

## Portrait of Public Debt, Fiscal Space, and Debt Impact: Islamic Finance Study on Islamic Countries Territory

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**Abstract:** *Policymakers, the Public debt is a problem that the monetary and fiscal authorities have long been concerned about. The amount of public debt concerning fiscal viability and the financial crisis has received a lot of attention recently. This study's goal is to examine and evaluate how the function and impact of debt, both external and internal, on the macroeconomic situation of various countries. The researcher will present several cases of empirical evidence regarding the impact of debt on the socio-economics of a country. The main focus of this research discussion is on the theoretical study of debt and the impact of debt in various countries in the region, as well as the views of Islamic thinkers on public debt. A library study was the research methodology employed. by collecting, identifying, and analyzing articles and related references (literature review) related to the focus research. Furthermore, researchers will examine several cases of portraits of various empirical evidence concerning the country's socioeconomic debt. The findings demonstrate that an Islamic state will be successful based on its ability to collect taxes, alms, and other required and optional sources of income, as well as revenue from public works projects, real estate, and natural resources. To achieve a balanced budget and prevent wasteful spending, the state will implement the middle-at-tawasuth principle.*

**Keywords:** *Public Debt, Fiscal Space, Failed to Pay, Islamic Perspective*

**Abstrak :** Masalah utang publik secara keseluruhan telah lama menjadi perhatian utama pembuat kebijakan otoritas fiskal dan moneter. Banyak perhatian telah diberikan dalam beberapa tahun terakhir pada tingkat utang publik yang terkait dengan kesinambungan fiskal dan krisis keuangan. Tujuan dari penelitian ini adalah untuk melihat dan menganalisis bagaimana peran dan pengaruh utang, baik eksternal maupun internal, terhadap situasi makroekonomi berbagai negara. Peneliti akan memaparkan beberapa kasus bukti empiris mengenai dampak utang terhadap sosial ekonomi suatu negara. Fokus utama pembahasan penelitian ini adalah pada kajian teoritis tentang utang dan dampak utang di berbagai negara di kawasan serta pandangan para pemikir Islam terhadap utang publik. Metode yang digunakan dalam penelitian ini adalah studi kepustakaan dengan mengumpulkan, mengidentifikasi, dan menganalisis melalui artikel dan referensi terkait (*literatur review*) yang terkait dengan fokus penelitian. Selanjutnya peneliti akan mengkaji beberapa kasus potret berbagai bukti empiris mengenai utang sosial ekonomi negara. Hasil penelitian menunjukkan bahwa efektivitas pemungutan pajak, sedekah, dan sumber pendapatan wajib dan sukarela lainnya, serta pendapatan dari proyek-proyek negara, properti, dan sumber daya alam, akan membuat negara Islam berdiri secara keseluruhan. Oleh karena itu, negara akan menerapkan prinsip tengah (*at tawasuth* yaitu mengupayakan anggaran berimbang, dan menghindari pengeluaran yang tidak produktif.

**Kata Kunci:** Utang Publik, ruang fiskal, gagal membayar, perspektif Islam

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### A. Introduction

Fiscal and monetary authorities' policymakers have long been very concerned about the problem of overall state debt. The amount of public debt concerning fiscal viability and the financial crisis has garnered a lot of attention in recent years. Despite the relatively low debt-to-GDP ratio, recent research has shown that several emerging markets have seen significant devaluations.<sup>1</sup> The rationale for public debt can be enhanced if, on the other hand, debt promotes economic growth or, at the very least, does not act as a barrier to capital formation and, consequently, growth, and policymakers

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<sup>1</sup> Jaejoong Woo and Manmohan S. Kumar, "Public Debt and Growth," *Economica* 82, no. 328 (2015): 705–739.

should pay close attention to the potential impacts of public debt. However, the general macroeconomic policy must control debt and work closely with fiscal policy.<sup>2</sup>

It is also hotly contested whether public debt and economic growth are related. Economists disagree on whether using debt to finance government spending is beneficial, bad, or neutral in terms of its actual impacts, especially on investment and growth. Regarding the connection between debt and economic growth, developing nations tend to benefit from growth in capital accumulation and productivity when their debt levels are reasonable.<sup>3</sup> There are significant worries about the economic effects of the recent global financial crisis because it has caused an unprecedented rise in public debt globally. Slower ensuing growth was found to be significantly correlated with high starting public debt. The disparities between developed and emerging market economies are examined, along with non-linearity and debt in different currency denominations. The negative impacts are generally a reflection of a slowing increase in worker productivity, which is mostly caused by a slower rate of capital accumulation. The findings are confirmed by extensive endurance checks.<sup>4</sup>

According to data from the Central Intelligence Agency, 179 nations around the world have public debt (C.I.A.). With a debt-to-GDP ratio of more than 200%, Japan has the highest level of debt compared to other nations. The United States, Spain, France, Italy, and other developed nations are among those on the list. This data demonstrates that practically all countries, including underdeveloped, developing, and industrialized countries, have a problem with public debt and policy. Developing countries, which include all Islamic countries, aspire to achieve rapid economic growth and accelerated development because production and consumption levels in them are very low, and overall welfare is still far below contemporary standards. However, domestic resources in many of these countries in the form of investable funds and foreign exchange earnings are insufficient to fully finance these aspirations.<sup>5</sup>

As a result, they have to use foreign loans continuously in greater amounts, not only to finance their growth and development programs but also sometimes even to support their basic needs. Thus, the foreign debt stockpile of Islamic countries, and developing countries as a whole, quickly accumulated to a substantial amount, and serious difficulties began to arise even in servicing such a large amount, not only to finance their growth and development programs but also sometimes even to support their basic needs.<sup>6</sup> Thus, the foreign debt stockpile of Islamic countries, and developing countries as a whole, quickly accumulated to a substantial amount, and serious difficulties began to arise even in servicing such a large amount. The national debt can help developing

<sup>2</sup> Bram Gootjes and Jakob de Haan, "Procyclicality of Fiscal Policy in European Union Countries," *Journal of International Money and Finance*, no. XXXX (2020): 102276, <https://doi.org/10.1016/j.jimonfin.2020.102276>.

<sup>3</sup> Muhammad Ghafur Wibowo, "Public Debt and Economic Growth in The SouthEast Asian Countries," *Signifikan: Jurnal Ilmu Ekonomi* 6, no. 1 (2017): 177–188.

<sup>4</sup> Andros Kourtellos, Thanasis Stengos, and Chih Ming Tan, "The Effect of Public Debt on Growth in Multiple Regimes," *Journal of Macroeconomics* 38, no. PA (2013): 35–43, <http://dx.doi.org/10.1016/j.jmacro.2013.08.023>.

<sup>5</sup> Balázs Égert, "Public Debt, Economic Growth, and Nonlinear Effects: Myth or Reality?" *Journal of Macroeconomics* 43, no. November (2015): 226–238, <http://dx.doi.org/10.1016/j.jmacro.2014.11.006>.

<sup>6</sup> José Augusto Lopes Da Veiga, Alexandra Ferreira-Lopes, and Tiago Neves Sequeira, "Public Debt, Economic Growth and Inflation in African Economies," *South African Journal of Economics* 84, no. 2 (2016): 294–322.

countries. When tax collection capability is constrained, or the alternative would be to print money and threaten macroeconomic stability, this enables their governments to promote growth takeoff by investing in a significant number of infrastructure projects and the social sector.<sup>7</sup>

Furthermore, debt enables long-term initiatives to align costs and benefits fairly by shifting taxation from the current generation to future ones, which is vital for lowering production volatility. In the case of developing countries, defaults are more common, and therefore more empirical work has been done to identify the determinants of a government debt default.<sup>8</sup> This study's goal is to investigate how debt, both domestic and external, affect the macroeconomic status of various Islamic countries. In some cases, various empirical pieces of evidence regarding the impact of debt on a country's socioeconomic status will be presented. The focus of the discussion, first, is on the theoretical study of public debt; second, looking at the portrait of public debt and security in Islamic countries represented by various regions; third, the government's debt limit and fiscal space; and fourth; the impact of debt in various regional countries as well as the views of Islamic thinkers regarding public debt.<sup>9</sup>

Because of the global financial and economic crisis, affluent countries' sovereign debts have sharply increased, raising major questions about their ability to maintain their financial health and the effects this will have on the larger economy and financial markets. How much heavy public debt is likely to hinder capital accumulation, productivity, and slow economic growth, is a crucial problem. This can happen in several ways, such as increased long-term interest rates, potentially increased future distortionary taxation, increased inflation, increased unpredictability, and crisis susceptibility. Fiscal sustainability concerns are expected to worsen if economic growth is badly impacted, which raises the premium for swift fiscal adjustment measures to bring debt levels down to more manageable levels.<sup>10</sup>

Empirically, when comparing debt to G.D.P., the inclusion of automatic stabilizers or other factors that reduce growth can amplify the negative association between debt and growth, the use of the discretionary countercyclical fiscal policy. As an alternative, a third factor that influences both debt and growth could be to blame for the observed association between the two. For instance, a banking crisis might simultaneously slow down growth and result in a dramatic increase in debt. To prove that debt and growth are causally related, an instrumental variable that has a direct impact on debt but no direct (or indirect, other than through debt) impact on economic growth must be found.<sup>11</sup>

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<sup>7</sup> Cristiano Cantore and Lukas B. Freund, "Workers, Capitalists, and the Government: Fiscal Policy and Income (Re)Distribution," *Journal of Monetary Economics* 119, no. July 2019 (2021): 58–74.

<sup>8</sup> Martin et al., "Public Debt and Fiscal Vulnerability in the Middle East," *I.M.F. Working Papers* 07, no. 12 (2007): 1.

<sup>9</sup> Kielbasa Megersa and Danny Cassimon, "Public Debt, Economic Growth, and Public Sector Management in Developing Countries: Is There a Link?," *Public Administration and Development* 35, no. 5 (2015): 329–346.

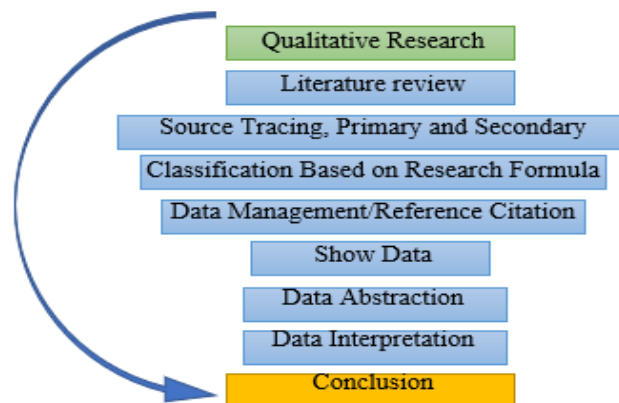
<sup>10</sup> Marica Frangakis, "Public Debt Crisis, Austerity and Deflation: The Case of Greece," *Review of Keynesian Economics* 3, no. 3 (2015): 295–313.

<sup>11</sup> Wellington Garikai Bonga, Frank Chirowa, and Joseph Nyamapfeni, "Growth-Debt Nexus: An Examination of Public Debt Levels and Debt Crisis in Zimbabwe," *I.O.S.R. Journal of Economics and Finance* 6, no. 2 (2015): 9–14.

## B. Research Methods

With the use of content analysis tools and library research, the author of this study employs a descriptive qualitative approach to comprehend the numerous concepts discovered during the research process.<sup>12</sup> Data collection techniques use secondary data originating from various scientific journals and scientific documents obtained using Publish or Perish, statistical data with the involvement of researchers as the main source by conducting analyzes carried out during data collection until the data is collected so that researchers can conclude well.

Figure 1. Qualitative Research Flow Literature Review



The figure above explains the editorial in the scenario of the type of qualitative research literature study. This research is qualitative and involves a literature review. Collecting primary and secondary library sources is a step in the research process. The research formula was used to classify the data in this study. In the advanced stage, data processing and/or reference citations are completed to exhibit them as study findings. Complete information is then abstracted, gathered, and processed to produce knowledge for concluding. When it comes to the interpretation stage, several methods or analyses are employed, such as exegetical, philosophical, theological, Sufistic, and other approaches.<sup>13</sup>

## C. Analysis and Discussion

The sum of all government loans made in the form of money or other assets is known as foreign debt. The goal of acquiring foreign debt in this situation is to transfer money from industrialized nations to underdeveloped nations to realize development and divide income. According to the material aspect, foreign loans represent capital transfers into the nation from abroad that can be converted into additional domestic capital. According to the formal aspect, foreign loans can be employed to boost investment and foster economic growth. While this is happening, foreign loans are one of the additional sources of funding required for development, depending on how they are used.

<sup>12</sup> David Crowther and Linne Marie Lauesen, "Qualitative Methods," *Handbook of Research Methods in Corporate Social Responsibility* (2017): 225–229.

<sup>13</sup> José Molina Azorín and Roslyn Cameron, "The Application of Mixed Methods in Organisational Research: A Literature Review," *Electronic Journal of Business Research Methods* 8, no. 2 (2010): 95–105.

Assistance in the form of projects and programs is provided through foreign debt or loans.<sup>14</sup>

Two important things that underlie the provision of foreign debt for donor countries to debtor countries are political motivation and economic motivation. These two things have a very close relationship with each other, this political motivation later became the main basis for the United States to provide financial Assistance in reconstructing the economy of Western Europe due to World War II, known as the Marshall Plan program. According to Basri (2005), the success of economic development that occurred in the Western European region through the Marshall Plan became the basis for the implementation of the provision of foreign aid to developing countries. This makes the Marshall Plan program used. Various regions of the world, including South Asia, are seeing economic development.

The second basis for granting foreign debt to debtor countries is economic motivation which is reflected in four important arguments, namely:

1. Foreign Exchange Constraints, this argument is based on a two-gap model in which countries are receiving foreign aid, especially developing countries, experience a shortage in accumulating domestic savings (domestic saving) so that the existing savings rate is unable to meet the needs of the level of investment needed to trigger the growth process. Economy. On the other hand, the shortcomings experienced by these countries are in meeting the needs of foreign exchange to finance the need for imports of capital goods and imports of intermediate goods. Foreign aid is the mainstay of choice in covering these two shortfalls.
2. Growth and the development process are said to be facilitated and accelerated by increased savings and foreign help. The increase in domestic savings to achieve a higher growth rate. Sufficient domestic resources to support an independent development process
3. Technical Assistance is a companion to financial support in the form of the transfer of highly qualified personnel to guarantee the utilization of grant funds efficiently to increase economic growth.
4. Absorptive Capacity, namely in what form the funds will be used. Apart from the factors that have been stated above, there is one thing that needs to be remembered the pull and push factors determine the capital moved to develop countries. These factors are a combination of political motives and economic motives, which are the main considerations for rational investors.<sup>15</sup>

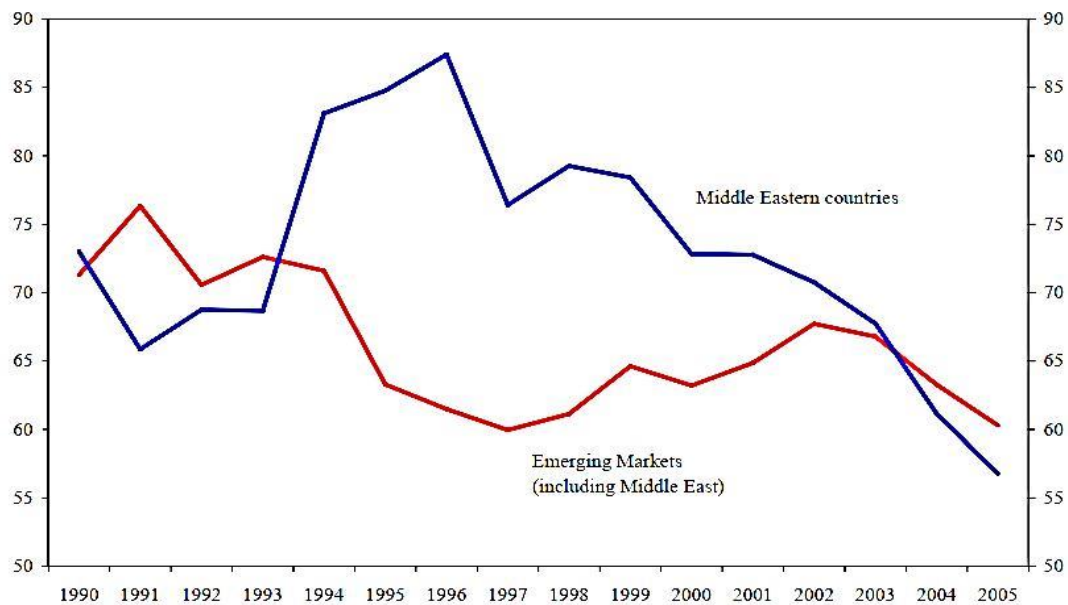
## 1. A Portrait of Middle Eastern Public Debt and Fiscal Vulnerability

The issue of fiscal sustainability and the financial crisis has become a global concern. The Middle East region has a high fiscal vulnerability, considering that income is highly dependent on oil production and price levels. The debt-to-GDP ratio is still very high and pro-cyclical.

<sup>14</sup> M.Zidny Nafi' Hasbi, "Portrait Of Economic Life In The Age Of The Prophet," *Al-Mutsala : Jurnal Ilmu-Ilmu Keislaman dan Kemasyarakatan* 3, no. 1 (2021): 1–8.

<sup>15</sup> Ipuk Widayanti, "Framing Information and Its Impact on Saving Decision in Conventional and Sharia Banks: Experimental Study of Students of the Faculty of Islamic Economics and Business in Yogyakarta," *Global Review of Islamic Economics and Business* 151, no. 1 (2015): 10–17.

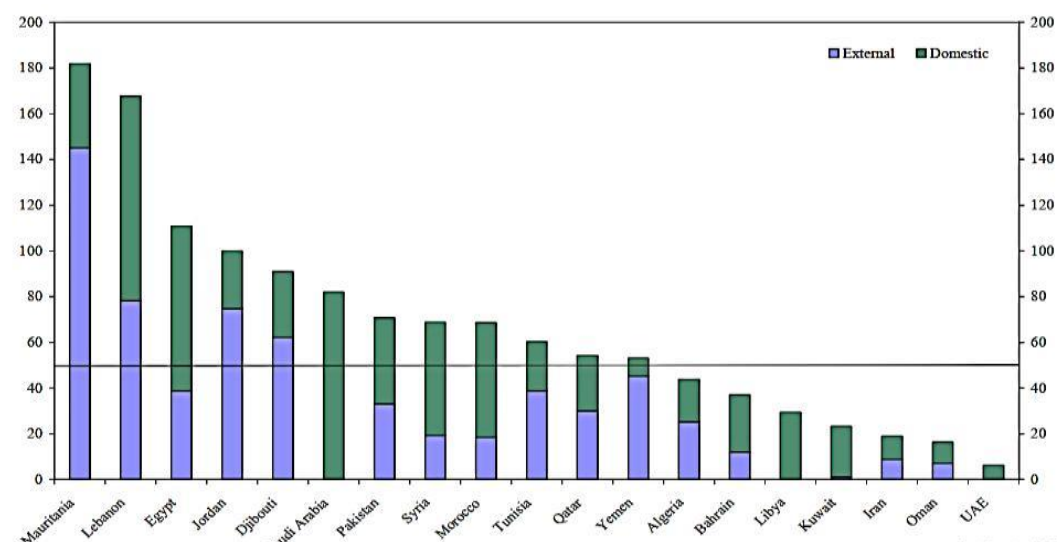
**Figure 2. Comparing The Middle East and Emerging Markets' Total Public Debt (Percent Of G.D.P.)**



Source: Manal Fouad

Debt levels in the Middle East are higher than the developing market average of 60 percent of G.D.P. in half of the nations. All non-oil producing nations are represented by more than two-thirds, which is above the 50% threshold. The Middle East's public debt ratios first rose, but they started to drop in the middle of the 1990s, and they have been declining ever since. Over the entire time frame, debt dropped from approximately 55 percent of G.D.P. to about 26 percent. 19 Middle Eastern nations are included in this study. They differ from one another despite sharing some commonalities. Based on differences in per capita income and degree of reliance on oil, the world has been divided into four subgroups: high-income oil producers (according to the Gulf Cooperation Council), which include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the U.A.E.; middle-income oil producers; and low-income oil producers.

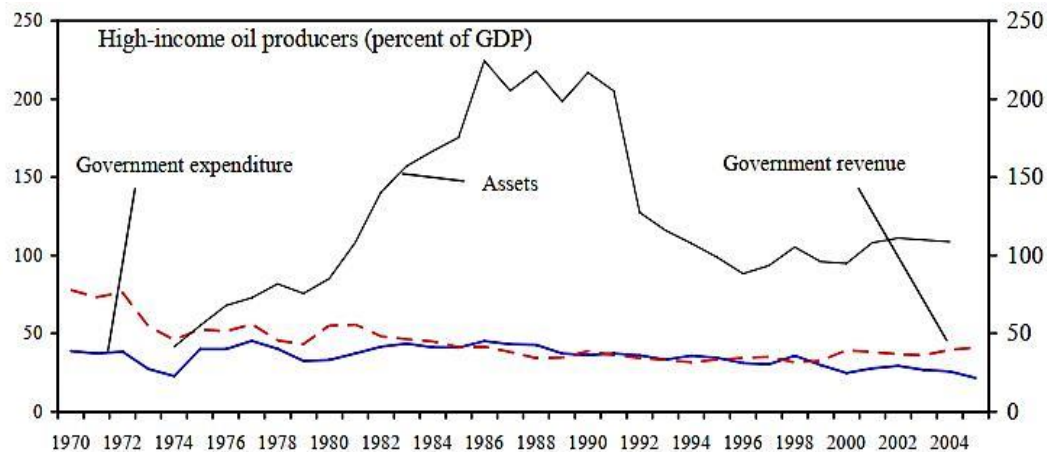
**Figure 3. Total Debt to G.D.P. in 2003**



Source: Manal Fouad

The emergence of debt, an increase in debt in the Middle East region, was caused by an increase in the allocation of government spending, but it was not followed by an increase in revenue, resulting in a fairly large budget deficit. The main factor that makes it difficult to increase state revenues is that the Middle East region is very dependent on oil. In general, the significance of traits in determining debt dynamics in the middle east region is influenced by: first; expenditure rigidity in the structure of expenditure; second; Uncertain and unstable income; third, Non-oil tax revenues are low and stagnant; and fourth, Dependence on Grants.<sup>16</sup>

**Figure 4. Income, Expenditures, Financial Assets, and External Debt**



Source: Manal Fouad

According to the idea, fiscal institutions that are not strong make it harder for fiscal policy to react to shocks. The centralized structure has led to significant budget fragmentation that is still present. Low level of political involvement and poor observance of tax legislation. Ineffective customs administration due to a lack of resources, knowledge, and Capacity. According to research, most of the debt reduction in countries that produce oil can be attributed to rising oil earnings. In high-income nations, the primary deficit expansion caused by non-oil and gas is significantly outweighed by the contribution from oil revenues across the sample. The primary non-oil and gas deficit and oil revenues accounted for most of the debt developments of oil-producing nations in the middle-income country group.

In contrast, debt in non-oil producing nations fell somewhat in 2004–2005. Debt reduction is strongly influenced by economic development, yet actual costs depreciate quickly, and interest rates are high. Benefit from strong economic development and low-interest rates to achieve significant debt reductions in low-income countries. In Pakistan's example, rapid economic expansion, significant gains in remittances and exports, and low real domestic and foreign interest rates have all helped to cause a significant drop in governmental debt. Debt reduction is strongly influenced by economic development, although interest rates are high and actual costs depreciate quickly.<sup>17</sup>

<sup>16</sup> Anderson Caputo Silva and Catiana Garcia-Kilroy, "Reforming Government Debt Markets in MENA," no. January (2010).

<sup>17</sup> Abbas Mirakhor and Nouredine Krichene, "The Recent Crisis: Lessons for Islamic Finance," *Journal of Islamic Economics, Banking and Finance* 5, no. 1 (2009): 9–58, [http://ibtra.com/pdf/journal/v5\\_n1\\_article1.pdf](http://ibtra.com/pdf/journal/v5_n1_article1.pdf).

Benefit from strong economic development and low-interest rates to achieve significant debt reductions in low-income countries. In Pakistan's example, rapid economic expansion, significant gains in remittances and exports, and low real domestic and foreign interest rates have all helped to cause a significant drop in governmental debt. Debt reduction is strongly influenced by economic development, yet actual costs depreciate quickly, and interest rates are high. Benefit from strong economic development and low-interest rates to achieve significant debt reductions in low-income countries. In Pakistan's example, rapid economic growth, significant increases in remittances and exports, and low real domestic and foreign interest rates have all helped to cause a substantial reduction in the nation's public debt.<sup>18</sup>

The findings demonstrate that fiscal policy sustainability generally responds substantially to changes in debt levels for non-oil countries, ensuring sustainability in this group. The Public Debt Coefficient's positive and statistically significant value in all criteria guarantees long-term solvency, which is required for sustainability, as previously stated. The primary balance rises between 0.5 and 0.8 percent of G.D.P. for every percentage point increase in G.D.P. in public debt, according to the debt lag coefficient in the response estimates. These numbers also seem to support the idea that the average debt-to-income ratio does not reverse course over an extended period.<sup>19</sup>

The main way the state responds is to change the income. Spending responded in the right direction, but the impact was not statistically significant. In both the income and spending equations, the output gap coefficient is small and inconsequential; hence it has been eliminated from the published specification. There is not always a direct link between output and income disparity. The analysis cannot vouch for the compatibility of fiscal policy with the P.O.I.M. in oil-producing nations. The sign of the coefficient for the present value of oil revenues is negligible and modest.<sup>20</sup>

The optimal distribution of government wealth may not match the simple P.O.I.M. model's prediction, and the government's willingness to invest in permanent income may be constrained by uncertainty about future oil prices and production. These are just two examples of possible violations of some of the model's key assumptions. It might also imply that governments do not generally implement policies that distribute wealth equally between generations but rather respond to market forces like oil prices and debt growth. The non-oil and gas primary balance and net debt have a close relationship, demonstrating the

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<sup>18</sup> M. Zidny Nafi' Hasbi, "Dampak Krisis Keuangan Global Terhadap Perbankan Di Indonesia," *LISAN AL-HAL: Jurnal Pengembangan Pemikiran dan Kebudayaan* 13, no. 2 (2019): 385–400.

<sup>19</sup> Vanesa Hana Budiarani et al., "The Kano Model: How the Pandemic Influences Customer Satisfaction With Digital Wallet Services in Indonesia," *Journal of Indonesian Economy and Business* 36, no. 1 (2021): 62–82.

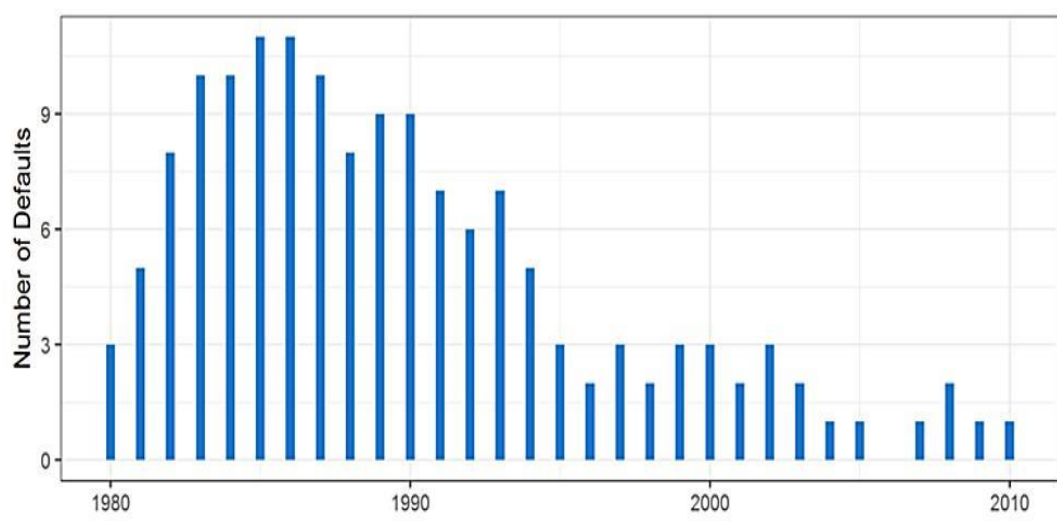
<sup>20</sup> Mohammad Nejatullah Siddiqi, "Islamic Banking and Finance in Theory and Practice: A Survey of State of the Art," *Islamic Economic Studies* 13, no. 2 (2006): 1–48, [http://79.132.221.61/files/takmili/islamic\\_econ/islamic\\_banking/vol\\_13\\_2..m\\_n\\_siddiqi..\\_isl\\_banking\\_and\\_finance...pdf](http://79.132.221.61/files/takmili/islamic_econ/islamic_banking/vol_13_2..m_n_siddiqi.._isl_banking_and_finance...pdf).

sustainability of the policy. It is sufficient for sustainability that the net debt coefficient is positive and sufficiently different from zero.<sup>21</sup>

## 2. Reflecting on Debt Limits and Government Fiscal Space

The increase in public debt experienced by various countries in the region has become a very serious concern, especially after the global crisis. Several recent studies have shown that there has been a consistent increase in the amount of government debt. In some cases in developing countries, there is default or at least overshadowed by default. Data shows that default on government debt can be caused by external or external debt. Data shows that many debt defaults occurred before 1990, then the number continues to decline every year. However, in the years after 2005, default cases in middle-income countries tended to increase.

**Figure 5. Default Crisis in Middle-Income Countries**



Source: Jean-Marc Fournier and Manuel Béтин

According to the study's findings, the debt load is the primary variable that significantly influences default. Economic expansion is a driving factor for changes in debt to G.D.P. Higher real growth will reduce the risk of default. This finding agrees with most of the literature and shows a strong relationship between default and business cycle conditions. This is in line with Vennot's, which states that default conditions mostly occur during the economic crisis.

Higher interest payments tend to increase the probability of default. The burden of interest payments referred to here is the payment of government debt to the ratio of exports, especially interest payments in foreign currency. Interest payments include domestic money and foreign debt to ensure consistency with default and debt data. The economy's dependence on oil and mining exports increases the probability of default, as does the number of defaults in various countries in the region and the size of growth shocks. Regarding the effects of dependence on commodity exports, there is evidence of dependence on oil and mining exports. Alternative tests not reported here revealed no significant effect on the export dependence of agricultural products. The effect of government effectiveness on the probability of default has a negative relationship and is similar in magnitude to that

<sup>21</sup> Cantore, C., & Freund, L. B. (2021). Workers, capitalists, and the government: fiscal policy and income (re) distribution. *Journal of monetary economics*, 119, 58-74.

found with time-varying indicators and a wider sample of countries. This may be because greater government effectiveness could improve long-term growth prospects. Dependence on liabilities such as equity and Capacity to raise taxes.<sup>22</sup>

The debt limit is defined as the boundary between multiple balances and high-risk single premium cases. In practice, countries that are closer to the possibility of default will choose whether to allow the possibility of default to occur or will take a rescue option by choosing to seek support from external parties, such as asking the I.M.F. for Assistance to provide access to loans with softer interest rates.

The value of a country's debt limit is the contribution of the average value of the export ratio, which contributes 8.71% on average, while the effectiveness of the government contributes 4.14%. The G.D.P. vitality factor contributed 3.32%, while exports of oil and mining to G.D.P. were 1.75%, economic growth was 1.68%, and the number of defaults in the region was 0.12%.

**Table 1. Average Absolute Value of Debt Limit Contribution**

Variables	Average
Export ratio	8.71
Government effectiveness	4.14
GDP volatility	3.32
Oil and mining exports to GDP	1.75
GDP growth	1.68
Number of defaults in the region	0.12

Sumber: Jean-Marc Fournier and Manuel Béтин

Isabel Ortiz et al. (2017) offer that realizing human rights and investing in women and children are two of the eight possibilities that must be investigated to increase budgetary flexibility and produce resources for Sustainable Development Goals (S.D.G.s). More than 60 nations have successfully renegotiated their debt, while more than 20 debt defaulters, including Ecuador, Iceland, and Iraq, are using the money they save from debt repayment to fund social programs. During the global recession, a significant number of developing nations employed deficit spending and a more flexible macroeconomic framework to satisfy urgent needs in periods of low growth and to encourage socioeconomic recovery. Given the significance of public investment in social protection, employment, and human rights, the government must investigate all options for increasing fiscal space to support national socioeconomic development and the S.D.G.s.

### 3. The Impact of Debt in Various Countries in the Region

From an economic and political perspective, the growth of the social sector is a significant area of importance. Our findings indicate that it is adversely impacted by external debt obligations. Policy managers need to make sure that the cost of debt servicing is shared fairly among the various economic sectors to lessen this effect. To achieve this, unnecessary present (non-development) spending, particularly in the area of public administration, needs to be drastically reduced. Following the nation's

<sup>22</sup> Anton Bawono, "Studi Empiris Atas Absolute Income Hypothesis Dan Permanent Income Hypothesis Dalam Perspektif Islam," *Inference* 7, no. 1 (2013): 51.

national security considerations, defense spending may also be lowered to a certain amount. Managers of debt-country policies could bargain with donor organizations to reduce interest rates and to ease regulations governing loan objectives, duration, negotiating expenses, and pledges to a moratorium. These actions will alleviate debt obligations to some extent.<sup>23</sup>

Given that repayment commitments absorb many of the limited resources raised through revenue, dependence on domestic borrowing, in particular circular debt, should be reduced. To the extent necessary to cover current expenses with the smallest possible margin, tax collections should be increased. This has to do with how effectively taxes are collected. For productive objectives and development projects, foreign loans must be strategically and effectively allocated. There should be restrictions on how these resources are distributed and measures for promoting foreign direct investment to promote infrastructure development. The impact of democratization on social spending is proof that sociopolitical pressures play a part in economic growth.

Finally, emerging nations must mobilize their resources and eventually lessen their reliance on foreign aid. This will aid in the conservation of finite resources (foreign exchange profits from exports and remittances), which may then be directed toward long-term development objectives, capital formation, and greater productivity, allowing the economy to progress toward sustainable growth. Contribute to an increase in the cost of debt, endangering the viability of fiscal policy by increasing the public debt and failing to allocate resources for the country. As a result, the budget deficit also makes it more difficult for the economy to grow sustainably.

The study discovers that nations with high levels of corruption control can reduce the detrimental effects of public debt and budget deficits on long-term economic growth. This is done by considering the interactive variable between controlling corruption and public debt or budget deficits. In other words, a country with a high degree of corruption control will see higher sustainable economic development than a country with a poor level of corruption control while having a higher public debt or budget deficit. The ability to enhance investment, lower inflation, boost national productivity, and promote economic growth will be made possible by low levels of corruption. A comfortable business climate results from effective corruption control since it creates chances for increased competition and innovation. Furthermore, effective anti-corruption measures lessen the burden.<sup>24</sup>

#### 4. Islamic View of Public Debt

A Muslim's entire life is governed by the faith of Islam, starting with worshiping Allah S.W.T. to establishing good relationships with other people and even with other animals. The only religion that governs debt management and

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<sup>23</sup> Jean-Marc Fournier and Falilou Fall, "Limits to Government Debt Sustainability in O.E.C.D. Countries," *Economic Modelling* 66 (2017): 30–41.

<sup>24</sup> Vo Thi Thuy Van et al., "The Relationship Between Public Debt, Budget Deficit, and Sustainable Economic Development in Developing Countries: The Role of Corruption Control," *Jurnal Ekonomi & Studi Pembangunan* 21, no. 1 (2020).

stipulates standards is Islam. As stated in Surah Al Baqarah 282-283 of the Qur'an, taking out loans and lending money hold a significant role in Islam.<sup>25</sup>

Instructions on how to execute debts and receivables are given in these two verses. The debt must be expressed in writing, signed by the debtor and the two reliable witnesses, and the debtor. Document evidence demonstrates that the borrower did accept the lender's loan offer. The paper includes some information, including the total amount of the supplied debt, the payment term, the method of repayment (cash or credit), and the number of installments. Required the start and end dates of the debt and the procedure for repaying the debt. For instance, by sending money to a bank account or getting cash). The two scriptures above also indicate that Islam permits debtors to take.<sup>26</sup>

For lenders as well as borrowers, these two passages stress moral principles in handling debt. Regarding debt, Islam is incredibly rigid. Prioritizing and correctly finishing debt payments are essential. Regarding using external loans to fund economic development, there are two points of view. According to the first perspective, Islamic law and teachings do not preclude the incurring of foreign debt if it does not contradict them. This means that funding is included in the framework of Islamic economic operations like Musyarakah, Murabahah, and Mudhorobah. The second perspective, though, is in opposition to using overseas lenders. Due to their dependence on the usury practice, loans are seen as a preventative measure as it is thought they would burden the government (loans with interest). 99% of lenders or.<sup>27</sup>

Umar Chapra and Munzer Kahfi, two Islamic economists, are vehemently opposed to Keynes' thesis. According to Chapra (1992), significant state spending can result in the misuse of state funds and poor management of the federal budgeting process. According to Munzer Kahf (1999), any nation must have enough resources and money to finance government expenditure; in other words, government spending is only possible with adequate funding. As a result, no government expenditures are greater than the anticipated state revenue.<sup>28</sup>

Different solutions are offered for Mannan's budget deficit notion. Muslim nations must raise taxes to pay for their deficits; specifically, their taxation structure must be changed, and state expenditure plans must be updated. They must not take the easy route by expanding their money supply or taking out loans. Because borrowing will result in usury, Chapra is more in favor of tax increases. Additionally, borrowing makes investment unnecessary. Long-term financial issues are burdened on future generations, while short-term ones are suspended. By limiting state spending, increasing revenue from government-owned businesses, and raising taxes, the deficit was closed. As a result of the growth in obligations and the rise in the number of subsidized positions, the state budget has currently grown

<sup>25</sup> Md. Akther Uddin and Asyraf Halim, "Islamic Monetary Policy: Is There an Alternative of Interest Rate?," *Munich Personal RePEc Archive*, no. 67697 (2015): 1–26, <https://mpra.ub.uni-muenchen.de/67697/>.

<sup>26</sup> Fournier and Fall, "Limits to Government Debt Sustainability in O.E.C.D. Countries."

<sup>27</sup> Munich Personal and Repec Archive, "Munich Personal RePEc Archive The Determinants of Banking Crises : Further Evidence," no. 70093 (2016).

<sup>28</sup> M. Umer Chapra, "Islam and the International Debt Problem," *Journal of Islamic Studies* 3, no. 2 (1992): 214–232.

heavy and bulky. Revenue from traditional Islamic sources like Z.I.S.W.A.F., Ghanimah, and Fay's.<sup>29</sup>

#### D. Conclusions

An Islamic state will be distinguished by how well it can raise money from taxes, alms, and other required and optional sources of income, as well as from state-run businesses, real estate, and natural resources. As a result, the state will implement the work toward a balanced budget and avoid wasting money are the middle principles at Tawasuth. In the event of a war or natural calamity that causes a national emergency or crisis, the government needs money; it can borrow money by increasing tax collection or printing money with the warning that it will expire once the emergency has passed. The more the government's foreign debt increases, the more burdensome the position of the Indonesian state budget is because the foreign debt must be paid along with the flowers. Ironically, during the economic crisis, the foreign debt must be paid using foreign aid, which means the same only with new debt because during the economic crisis, routine receipts government, especially from the tax sector, cannot be increased in proportion to budget needs. Our finding is that there is no evidence. Because policies that presume debt has a negative causal impact on economic growth are frequently supported by the negative correlation between debt and growth, it is important to consider whether the public debt has a causal impact on economic development.

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<sup>29</sup> Sayyid Tahir, "Islamic Perspectives on Economic Development," *The Pakistan Development Review* 34, no. 4II (1995): 845–856.

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