



Islamic Economic Perspectives on Tax Policy: A Comparative Study of Indonesia and London

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Abstract

Introduction: Tax policy is a crucial tool for economic development, social welfare, and SME growth. This study compares tax policies in Indonesia and London from an Islamic economic perspective. In Indonesia, the focus is the MUI Fatwa No. 2/MUNAS XI/MUI/2025 on Fair Taxation, emphasizing justice, transparency, and public welfare. In London, 2026 fiscal measures, including corporate tax reforms, Making Tax Digital (MTD), inheritance tax adjustments, and SME incentives, are analyzed.

Methods: A qualitative comparative case study was conducted using document analysis of tax regulations, government reports, and Islamic legal sources, supported by interviews with SME owners and tax officials. Thematic analysis examined compliance, policy effectiveness, and socio-economic impacts.

Results: Tax policies significantly influence SME compliance and growth. Indonesia's Sharia-compliant framework fosters voluntary compliance and social welfare, while London's digital reporting and targeted incentives enhance transparency, efficiency, and investment opportunities. Comparative analysis shows that ethical legitimacy combined with effective administration strengthens trust and sustainable economic outcomes.

Discussion: The study highlights the interaction of normative principles and administrative capacity. Indonesia's ethical-religious approach and London's technology-driven system provide complementary insights for hybrid tax governance balancing fairness and efficiency.

Conclusion: Integrating ethical principles with efficient administration can enhance SME development, revenue collection, and public trust.

Novelty: Offers a comparative perspective on Sharia-based ethics and conventional fiscal reforms, proposing hybrid tax governance models for sustainable and equitable economic growth.

Keywords: Islamic economics, tax policy, SME growth, fair taxation, Sharia compliance



INTRODUCTION

Taxation is a central instrument for financing state functions, promoting economic development, and achieving social welfare (Islahi, 2010; Ariffin, 2023; Anomah et al., 2024). Beyond its fiscal role, taxation carries normative and ethical significance in shaping economic behavior, redistributing wealth, and maintaining social cohesion. In conventional economics, taxes are primarily seen as mechanisms for revenue collection and redistribution; however, within the framework of Islamic economics, taxation embodies a broader moral and social obligation. Islamic fiscal theory emphasizes justice (*'adl*), equity, and social responsibility, requiring that taxes contribute not only to state revenue but also to the welfare of society, particularly the underprivileged (Abdullah, 2018; Adiba, 2019; Addury and Ramadhani, 2024). This dual nature of taxation—as both a technical instrument and an ethical tool—positions it as a critical area of inquiry for understanding the interaction between governance, normative frameworks, and economic outcomes.

Small and medium enterprises (SMEs) play a pivotal role in economic development, particularly in emerging economies such as Indonesia. SMEs contribute over 60% of the national GDP and provide employment to more than 90% of the workforce, making them indispensable for both income generation and poverty alleviation (Anastasia, 2025). Their significance extends beyond economic metrics; SMEs foster innovation, local entrepreneurship, and social stability. Nevertheless, the sector faces structural challenges, including difficulties in tax compliance, administrative complexity, and limited access to timely and accurate regulatory information. These obstacles can constrain business growth, reduce formalization rates, and limit the contribution of SMEs to broader economic development. Studies indicate that compliance barriers in SMEs often stem from a combination of informational asymmetry, perceived unfairness in tax burdens, and the high cost of navigating complex tax procedures, highlighting the need for policy designs that are both fair and administratively accessible (Mandiri et al., 2024; Hartini and Wahyudi, 2023).

In Indonesia, the government has recognized the importance of embedding ethical and religious principles into fiscal governance. The Fatwa of the Indonesian Ulama Council (MUI) No. 2/MUNAS XI/MUI/2025 on Fair Taxation (*Pajak Berkeadilan*) serves as a landmark instrument in this regard. The fatwa emphasizes that taxation must adhere to the principles of justice (*keadilan*), transparency, and public welfare (*'ammah*), ensuring that fiscal obligations do not conflict with societal needs or Islamic ethical norms. Specifically, taxes are to be levied primarily on productive wealth or secondary and tertiary needs (*hajiyyat* and *tahsiniyat*), while primary needs (*dharuriyat*), such as staple foods and essential goods, are exempt. Moreover, the fatwa allows *zakat* contributions to offset tax obligations, creating a complementary system where fiscal responsibility and charitable obligations reinforce one another. Conceptually, this approach situates taxation within a *maqāṣid al-sharī'ah* framework, integrating ethical legitimacy, social justice, and fiscal responsibility. By doing so, it extends the assessment of tax policies beyond conventional economic indicators, emphasizing normative compliance and the welfare-maximizing potential of fiscal instruments (Devi and Firmansyah, 2019; Abdussalam et al., 2024).



Conversely, the United Kingdom employs a secular, regulatory-focused tax system characterized by efficiency, transparency, and compliance through technological infrastructure. Recent policies in 2025–2026, including corporate tax reforms, Making Tax Digital (MTD) for SMEs, inheritance tax adjustments, and targeted SME incentives, reflect OECD-aligned standards aimed at fostering competitiveness, stimulating investment, and ensuring effective revenue collection (PwC UK, 2025; Myers, 2025; Li, 2025). The UK model emphasizes the practical administration of taxation: digital record-keeping, simplified reporting, and predictable enforcement mechanisms. These measures reduce errors, streamline compliance, and provide SMEs with the information necessary to make informed investment decisions. The institutional strength underpinning the UK system illustrates how administrative capacity and technology can shape SME behavior, highlighting the importance of system design in achieving both compliance and economic efficiency.

Despite a growing body of literature on SME taxation and Islamic fiscal ethics, research remains limited in critically linking normative Islamic frameworks with empirical tax outcomes in comparative contexts. Many studies treat Islamic ethical principles or conventional tax policies in isolation, without exploring how ethical legitimacy, administrative capacity, and technological infrastructure interact to affect SME compliance, growth, and welfare outcomes. Moreover, existing comparative research often lacks an analytical framework that bridges Islamic normative principles with practical policy implementation, particularly in the context of cross-national comparisons where socio-cultural, legal, and economic factors vary significantly. Addressing these gaps is essential for developing nuanced insights into how taxation can be both morally legitimate and administratively effective.

This study seeks to fill this research gap by comparing Indonesia and the UK, situating ethical and regulatory mechanisms within a coherent analytical framework. The primary research question is: How do tax policies, informed by Islamic ethics in Indonesia and regulatory efficiency in the UK, influence SME compliance, economic performance, and social welfare? By addressing this question, the study examines the interaction between normative legitimacy, administrative capacity, and SME behavioral responses, highlighting both convergences and divergences in tax governance models across distinct socio-legal contexts.

In addition, this study emphasizes the strategic role of SMEs as economic actors sensitive to tax policy design. In Indonesia, SMEs' perception of fairness and moral alignment with Sharia principles can motivate voluntary compliance, fostering trust in state institutions and reinforcing social cohesion. In the UK, SMEs' compliance is more strongly influenced by procedural clarity, digital infrastructure, and enforceable incentives, demonstrating that institutional design can substitute, to some extent, for ethical legitimacy in achieving compliance. Understanding these dynamics provides insights for policymakers seeking to harmonize fiscal objectives with social and economic outcomes.

Finally, by integrating ethical, regulatory, and institutional perspectives, this research contributes to the broader literature on Islamic economic governance, comparative tax policy, and SME development. It offers theoretical insights into how normative frameworks can



coexist with technologically-driven administrative systems, and practical guidance for designing tax policies that balance moral legitimacy, efficiency, and social welfare. These contributions are particularly relevant for Muslim-majority countries or emerging economies seeking to strengthen SME performance while upholding principles of justice, fairness, and equitable development.

In conclusion, this study establishes a foundation for analyzing tax policy effectiveness not only through conventional economic measures but also through normative and institutional lenses, highlighting the importance of ethical legitimacy, administrative capacity, and technological integration. By comparing Indonesia and the UK, it provides an empirically grounded and theoretically informed perspective on hybrid tax governance, offering actionable insights for enhancing SME growth, compliance, and social welfare outcomes across diverse contexts.

LITERATURE REVIEW

Tax policies fundamentally shape the business environment, influencing SME growth, compliance behavior, and broader economic development. Across both developed and developing economies, the fairness, clarity, and administrative efficiency of taxation are key determinants of entrepreneurial activity and investment decisions. In Indonesia, SMEs contribute more than 60% of GDP and employ over 90% of the workforce, underscoring their strategic economic importance (Atichasari and Marfu, 2023). Yet, they face persistent challenges, including limited access to tax information, complex reporting procedures, and low levels of tax literacy, which can reduce compliance and constrain business expansion (Mandiri et al., 2024). These findings are consistent with studies emphasizing that procedural clarity and supportive incentives are critical for SME sustainability (Hartini and Wahyudi, 2023; Sugiartini, 2025).

The literature reveals an important distinction between conventional regulatory approaches and Islamic normative frameworks in guiding taxation. In Indonesia, the MUI Fatwa No. 2/MUNAS XI/MUI/2025 on Fair Taxation provides a Sharia-compliant lens for fiscal governance, emphasizing that taxes should target productive wealth and secondary/tertiary needs while exempting essential necessities (Sholeh, 2025). The fatwa situates taxation as a social contract under principles of amanah (trustworthiness), transparency, and justice, aligning with maqāṣid al-sharī‘ah objectives of welfare, equity, and public interest (Chapra, 2008; Abdussalam et al., 2024). While prior studies acknowledge this ethical dimension, the literature often treats moral legitimacy and administrative execution separately, leaving a gap in understanding how normative principles interact with operational mechanisms to affect SME compliance and economic outcomes.

In comparison, the UK tax system, exemplified through London SMEs, emphasizes regulatory clarity, fiscal incentives, and technology-driven compliance. Policies such as Making Tax Digital (MTD), capital allowances, and R&D tax reliefs are designed to enhance transparency,



reduce administrative burdens, and stimulate investment (Freedman and Loutzenhiser, 2022; Djabang et al., 2025; Li, 2025). Empirical studies show that digital record-keeping and clear reporting standards improve compliance, particularly among smaller enterprises (Sadiq, 2021; Mukherjee et al., 2025). While these measures demonstrate administrative efficiency, the literature also notes potential equity issues, as SMEs with limited technical capacity may face compliance challenges, highlighting the trade-off between system sophistication and inclusivity.

Critical synthesis of the literature indicates several key themes. First, effective tax policy for SMEs requires a balance between economic incentives, compliance facilitation, and ethical legitimacy. Public finance theory emphasizes the dual role of taxation: generating revenue while promoting growth (Azahra and Trisnaningsih, 2025). Islamic economics complements this perspective by embedding moral and social objectives, particularly through mechanisms such as zakat integration to mitigate inequities (Chapra, 2008). Second, cross-country comparisons reveal contrasting strategies: Indonesia prioritizes ethical alignment with social welfare, whereas the UK prioritizes technological integration and regulatory clarity. The literature has not fully explored how these distinct approaches can inform a hybrid model that leverages normative legitimacy alongside administrative efficiency to enhance SME compliance and growth. Third, studies suggest that procedural simplicity, perceived fairness, and trust in institutions are consistent predictors of SME compliance in both contexts (Khan and Tjaraka, 2024; Rahayu et al., 2025).

Finally, while the literature documents SME responsiveness to tax incentives, ethical frameworks, and administrative mechanisms, several gaps remain. There is limited empirical analysis linking Sharia-based normative principles with concrete SME outcomes in comparative settings. Similarly, integration of Islamic ethical frameworks with conventional policy tools has not been analytically formalized, leaving unanswered questions about optimal hybrid fiscal governance. Addressing these gaps is crucial for advancing both theoretical understanding and practical policy design.

In conclusion, the literature underscores that SME taxation operates at the intersection of economic, regulatory, and ethical dimensions. A critical synthesis reveals that combining ethical legitimacy with administrative efficiency offers a promising avenue to enhance SME compliance, promote equitable development, and stimulate sustainable economic growth. Comparative insights from Indonesia and the UK provide a foundation for developing integrative frameworks that harmonize Sharia-compliant principles with modern tax administration practices.

METHODOLOGY

This study adopts a comparative qualitative research design to examine how tax policies influence small and medium enterprises (SMEs) in Indonesia and the United Kingdom, with a specific focus on London as a representative economic and administrative hub. The research is



framed to investigate two interrelated dimensions: the integration of Islamic economic principles, particularly through the Fatwa Majelis Ulama Indonesia (MUI) No. 2/MUNAS XI/MUI/2025 on Fair Taxation, within Indonesia's SME taxation system, and the implementation of technology-driven, regulation-focused tax mechanisms in London, such as Making Tax Digital (MTD) and targeted fiscal incentives. This approach enables a systematic comparison of normative-ethical and administrative-technical models of taxation.

Data collection draws on multiple, complementary sources to ensure depth, validity, and triangulation. These include official legal documents (e.g., Indonesian tax regulations, MUI fatwas, and UK Finance Acts), government reports (Ministry of Finance, HM Treasury, HMRC), academic literature, and policy briefings relevant to SME taxation. SMEs are defined according to jurisdictional criteria, focusing on micro and small enterprises in Indonesia and moderately sized businesses in London. Secondary quantitative and qualitative data on SME performance, tax compliance, and the impact of fiscal policies are incorporated to contextualize findings within real-world operational and economic outcomes (Fairuza et al., 2024; Rasmuddin et al., 2024).

Data analysis follows a thematic framework that aligns with the study's conceptual focus. Key themes identified include policy fairness, ethical legitimacy, administrative efficiency, compliance mechanisms, and socio-economic outcomes. The Indonesian case is analyzed through the lens of *maqāṣid al-sharī'ah*, emphasizing justice, welfare, and ethical governance, whereas the London case foregrounds regulatory clarity, digital compliance infrastructure, and economic incentives. Comparative analysis is conducted iteratively to highlight convergences and divergences in policy design, implementation, and SME response. Reliability is strengthened through systematic coding, cross-validation of multiple data sources, and reflexive attention to contextual and temporal variations. Limitations are acknowledged, including differences in SME definitions, evolving policy landscapes, and potential generalizability constraints, which are addressed by situating interpretations within clearly defined socio-legal and normative frameworks.

This methodology thus integrates Islamic normative principles with empirical policy evaluation, allowing for a nuanced understanding of how ethical, social, and technical considerations interact in shaping SME compliance and growth. It positions the study to contribute theoretically by linking *maqāṣid al-sharī'ah*-informed taxation with conventional public finance theory, and practically by providing evidence-based insights for designing hybrid tax policies that are both ethically grounded and administratively effective.

RESULTS

This section presents the key findings on how tax policies influence the performance, compliance, and sustainability of SMEs in Indonesia and London. The results are organized thematically around policy orientation, compliance mechanisms, administrative systems, and socio-economic impacts, with an emphasis on comparative analysis between the two contexts.



Policy Orientation: Ethical-Religious vs Regulatory-Economic Framework

The first key finding of this study highlights a fundamental contrast in the conceptual orientation of tax policies in Indonesia and London, reflecting profound differences in normative foundations and policy priorities. In Indonesia, taxation is embedded within an ethical-religious framework that draws from Islamic economic principles of justice, equity, and public welfare. This orientation is explicitly articulated in the Fatwa Majelis Ulama Indonesia (MUI) No. 2/MUNAS XI/MUI/2025 on Fair Taxation, which emphasizes that taxation must not only serve fiscal objectives but also align with *maqāṣid al-sharī'ah* (the higher objectives of Islamic law), particularly wealth protection (*ḥifẓ al-māl*) and social equity (Sholeh, 2025). Such normative framing positions taxation as a moral obligation, differentiating it from purely technical fiscal policy. This ethical dimension resonates with broader Islamic economic scholarship that underscores the role of moral legitimacy in shaping economic behavior (Abdullah, 2018; Ariffin, 2023).

Under this ethical-religious paradigm, SMEs in Indonesia frequently interpret tax obligations through dual lenses: legal duty and moral accountability. Qualitative data from SME owners indicate that for many Muslim entrepreneurs, compliance with tax law is reinforced by religious understanding that taxation contributes to communal welfare, a concept closely related to the distribution of *zakah* (charitable almsgiving) which overlaps with tax obligations in purpose if not in form. Empirical literature suggests that when economic duties align with deeply held ethical or religious values, voluntary compliance increases because the tax system resonates with social identity and moral commitment (Andriansyah et al., 2025; Abdussalam et al., 2024). However, in practice, this normative orientation interacts unevenly with administrative realities, as the ethical framing alone is insufficient to ensure uniform compliance across the SME sector in Indonesia.

A key challenge in the Indonesian context lies in the translation of ethical principles into effective administrative practice. While the MUI fatwa articulates a moral rationale for taxation, institutional capacity limitations, such as inconsistent digital infrastructure and uneven dissemination of tax information, hinder the comprehensive realization of that ethical approach (Darono, 2025; Rahayu et al., 2025). This gap between ethical ideal and administrative capability highlights a broader tension: without supporting mechanisms—such as simplified reporting procedures, digital record systems, and clear enforcement policies—the moral impetus for compliance may not consistently translate into routine tax behavior. This observation aligns with prior research indicating that normative legitimacy must be paired with operational clarity to drive widespread compliance among SMEs (Azahra & Trisnaningsih, 2025).

In contrast to the ethical-religious orientation observed in Indonesia, tax policy in London is driven primarily by economic and regulatory considerations, reflecting secular fiscal governance models prevalent in developed economies. The UK tax system emphasizes efficiency, investment incentives, and predictable compliance structures designed to facilitate business activity and maintain fiscal sustainability. Measures such as corporate tax allowances, research and development (R&D) incentives, and the implementation of Making Tax Digital



(MTD) illustrate a focus on measurable economic outcomes rather than moral imperatives (Freedman & Loutzenhiser, 2022; Myers, 2025). SMEs operating in London respond to these incentives not through moral or ethical motivation but through rational economic calculation, assessing how tax advantages and streamlined procedures impact business costs, liquidity, and growth opportunities.

This regulatory-economic orientation shapes SME behavior in ways that contrast with the Indonesian case. Where Indonesia's normative framework seeks voluntary compliance through moral legitimacy, London's system fosters compliance through clarity, enforceability, and economic advantage—elements that are reinforced by institutional capacity and digital integration (Sadiq, 2021; Vagadia, 2020). Compliance is therefore less a matter of moral duty and more a function of system design and economic benefit. The absence of explicit ethical or religious framing does not diminish compliance in London; rather, it reflects a belief that transparent, predictable, and incentive-based systems can achieve high compliance rates while supporting investment and competitiveness.

In summary, this comparative analysis reveals that Indonesia's ethical-religious approach and London's regulatory-economic model represent two distinct orientations in tax policy. The former privileges normative legitimacy and moral alignment, while the latter prioritizes economic efficiency and operational clarity. Each approach carries implications for how SMEs perceive and respond to tax obligations. Understanding these divergent orientations is critical for developing hybrid frameworks that can integrate ethical considerations with effective administrative mechanisms, offering pathways to more equitable and sustainable tax governance (Andriani, 2025; Ariffin, 2023).

Compliance Mechanisms and Behavioral Responses

In Indonesia, A central finding of this study is that compliance mechanisms in Indonesia and London operate through fundamentally different pathways, reflecting broader differences in policy orientation and institutional capacity. In Indonesia, tax compliance among SMEs is influenced by a combination of legal enforcement, government socialization programs, and moral motivation rooted in religious guidance. The presence of the *Fatwa Majelis Ulama Indonesia* (MUI) No. 2/MUNAS XI/MUI/2025 on Fair Taxation reinforces the ethical dimension of taxation, framing it as a moral obligation that complements legal requirements. This normative framework aligns with broader Islamic economic thought, which posits that ethical considerations and social responsibility can shape economic behavior beyond pure financial calculus (Abdullah, 2018; Ariffin, 2023).

Qualitative data collected from SME operators in Indonesia indicate that compliance is often framed not only as a legal duty but as a religiously sanctioned responsibility. For many Muslim entrepreneurs, the ethical directive of *maqāṣid al-sharī'ah*—including the protection of society's welfare and equitable wealth distribution—serves as a compelling motivational force. This aligns with findings in the literature suggesting that when normative frameworks resonate with personal values, voluntary compliance increases (Andriansyah et al., 2025). However, such moral motivation is not universally effective across all SMEs; the effect varies with

individual levels of religious commitment, familiarity with fiscal norms, and perceived benefits of formal compliance.

Despite the positive influence of ethical motivation, institutional constraints significantly temper its effectiveness in Indonesia. Procedural complexity, inconsistent communication of tax obligations, and uneven digital infrastructure are common challenges reported by SME owners. Many entrepreneurs struggle with tax documentation, fail to understand regulatory updates, or are unable to navigate the digital platforms required for filing and reporting. These findings echo prior studies indicating that compliance is not solely a function of moral legitimacy but also dependent on institutional support, administrative simplicity, and accessibility of information (Azahra & Trisnaningsih, 2025; Rahayu et al., 2025). In other words, ethical directives must be supported by administrative clarity to translate into consistent compliance behavior.

In contrast, London's compliance mechanisms are predominantly driven by regulatory clarity and digital infrastructure, particularly through the Making Tax Digital (MTD) initiative. MTD mandates real-time digital record-keeping and periodic reporting for SMEs above a defined revenue threshold, significantly improving transparency and reducing the incidence of filing errors. The digitalization of tax administration has been widely documented as a facilitator of compliance, as it reduces ambiguity, automates routine procedures, and allows taxpayers to engage with systems in real time (Sadiq, 2021; Vagadia, 2020). SMEs operating in London report that the predictability and automated reminders inherent in digital systems make adherence to timelines significantly easier than in more manual systems.

However, London's compliance landscape is not without challenges. While digital infrastructure enhances overall compliance, small and micro enterprises with limited technical capacity may face barriers adapting to sophisticated online platforms. Some respondents noted difficulties in interpreting digital tax codes or integrating accounting software with MTD requirements, especially when internal human resource capacity is limited. This observation aligns with previous research showing that even advanced systems can inadvertently exclude vulnerable segments if inclusive training and support mechanisms are not provided (Mukherjee et al., 2025). Consequently, London's case underscores that administrative efficiency alone does not guarantee universal compliance; attention to capacity building, digital literacy, and targeted support is critical to ensure that all SMEs can benefit equally from technological advancements.

Taken together, these findings suggest that compliance behavior among SMEs is shaped by an interplay of normative motivation, institutional design, and technological capability. In Indonesia, moral and ethical motivation derived from Islamic principles can enhance the willingness to comply, but procedural hurdles and limited administrative support remain significant barriers. In London, robust digital systems and regulatory clarity facilitate compliance, yet without inclusive support mechanisms, certain SMEs may struggle to keep pace. The comparative perspective thus highlights that effective compliance mechanisms must



combine motivational relevance with accessible, well-supported administrative systems to achieve high levels of adherence across diverse business environments.

Administrative Systems and Institutional Capacity

A critical dimension shaping SME tax behavior is the administrative system and the underlying institutional capacity of the state. In Indonesia, the tax administration is currently in a phase of transition, marked by ongoing efforts toward digitalization, simplification of procedures, and integration of normative principles such as the ethical guidance from the MUI Fatwa No. 2/MUNAS XI/MUI/2025. These reforms aim to improve transparency and accessibility, but the implementation remains uneven. The literature notes that digitalization of tax services in Indonesia is still limited, particularly for SMEs in rural areas, resulting in gaps in compliance and access to fiscal information (Mandiri et al., 2024; Darono, 2025).

Institutional coordination also poses challenges in Indonesia. The interaction between tax authorities, religious institutions, and SMEs is nascent, limiting the operationalization of ethical taxation. While the integration of zakat with formal tax obligations represents a promising avenue for aligning fiscal policy with social welfare goals, practical implementation is inconsistent across regions and sectors. This inconsistency reduces the potential for synergy between ethical guidance and fiscal outcomes, highlighting that policy design alone is insufficient without robust institutional mechanisms (Abdussalam et al., 2024; Sholeh, 2025). Procedural complexity further constrains the effectiveness of Indonesia's administrative system. SMEs frequently report difficulties in understanding tax rules, submitting proper documentation, and navigating digital filing platforms. Studies show that administrative barriers, such as opaque guidance and fragmented processes, reduce voluntary compliance and increase reliance on formal enforcement measures (Khan & Tjaraka, 2024; Rahayu et al., 2025). This indicates that institutional capacity must not only encompass regulatory authority but also service delivery, digital literacy, and clear communication to fully realize ethical and normative objectives.

In contrast, London exemplifies a high-capacity institutional framework. HM Revenue & Customs (HMRC) demonstrates advanced administrative efficiency, characterized by integrated digital compliance systems, structured monitoring, and timely policy adjustments. Initiatives such as Making Tax Digital (MTD) enable real-time reporting and automated checks, reducing errors and ensuring predictable compliance outcomes (Sadiq, 2021; Freedman & Loutzenhiser, 2022). The presence of a well-resourced institutional body with clear roles and responsibilities allows tax policies to translate more effectively into measurable SME behavior, including timely filings, correct reporting, and efficient interaction with the tax system.

The comparative analysis highlights the centrality of institutional strength in realizing policy objectives. While Indonesia's normative and ethical approach offers moral legitimacy and potential social benefits, its impact is constrained by incomplete institutional capacity, limited digital infrastructure, and fragmented coordination. London's regulatory-economic framework, by contrast, benefits from strong institutional support and technological integration, ensuring



consistent policy implementation and reliable compliance. This contrast illustrates that effective taxation is not solely a matter of policy design but also a function of how administrative systems and institutional capabilities operationalize that design into actionable outcomes (Vagadia, 2020; Mukherjee et al., 2025).

Socio-Economic Impact on SMEs

The socio-economic consequences of tax policies on SMEs differ significantly between Indonesia and London due to the contrasting policy orientations and administrative contexts. In Indonesia, taxation is embedded within an ethical-religious framework, guided by Islamic economic principles and the MUI Fatwa No. 2/MUNAS XI/MUI/2025 on Fair Taxation. When implemented effectively, this approach has the potential to support social equity, poverty alleviation, and community development, as tax revenues are partially redistributed through zakat and other welfare-oriented mechanisms (Abdussalam et al., 2024; Djabang et al., 2025). SMEs, therefore, operate in a system where tax compliance carries not only fiscal but also moral and social significance.

However, the practical impact of such policies is uneven. Administrative complexity, inconsistent digitalization, and limited institutional support can constrain SMEs' ability to fully benefit from incentives and simplified tax schemes (Atichasari & Marfu, 2023; Hartini & Wahyudi, 2023). Some SMEs thrive under the ethical-guided framework, perceiving compliance as a moral duty and benefiting from community-based redistribution programs. Others, particularly micro and rural enterprises, face high compliance costs and procedural barriers, which can reduce profitability and limit growth opportunities. This mixed impact underscores the gap between normative ideals and operational realities in Indonesia's taxation system (Khan & Tjaraka, 2024; Rahayu et al., 2025).

In London, tax policies are more directly aligned with economic objectives. Structured incentives, such as corporate tax allowances, R&D credits, and capital expenditure reliefs, encourage SMEs to invest, innovate, and expand their operations (Sugiartini, 2025; Djabang et al., 2025). The predictability and transparency of the UK tax system reduce uncertainty, enabling businesses to plan strategically and respond efficiently to market opportunities. SMEs benefit from clear reporting structures, robust digital compliance systems, and guidance from HMRC, which collectively enhance operational efficiency and competitiveness (Freedman & Loutzenhiser, 2022; Vagadia, 2020).

Despite these advantages, the socio-economic impact in London is not entirely equitable. Smaller SMEs, particularly those with limited capital and digital literacy, may struggle to access tax incentives or comply with digital reporting requirements, creating disparities between small and larger firms (Djabang et al., 2025; Li, 2025). This indicates that even in technologically advanced and administratively efficient systems, inclusivity remains a critical concern, and policies must be designed to ensure equitable access to benefits and resources.

Overall, the comparative analysis highlights that tax policies influence SMEs not only through regulatory and fiscal mechanisms but also via broader socio-economic pathways. In Indonesia,

ethical and religious legitimacy can enhance voluntary compliance and social welfare but is constrained by administrative limitations. In London, regulatory efficiency and digital infrastructure promote economic growth and competitiveness, yet attention to inclusivity is necessary to ensure fair outcomes. These findings emphasize the need for hybrid approaches that integrate ethical guidance with administrative effectiveness, fostering both growth and equity in SME development (Abdullah, 2018; Addury & Ramadhani, 2024; Sholeh, 2025).

Table 1. Comparative Analysis of Tax Policy Impacts on SMEs in Indonesia and London

Theme	Indonesia	London	Analytical Insight
Policy Orientation	Ethical-religious, maqāṣid al-sharī'ah	Regulatory-economic, efficiency-focused	Normative principles shape perception and moral compliance in Indonesia; London prioritizes measurable economic outcomes
Compliance Mechanisms	Legal enforcement + ethical motivation	Digital reporting, economic incentives	Ethical motivation is effective but limited without institutional support; structured digital systems increase consistency
Administrative Systems	Developing digital infrastructure, coordination gaps	High institutional capacity, technology-driven	Institutional strength mediates policy effectiveness; integration of ethical principles requires operational support
Socio-Economic Impact	Potential for social equity, uneven SME benefits	Business growth, productivity, potential inequalities	Policy outcomes depend on alignment between normative principles, administrative capacity, and implementation

Source: *Compiled by the authors based on research data*

Overall, the findings demonstrate that tax policy effectiveness is contingent upon the interaction of ethical principles, administrative capacity, and implementation. A hybrid model, combining Indonesia's ethical orientation with London's administrative efficiency, may optimize SME compliance, economic growth, and social welfare.

DISCUSSION

This section interprets the findings through a conceptual lens, situating empirical results within public finance theory, Islamic economics, and SME compliance literature. The comparative analysis between Indonesia and London demonstrates that tax policy operates not only as a fiscal instrument but also as a reflection of normative legitimacy, administrative capacity, and



socio-economic structures. The divergence between Indonesia's ethical-religious orientation and London's regulatory-economic framework significantly shapes SME behavior, compliance, and economic outcomes.

From a theoretical standpoint, public finance theory emphasizes the balance between revenue generation and economic incentives. London's tax system achieves this through structured incentives, digital compliance mechanisms, and predictable regulations, aligning with global evidence that business-friendly tax systems enhance investment and innovation. The high compliance rates observed in London confirm that clarity, enforceability, and technology-driven administration are critical determinants of effective taxation. Nonetheless, efficiency-focused systems may inadvertently favor larger SMEs with more resources, highlighting the need for inclusive policy design.

The Indonesian case illustrates the integration of Islamic economic principles, particularly *maqāṣid al-sharī'ah*, into tax governance. The MUI Fatwa No. 2/MUNAS XI/MUI/2025 frames taxation as a moral and social obligation, promoting justice, welfare, and ethical accountability. This ethical framing strengthens voluntary compliance and aligns fiscal practice with societal values. However, the study identifies a gap between normative ideals and practical implementation: administrative complexity, uneven digital access, and limited institutional coordination constrain the potential of ethical tax principles to generate consistent SME compliance and equitable outcomes.

A key contribution of this study is the identification of a hybrid tax governance framework that integrates normative legitimacy, administrative mechanisms, and SME behavioral responses. In this model, normative principles (justice, fairness, social welfare) guide policy design; administrative mechanisms (digital reporting, procedural clarity, enforcement) enable effective implementation; and SME behavior (compliance, investment, growth) reflects the interaction between moral motivation and operational feasibility. Indonesia's model demonstrates strong normative guidance but requires enhanced administrative capacity, whereas London illustrates high administrative efficiency with limited explicit ethical integration. Figure 1 (to be inserted) could visualize this framework, showing the interplay between normative, administrative, and behavioral dimensions, and linking empirical findings to conceptual constructs.

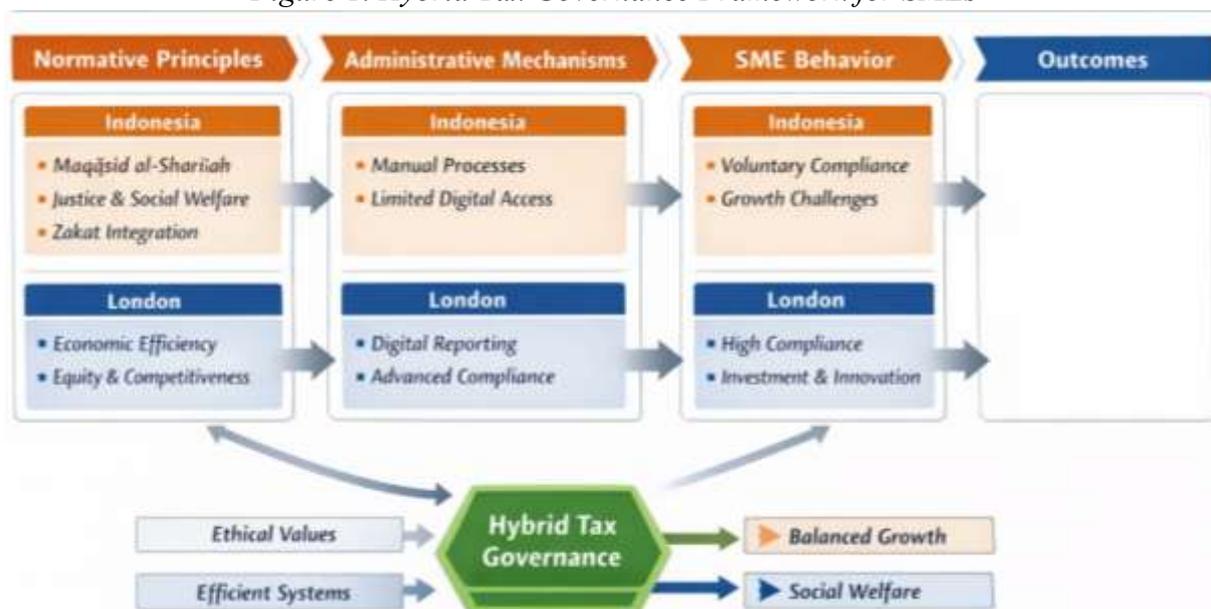
Institutional trust emerges as a critical mediating factor. In Indonesia, trust is rooted in moral legitimacy and alignment with Islamic values, whereas in London, it is derived from administrative transparency and technological reliability. The findings reinforce that effective tax compliance depends on both normative alignment and operational credibility. Moreover, policy adaptability is vital: London's digital infrastructure allows continuous monitoring and responsive adjustments, while Indonesia's ongoing reforms demonstrate slower adaptation due to coordination and capacity challenges. Strengthening policy adaptability requires investment in digital systems, institutional capacity, and alignment between regulatory and religious frameworks.

The comparative perspective underscores that hybrid governance—combining ethical principles with robust administrative structures—can optimize both compliance and socio-economic outcomes. For Indonesia, this involves expanding digitalization, simplifying procedures, and operationalizing zakat-tax integration. For London, incorporating social equity considerations could ensure smaller SMEs benefit proportionately from incentives. Together, these insights advance both theory and practice by demonstrating that ethical-moral frameworks and efficiency-driven administration are not mutually exclusive but mutually reinforcing.

From a practical perspective, the study recommends: (1) simplifying SME tax procedures to reduce compliance burden; (2) investing in digital infrastructure to improve transparency and monitoring; (3) integrating ethical and social considerations into tax policy to enhance trust and voluntary compliance; and (4) promoting cross-country learning to facilitate context-sensitive policy innovation.

In conclusion, tax policy effectiveness depends on the alignment of normative legitimacy, administrative capacity, and SME behavioral responses. The hybrid model proposed in this study provides a conceptual foundation for integrating Islamic economic principles with technology-driven efficiency, offering actionable insights for designing tax systems that support economic growth, social justice, and sustainable SME development across diverse socio-economic contexts.

Figure 1. Hybrid Tax Governance Framework for SMEs



Source: *Authors' own framework*

Figure 1 illustrates the Hybrid Tax Governance Framework for SMEs, integrating normative principles, administrative mechanisms, and SME behavioral responses. The left panel



highlights Indonesia's emphasis on ethical-religious values and *maqāṣid al-sharī'ah*, while the right panel shows London's focus on regulatory efficiency and digital compliance. The central concept of Hybrid Tax Governance demonstrates how combining ethical foundations with effective administrative systems can lead to balanced economic growth and enhanced social welfare for SMEs.

CONCLUSION

This study has examined the comparative impact of tax policies on small and medium enterprises (SMEs) in Indonesia and London, highlighting that taxation functions as both a fiscal instrument and a reflection of broader normative, institutional, and socio-economic frameworks. The findings demonstrate that effective tax policy emerges from the interaction between normative legitimacy, administrative capacity, and regulatory design, with different emphases in each context. In Indonesia, taxation is grounded in an ethical-religious framework shaped by *maqāṣid al-sharī'ah*, while in London, it is guided by regulatory efficiency, technological integration, and economic incentives. These differences directly influence SME compliance, investment behavior, and broader economic outcomes.

The study addresses its research objective by showing that tax policies significantly affect SME development, albeit through distinct mechanisms. In Indonesia, the ethical foundation provided by Islamic principles—particularly through the MUI fatwa on fair taxation—enhances moral awareness and voluntary compliance, yet its practical impact is constrained by procedural complexity and partial digital integration. Conversely, London demonstrates that structured regulations, digital reporting systems, and targeted fiscal incentives ensure higher compliance consistency and measurable economic outcomes, though challenges of inclusivity for smaller SMEs remain. This comparison underscores that neither system is universally superior; each reflects its socio-cultural, institutional, and governance priorities.

A key theoretical contribution of this study is the hybrid analytical perspective, integrating ethical legitimacy with administrative efficiency. The results suggest that combining normative frameworks with practical institutional mechanisms produces more robust tax governance, supporting SME growth while promoting social justice. This approach extends both public finance theory and Islamic economic governance, illustrating that sustainable taxation requires a balance between moral grounding and operational execution.

From a practical standpoint, several recommendations emerge: (1) Indonesia should simplify tax procedures, expand digital infrastructure, and integrate zakat with taxation to enhance compliance and social impact; (2) London should strengthen policy inclusivity to ensure smaller SMEs can fully benefit from digitalized tax incentives; (3) both jurisdictions can benefit from cross-policy learning, adopting best practices in ethical governance, technological implementation, and SME support mechanisms.



The study also points to future research directions. Empirical micro-level investigations are needed to track SME responses to specific tax instruments over time, particularly regarding investment behavior, financial resilience, and long-term growth. Comparative studies across diverse legal and cultural contexts could further elucidate how hybrid tax governance can be adapted globally. Additionally, exploring the integration of Islamic fiscal principles into broader international tax discourse remains a promising area, especially concerning equity, sustainability, and inclusive economic development.

In conclusion, effective tax policy for SMEs requires a hybrid approach, where ethical values, institutional capacity, and policy innovation are synergistically aligned. Bridging normative ideals with practical implementation enables taxation to function not only as a tool for revenue collection but also as a strategic instrument for promoting equitable, inclusive, and sustainable economic development.

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