations to make it easier for MSMEs to access capital from Islamic financial institutions, especially Islamic banking, and to obtain licenses so that more and more MSMEs can stand up and progress in West Java. From a banking perspective, Islamic banking needs to provide easy access for MSME players so that MSMEs have the capital to expand their businesses and produce more products to absorb more labor and contribute to the West Java economy. In this case, banking, at the heart of the growth of various domestic businesses, must focus more on the real sector and less on consumption activities so that accelerated development can be implemented and the Indonesian economy continues to grow.

The government also needs to establish and control regulations to control the inflation rate so that rising inflation does not have negative implications for economic growth. Due to the effects of the COVID-19 pandemic, inflation has decreased due to mobility restrictions and a slowdown in the economy. Therefore, the government needs to increase the inflation rate to the normal threshold set by Bank Indonesia, which is 3-4%, so that the economy recovers and improves as before and growth can be achieved.

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