

## Sukuk and economic development (Prospects and Challenges)

### Refer to the experience of Malaysia

(الصكوك والتنمية الاقتصادية (الآفاق والتحديات

الرجوع إلى تجربة ماليزيا

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#### Abstract:

This study is designed to identify the Islamic financial sukuk as one of the Islamic financial instruments for mobilizing saving and for the use of investment instruments to contribute to the financing for economic and social development process. The financial sukuk is known as financing instruments used in Islamic financial instruments according to the regulations of Islamic law (chari'a), and vary the versions of the diversity and versatility of the exporting as well as nature. Despite the increasing trend toward these instruments according to the Islamic finance act of 2018 and following the successful experience of Malaysia, but this deal funding instruments still sees many challenges.

**Keywords:** Sukuk, economic development, social development, types of Sukuk, the challenges of Sukuk , Malaysian Experience

**JEL Classification:** O11, O12, O16

#### Résumé :

Cette étude vise à identifier le sukuk financiers islamiques comme l'un des instruments financiers islamiques destinés à mobiliser l'épargne à utiliser les outils d'investissement pour contribuer au financement du processus de développement économique et social. les sukuk financiers sont défini comme étant des outils de financement utilisés dans les établissements financiers islamiques selon les règlements de la loi islamique (chari'a). ses formes sont variées selon leurs utilisations. Leurs émetteurs et leurs natures.

Malgré la tendance croissante vers l'utilisation de ces outils conformément au rapport financier de l'année 2018 et à la suite de l'expérience réussie du Malaisie, leur utilisation est confrontée à plusieurs défis.

#### Mots clés :

sukuk financiers islamiques, développement économique, développement social, types de sukuk, les défis sukuk financiers islamiques, Expérience malaisienne

**JEL Classification:** O11, O12, O16

**ملخص:** تهدف هذه الدراسة إلى التعرف على الصكوك المالية الإسلامية كأحد الأدوات المالية الموجهة لتعبئة المدخرات لصالح استعمالها كأدوات استثمارية تساهم في تمويل عملية التنمية الاقتصادية والاجتماعية. تعرف الصكوك المالية على أنها أدوات تمويل تستخدم في المؤسسات المالية الإسلامية وفق ضوابط وأحكام الشريعة الإسلامية، وتتنوع صيغها بتنوع استعمالها، الجهة المصدرة لها وكذا طبيعتها.

بالرغم من زيادة التوجه نحو هذه الأدوات وذلك وفقا لتقرير المالية الإسلامية 2018 و ما أسفرت عنه التجربة المالية الرائدة، إلا أن التعامل بهذه الأدوات التمويلية لا زال يشهد العديد من التحديات.

**الكلمات المفتاحية:** الصكوك المالية الإسلامية، التنمية الاقتصادية، التنمية الاجتماعية، أنواع الصكوك، تحديات الصكوك المالية الإسلامية، التجربة المالية

تصنيفات JEL : O11، O12، O16.

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## **1. Introduction:**

Islamic finance process has contributed in developing Islamic finance products which meets customers' needs .where development and invention become an absolutely imperative in this sector to face the increasing demand for Islamic financial products and tools that rule out dealing in sand taking a tender, in one hand, and maintaining its position on the financial and banking market in the other hand .

Islamic financial sukuk emerged as one of the formulas for financial investments, opening the way for popular participation to support the needs and requirement of economic development, where financial surpluses are collected in the form of sukuk directed to direct financing of various economic projects .

Based on that we ask the following problematic:

**how Islamic sukuk meet to achieve the economic development ?**

❖ **Study partcles:** to answer the problematic we divided this research to the following partcles:

**First:** generalities about Islamic sukuk.

**Second:** mechanisms for the operation of Islamic sukuk.

**Third:** application of Islamic sukuk and their importance.

**Fourth:** challenges of working with Islamic sukuk .

❖ **The research importance :** it is rooted through its exploration of one of the most widely used Islamic financial sukuk in the Islamic financial market, which has characteristics in term of innovation, diversity as well as economic efficiency and the level of acceptance resulting from legitimacy and credibility.

❖ **The research objectives :** this research aims to :

- Identify the meaning of the Islamic sukuk and such types.
- Importance of this kind of sukuk in achieving the economic development.
- Regulations and mechanisms for the operation of Islamic financial sukuk.
- The challenges that face this kind of finance.

❖ **The research methodology:** to complete the research elements, we have relied on the desk survey of various books and previous studies of this kind of sukuk and on various reports issued by official bodies to identify the development of Islamic sukuk at the financial and banking levels.

## **2. Generalities about Islamic sukuk:**

The Islamic finance researchers focused on the necessity of finding a substitute for the securities used for economic finance, as the latter works according to the Islamic Shari'a rules and principles. Investment sukuk (Islamic sukuk) has been used as an alternative to financing investment projects in accordance with the principles of Islamic law.

### **2.1. Islamic sukuk concept:**

A- **the language definition:** sukuk in language the plural of the word sak, means severe beating, which also means a book. It means what is written in the paper and toward it, and it is used to prove the right or the religion. A sak is a document of recognition of the property arrested, or a right document in the property, and so on )ali 2014(

B- **terminological: Islamic sukuk are known as:**

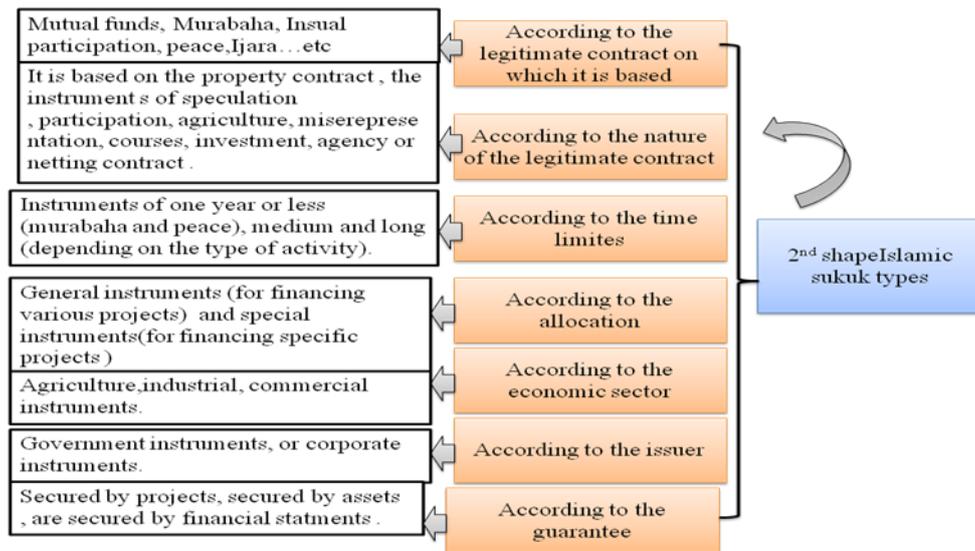
- ❖ Transfer a set of non-liquid assets to negotiable sukuk guaranteed by such assets and then sale them in financial markets, taking into account trading control )habib 2003(
- ❖ Investment sukuk based on the division of capital into equal shares , with view to issuing capital instrument on the basis of equal units registered with the owners' names )A. ali 2013(
- ❖ Equal-value documents represent common shares in the ownership of an entity, benefits, services, ownership of a particular project's assets or investment activity, after the collection of the value of the sukuk, the closing of the subscription and the commencement of its use, for which it was issued )A. ali 2013( .
- ❖ A document of financial value, using the word instead of bonds ,which is part of ownership and sale of specific assets that represents the sale of part of the project's assets, in contrast to bonds representing the relationship between creditor and debtor )a. ali 2014(

2.2. **The advantages of Islamic sukuk:** sukuk are characterized by a combination of features which are:



Source : prepared by the research based on study data.

2.3. **Islamic sukuk types:** instruments types various according to its own terms and areas of employment , so it can various according to it nature or the author of the book , and therefore , can distinguish between the following types:



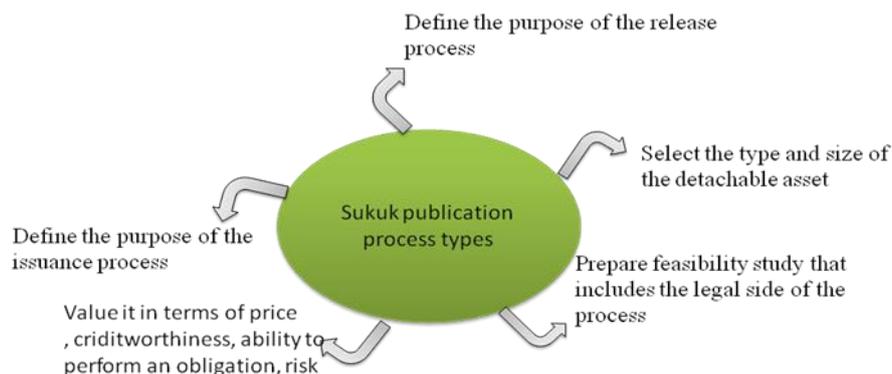
Source: prepared by the researcher based on: )dammagh 2012(75 ‘ )A. ali 2013(27 ‘

### 3. The mechanisms of Islamic sukuk work:

The mechanisms for the operation of the sukuk are based on their issuance and circulation in terms of technical procedures and legal regulations, starting with the subscription process and defining the relationship between the parties to the issuance contract, which is followed by the circulation of their latter.

❖ **Publication of sukuk:** the lunch phase of the sukuk is one of the first stages of the process dismantling, where the sukuk are made public for public or private subscription )dammagh 2012 ‘ (88 )A. ali 2013(107 ‘ the contracting process is followed by the issuance of the publication. The subscription to the sukuk by the public is positively reflected in the acceptance by the author or the dealer (organization of the islamic conference 4/8/88 N=5).

#### 3rd shape: Sukuk publication process types

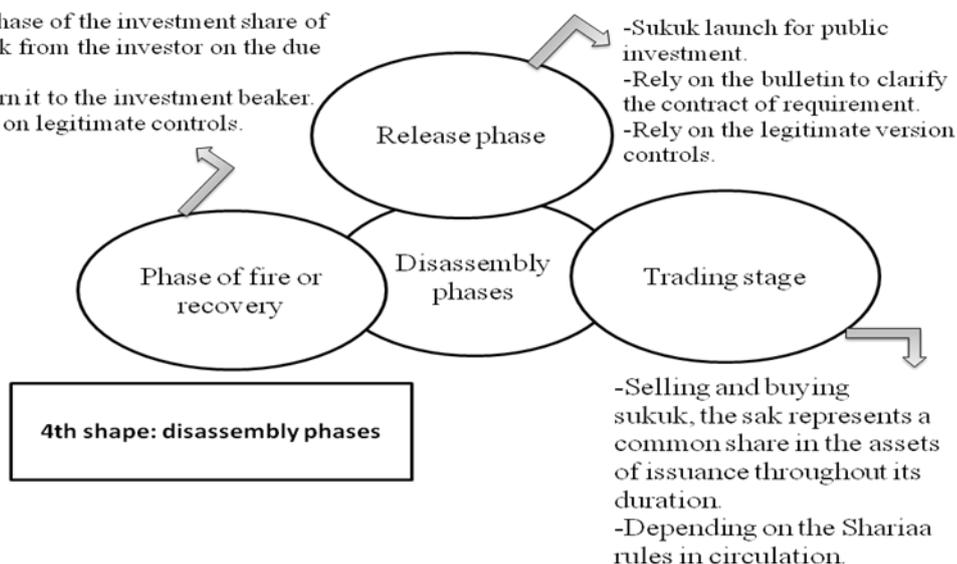


Source: the searcher preparation relying on the study elements.

Sukuk publication process relies on a set of organizational stages which are )dammagh 2012(90 ‘:

- define parties associated with the disassembly process (duties and rights of each party).
- determining release expenses to enable the identification of administrative and financial requirement for the operation.
- Identification of key process contracts (underwriting, contract of sale of assets in question, contract of asset management, contract of use and contract of guarantee).
- Determine the guarantee of the sukuk value, where this is one of the important factors for the success of the sukuk marketing and sale.

- Undertake to cover and manage the entire issuance process in accordance with requirement set out in the bulletin according to a schedule.
- Preparing the publication (subscription), which includes the terms of contract of adequate data on the participants and the conditions of their appointment and dismissal.
- implementation of the issuance process where the originator entrusts or sells the assets to the company(s.v.p) and the sale is therefore a genuine, final and transfer of all rights and obligations of the originator where they not liable to pay any right after the sale is made to the dismantling company.
- Reclassification and division of assets by the liquidator into units suitable for the target investor segments so that assets can be transferred to sukuk.
- ❖ **Trading stage:** it is a sak transfer from person to another by the direct sell or by an intermediary. Where it is done accordingly by transferring all the planned rights whether nominal value, the logistic or any value agreed according to the Shari'a terms. Trading operation is according to legitimate and represented settings.
- ❖ **Phase of fire or recovery:** the third phase of dismantling process is where investment quotas are sold and purchased in the sukuk in accordance with the Shariaa controls in the fire; there are two methods in the process.
- **The manner of extinguishing by extinction (liquidation):** where is the actual value of the money paid by the owner once to the sukuk holders on the due date.
- **The method of periodic assessment extinguishing:** payment is made periodically as these amounts are payments under the account and the amount of the extinguisher is downloaded from the nominal value of sukuk. The return is divided into two parts, the first for owners of sukuk such as the profits and the encumbrance against the fire. Generally ,the dismantling stages are as the following:



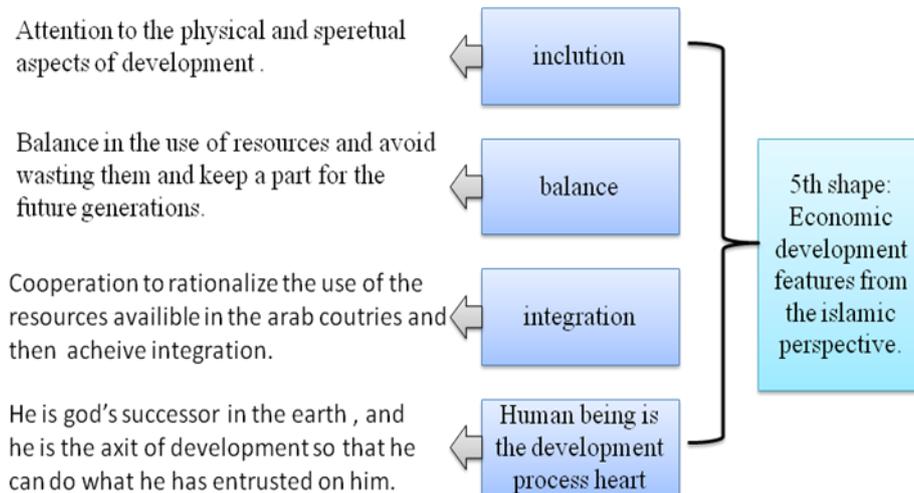
Source: )dammagh 2012(90-88 ◊ )A. ali 2013(124-107 ◊

#### **4. Islamic sukuk practices and their importance in achieving the economic development :**

The Islamic finance rely on Islamic financial instruments and formulas allow economic development and social development alike, as the Islamic Shari'a texts came to prompt muslims to preserve money by investing and developing it with the means and the ways, with sponsor the application of the Islamic shari'a principles, and avoiding all forms of monopoly ,acquisitions and reputations in transactions.

Islamic sukuk are one of created instruments within the Islamic financial system to achieve the economic development, so what is the relationship between the Islamic sukuk with the economic and the social development?

**4.1. economic development meaning from the Islamic perspective:**



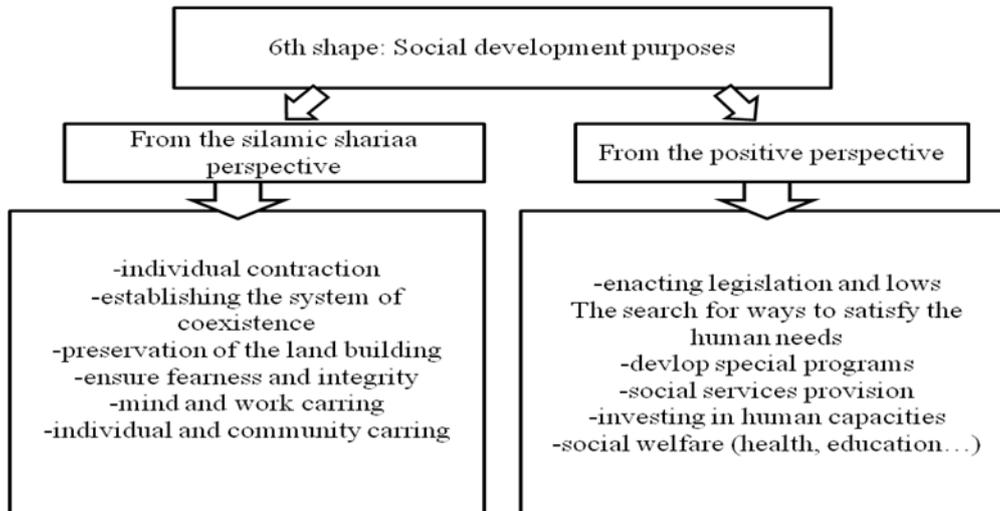
Source: the searcher preparation relying on the study elements.

**4.2. Social development meaning from the Islamic perspective :**

The realization of the necessary requirement of the five faculties of each member of society in the framework of Islamic low, and the five faculties are the basic necessities of religion, soul, birth, mind and money. The breach of any element inevitably leads to a breach of the security, stability and prosperity of the society.

The social development in Islam, aims to construct individual and please him what reflect on the community, it also seeks to preserve the system of coexistence and building the land and its ongoing rehabilitation of its successors, and doing what they have been entrusted about justice, integrity and rational, work, reform the land and draw conclusions and measures the benefits for all )Fassi 1979(41 ‘

In general, it is a social change to social construction and its foundations in order to satisfy the social needs of individuals. This definition shows that the goal of the social development is to provide social services that maximize the investment of human potentials in society. The deference between social development from traditional and Islamic perspective can be explained in the table billow )Laounia 2017(:



Source: the searcher preparation relying on the study elements.

#### **4.3. The relationship between economic and social development from the Islamic perspective :**

The Islamic economic system, since its appearance, focused on the hand of Khair Al Anam our master Mohamed, may Allah bless him and grant him salvation, on linking the different fields in life, especially between the economic and social fields. The relationship between development and social development in Islamic society has a special law, which relates to the principles of Islamic law, which are linked to faith and piety. The relationship of economic development to the social development in Islam stems comes from )Laounia 2017(:

- Belief in god and the need for achieving justice and equality.
- Principle basic of building an individual by strengthening his faith and guiding him to reform himself and to contribute in the building and promotion of his community.
- Believing in the importance of economic and social integration through the principles of brotherhood and social solidarity.
- The importance of cooperation to meet the needs of the individual and society and to achieve the interest in the world and the hereafter, obedience to God's command.
- Relaying on the participation principle in the provision of social services .
- Islamic Sharia'a adoption of the principle of Zakat and distribution it to its beneficiaries to guarantee the sufficiency of the poor social classes.
- Islamic law depends on building the individual so he can rationalize social policies and achieve economic development.
- The adoption of Islam on the principles of complimentary in the organization of rights and duties.

#### **4.4. The importance of Islamic sukuk in development events:**

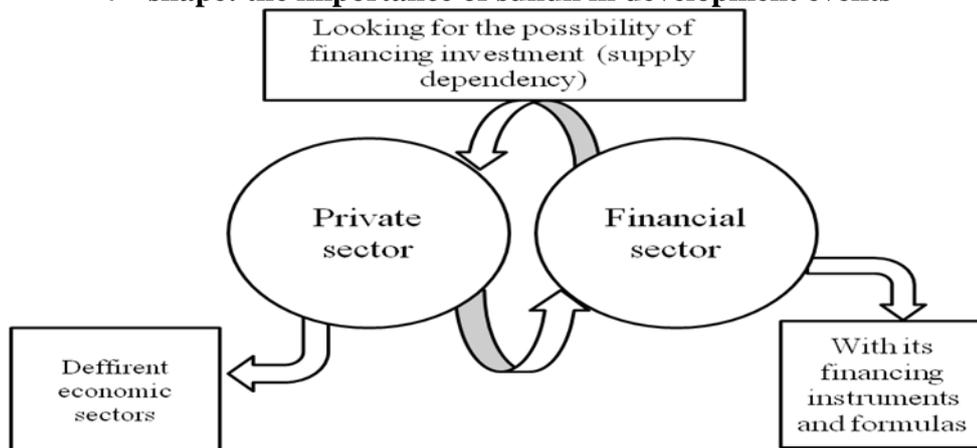
The importance of Islamic sukuk in development events (economic and social) emerge from the relationship which relates the financial sector with the private sector. To select this latter, there showed up a lot of opinions we mention )A. ali 2013(19-18 :

- ❖ (Mc- kinnon , Tobin, Shumpeter) explain that the proposed services from the financial sector are a result of mobilizing savings geared to stimulating economic growth, where the financial sector is an important key for the process.
- ❖ While (Lucu,Stockman,Sidruss) see that the financial growth of the private sector is dependent, given that the long-term capital stock is the result of several variables such as depreciation rate and capital growth rate. The change in capital accumulation is only the result of a change in technology production.

❖ While (Gupta, Gung, Patrick) see that there is a reciprocal relationship between the two sectors, where the trend of causation differs depending on the stage of economic growth. In the search for investment financing possibilities (supply leadership), the relationship goes from the financial sector, while the opposite occurs in advanced stage of development (demand dependency), the financial sector must be developed to meet the demand of the private sector. Thus, growth in the financial sector is a continuous process on the private sector.

❖ And also Patrick explains that development works to develop the credit market which is called demand dependency, and the credit market services command is a function in the real output progress.

### 7<sup>th</sup> shape: the importance of sukuk in development events

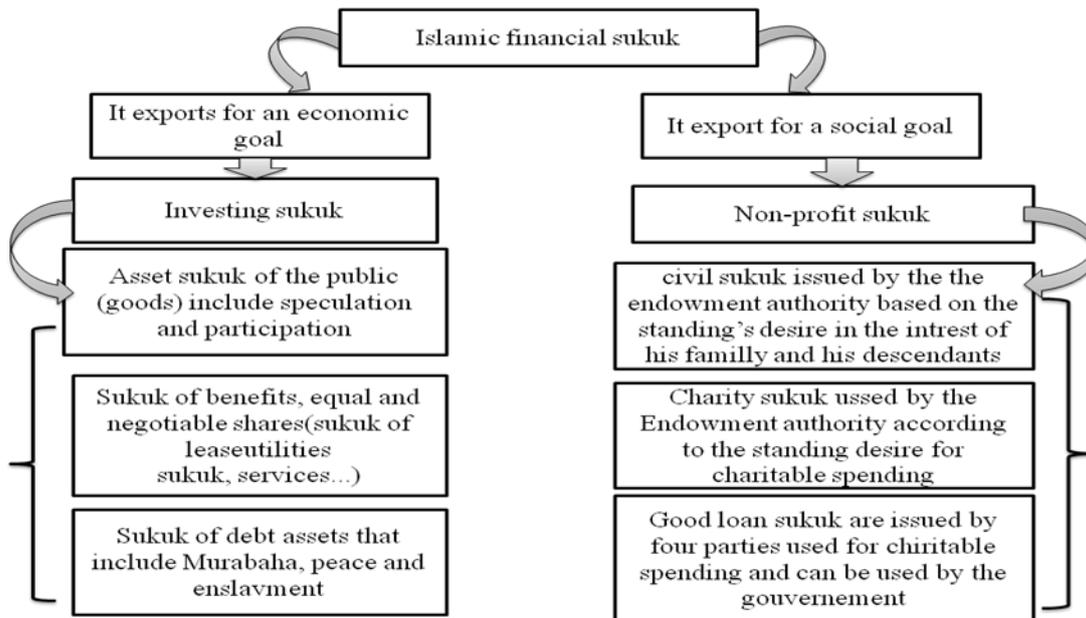


**Source:** prepared by the researcher based on the study elements

And about what is related with sukuk and its role in achieving economic development, it generally lurks in )dammagh 2012(69 ◊ )a. ali 2014(37 ◊ )A. ali 2013(205 ◊ :

- An important financial instrument in providing liquidity to the various economic sectors.
- Financial instrument that allow saving mobilization.
- Easy flow of funds for investments.
- Diversifying and developing investment financial instruments.
- The Islamic financial market base is expanded, as it represents the complementary party of shares and the second wing of the stock exchange through which the money moves freely and easily.
- Integration of Islamic economies with the rest of economies.
- Met the needs of the state is financing infrastructure and development projects rather than relying treasury bonds and public debt instruments.
- it contributes in the advancement of the Islamic economy in theory as it is complementary to the economic episodes besides the bank and the Islamic insurance companies and in practice it lifts the religious embarrassment from investors .

### 8<sup>th</sup> shape: importance of sukuk issuance according to the issuance goal.

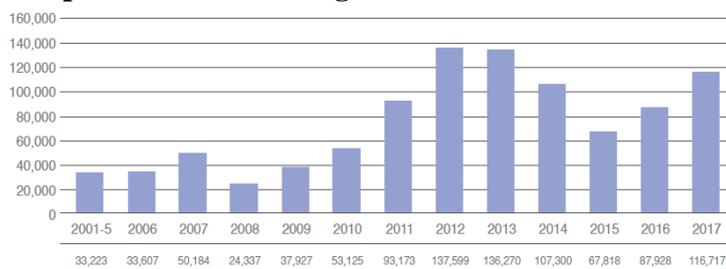


Source: the searcher preparation relying on the study elements.

#### 4.4. Evolution of the global sukuk market :

The development of the global sukuk market has grown significantly with the value or overall issues for the year 2017 reaching Us\$116.7billion against Us\$87.6billion in 2016, a growth rate of 32%in the volume of the issue. The rise is due to the growth of Saudi market investment of Us\$20 billion, compared to Us\$760044 million for the Malaysian market during the period 2001-2017. (IFSB 2018, 10).

9<sup>th</sup> shape: evolution of the global sukuk issuance 2001-2017

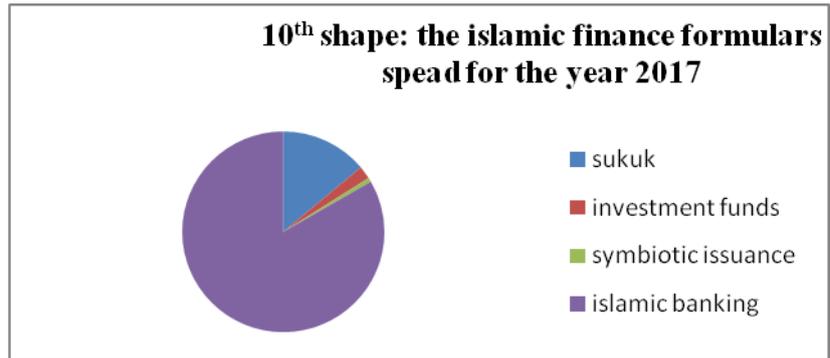


(IFSB 2018)

As for the issue of sukuk between the domestic market and the international market, the report of the world market or Islamic sukuk(WSE) of 2018 showed that the level of issuance was 78%compared with the world market by 22%. As the report showed, that the Islamic sukuk issued in the world market distribution according to the its type for 2017 and the sukuk agency appear as a features type of version reaching as a value 19255 million American dollar followed by the speculative / Murabaha sukuk with value of 9000 million American dollar, leasing sukuk with the value of 4650 million American dollar followed by leasin/Murabaha issuances with value of 3350 million American dolar.

#### 4.6. Prospects for dealing with the Islamic financial sukuk:

The Islamic finance is known with the Islamic funding formulas between financial funding instruments. Islamic funds, financial sukuk as well as co-financing. Finance cover by Islamic sukuk progress between 2016-2017 with percentage of 0,16% as it passed from 16,8% to 19,5% respectively.



**Source: prepared by the searcher relaying on (IFSB 2018, 10).**

The sukuk market development has been marked in recent years by the fact that it has become an instrument of investment finance for economic institutions, government, infrastructure projects, SMEs and even the Islamic banks, as it contributes to mobilizing financial resources to meet financing needs in accordance with Islamic law. The financing needs of projects vary according to the nature of the work and variety of purpose of the financing (dammagh 2012(237) which it can be selected in the following points:

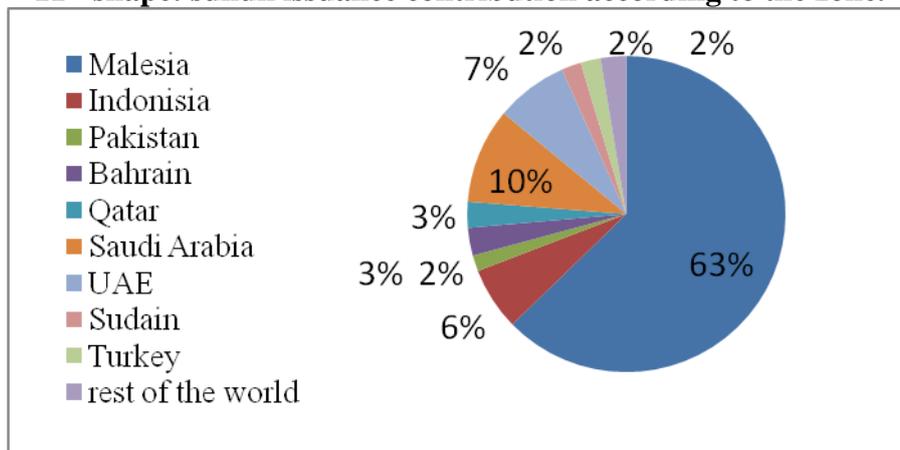
- Financing of the required operation liquidity.
- Financing of raw materials and necessary goods.
- Financing of the necessary tools and equipment.
- Financing of land and building as well as the necessary construction.

Thus, the process of issuing sukuk may vary depending on the different assets they represent, and may therefore be in the higher, benefits, money or debt, and thus may be classified according to their contribution to economic and social development.

Thus, it can issue sukuk to achieve the economic purpose in the form of investing sukuk as it can be issued as a social goal in the form of non-profit sukuk.

The sukuk importance and their financing role are in the issuance percentage progress in various states, where Malaysia took control of the total issuances with 63% as the biggest share, to contribute the rest of percentages to the rest of states with mixed ratios, where the Arabic Saudi came with 10%, and then UEA and Indonesia with percentages 7%, 6% respectively, while the issuance percentages where low in Qatar and Bahrain with 3%, Sudan and turkey and the rest world states with 2%. What is observed is the bond issuance progress at the global level as a whole.

**11<sup>th</sup> shape: sukuk issuance contribution according to the zone.**

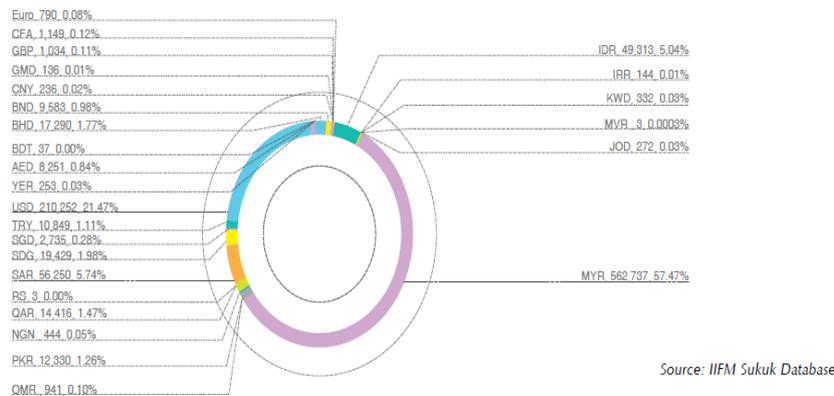


**Source: (IFSB 2018)**

And about sukuk issuance according to the currency, it has know joining 26 currency at the global level. The Malaysian currency (ringgit) dominate in issuance market with 45%, 47% followed by

the American dollar in the second place with 21,4%, without forgetting the currency dealing with it in the local market for the gulf states.

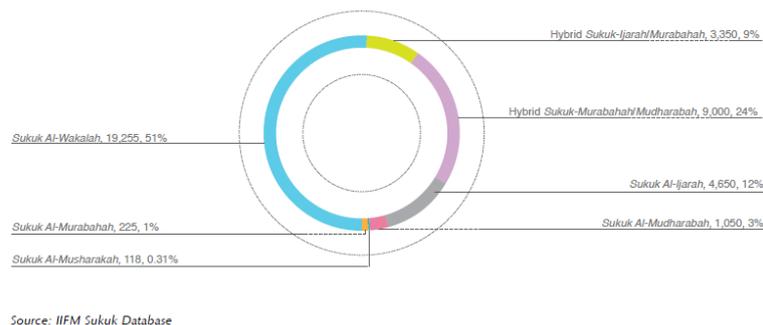
**12<sup>th</sup> shape: sukuk issuance volume according to the currency.**



Source: (Report 7th Edition , April 2018, P597)

It should be noted, that sukuk issuance touched deferent currency, so it incomes deferent sectors that find in this financing instruments the effectiveness and efficiency required, where issuance several of this latter according to its formulas diversity. In the extended period from January 2017 to December 2017, it issued agency sukuk the first place with value of 51% equivalent of 19255sak, followed by mixed Murabaha sukuk with percentage 24%, and Ijara sukuk 12%.

**13<sup>th</sup> shape: global issued sukuk types January 2017-december 2017**

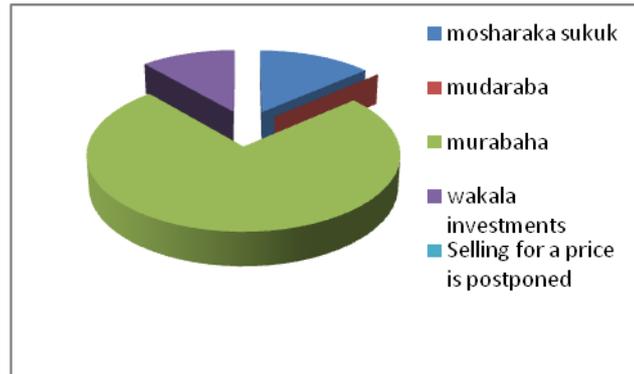


Source: (Report 7th Edition , April 2018, P597)

**4.7 experience of Malaysia in dealing with Islamic financial sukuk for financing economic development:**

The Malaysian Islamic sukuk market represent one of the successful global experiences, whether from the issuance quantity or from sukuk using in financing different projects in various economic sectors. Malaysia ranked first in the process of issuing sukuk by 63% of the world’s total sukuk , with 37% divided among the rest of the countries.

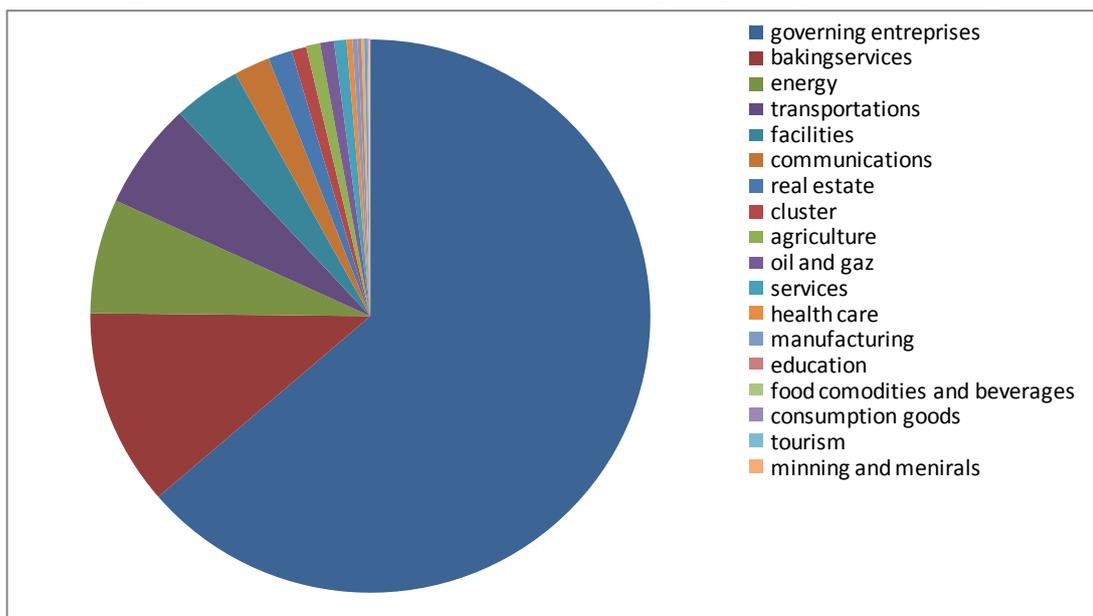
**14<sup>th</sup> shape : development of Islamic sukuk in Malaysia 2015.**



The handling of Islamic sukuk has proved its ability to finance economy development, especially in the wake of the global financial crisis, as demonstrated by the evolution of the evolution of the global stock market.

Malaysia is one of important client of Islamic financial sukuk in financial economic development sector with issuance percentage of 63% in 2017 (IFSB 2018) , where it relies on these sukuk in financing many projects related with the infrastructure and the giant projects (roads, airport, gaz drilling...etc). Islamic sukuk issuance rises for financing economic development to 2438 issuance in September 2013. With 324.576.9 suk as value geared to economic development in various areas.

**15<sup>th</sup> shape: the classification of Islamic sukuk grouped by sector during 2016.**



(IFSB I. f., 2018)

Malaysia tries to fill the necessary funds to finance its economy development relying on Islamic sukuk, where the government sector exports the value of the issues by a percentage 63,63% followed by financial services sector by a percentage 11,46%, and the solar energy by a percentage 6,66% and so with all economic sectors. What can be seen in the use of sukuk as a funding mechanism in all sectors, constructions, agriculture and transport, services...etc this demonstrates the importance of sukuk as an important mechanism in financing development, as well as the role of a state in ensuring the diversification of the use of Islamic development resources.

**5. The challenges of Islamic sukuk working:**

Islamic financial sukuk working is facing a lot of difficulties, however handling it allows for future prospects in the Islamic financial field, this latter emerges from )dammagh 2012( (Shaair 2013, no.1) (Zaid 2013, no.1, volume 21)

- **The legitimate difference:** the Islamic financial sukuk like the author Islamic financial products, faces many campaigns whether with the concerned with Islamic banking or others regarding its conformity with Islamic Shariaa law, which reduces confidence in it and consequently the interest in it retreated.

- **Absence of legislative and regulatory framework:** it is about finding a common legislative framework rules this latter issuance process and so following its circulation stages arriving to its termination stage (recovery).

Economic situations change: the thing here is about sukuk guarantee problem, it is considered by specialists a very dangerous matter as it represents an obstacle to the growth and development of the latter.

- **Credit rating and financial institution supervision:** issuing process of this latter requires that they be subject to the credit by international rating bodies, in addition of to the absence of the necessary technical publications that allow for decreasing subscription concerns.

- **A qualified human resource:** the production of this kind of paper requires qualification for the human resource whether in terms of its issuance provisions or accounting handling methods, legally or juridical.

- **Common legal standards for dealing with sukuk:** the unification of legal standards is a matter of dealing with the latter.

- **Provide database:** a database must be provided on the various investment opportunities in this area as well as the returns and risks involved, making things clean and transparent to the public at large.

In general, Islamic financial sukuk face a range of challenges, which can be illustrated in the following form.



**Source: the searchers preparation according to the study types.**

## **6. Conclusion:**

Finance with sukuk importance emerges as an investment finance instrument works according to Islamic Shari'a provisions and principles, as it is one the financial instruments which allow finance resources diversity and so providing the needed liquidity for various projects whether governmental or private.

This latter use vary where it becomes tools for social development and economic development finance both and that according to their issuance ways and methods ( public assets, utilities or debts ).

Financial sukuk have been widely used in recent years although there are some challenges, particularly those of common legal standards to deal with the latter.

The prospects and ambition of developing the Islamic financial sukuk market remain substantial and linked to the standardization of Islamic Shari'a standards governing this type of transaction, in addition to provide a database containing the various investment opportunities available, and in order to rehabilitate the human resources operation in the sector.

### **Study results:**

In view of the importance of the growing importance of Islamic sukuk for economic development at the global level and in various sectors, it is essential to:

- Creating a legitimate consensus among the various legal bodies based on the issuance of Fatwas in connection with this kind of sukuk.
- The creation of the legislative and the regulatory framework governing this type of sukuk particularly because of its specificity.
- Establishment of credit classification as well as supervision institutions, which allows for an increase in subscription to this type of financing sukuk.
- To qualify the human resource in the field of Islamic finance and increase its efficiency in dealing with this tools.
- The unification of legal norms to deal with sukuk.
- Provide a detailed database of investment opportunities in sukuk in terms of return and risks.

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