

# **The Role of Islamic Finance In Economic Development**

**By: Khodijah Ishak  
STIE Syariah Bengkalis  
Dosen Perbankan Syariah**

## **Abstract**

*This paper aims to determine Islamic finance refers to investments that are permissible in accordance with Sharia, the Islamic law. Sharia law views money as a measuring tool for value and not an “asset” itself. “It does not permit receipt and payment of riba(interest), gharar (excessive uncertainty), maysir (gambling), short sales or financing activities that it considers harmful to society” (IMF website.)*

*The paper relies functions, and variance decomposition analysis, focusing on the period from January 1994 to May 2007.*

*The results show that both Islamic banks’ financing and deposit play important roles in the monetary transmission process in the Malaysian economy. In particular, both Islamic deposit and financing are shown to be statistically significant in linking the monetary policy indicator to the real output.*

*The results imply that the monetary authority should also consider the Islamic banks in the implementation of monetary policy in Malaysia. The results also imply that ensuring the stability of the Islamic financial institutions is just as important as that of the conventional counter part to achieve an effective transmission of monetary policy in the economy.*

*This paper is a pioneer study undertaking empirical investigation on the role of Islamic banks in the monetary transmission process in an economy.*

**Keywords:** *Monetary policy, Financing, Malaysia, Banks, Islam, Economics*

## **Introduction**

Over the last decade, sukuk (singular. sak) have become an increasingly popular debt instrument in the international capital markets. Issuers ranging from sovereigns, quasi-sovereign entities and corporates as well as supranational organisations in the Muslim and non-Muslim world have either issued sukuk or have expressed an interest in issuing sukuk in the future. Commonly referred to as Islamic bonds because they are seen as tradeable securities, similar to conventional bonds, sukuk denote ownership or financial certificates of assets or a pool of underlying assets. Sukuk can also provide holders the right to receive income generated from that business of the issuer.

Sukuk adhere to and are consistent with Islamic law known as Shariah. Shariah originates from the Qur’an, the holy text of Islam, and the Sunnah, social and legal customs and practices of Muslims stemming from the lifetime of the Prophet Muhammad. It provides Muslims with the legal framework for various day-to-day activities including politics, economics, banking, business, contract and social issues.

In order for sukuk to be Shariah compliant, they must comply with the principles of Islamic finance by Shariah scholars. It is worth noting that Shariah is interpreted differently across the Muslim world and that there is no single unified

view of what is acceptable. Shariah scholars in various jurisdictions have differing opinions on debt, the use of debt or trading of debt.

As a result, whether a sukuk transaction complies with Shariah, is dependent upon the jurisdiction of the issuer and the discretion of the Shariah scholars within that jurisdiction. Sovereign issuers and larger banks tend to have in-house Shariah compliance boards, however the lack of a globally unified approach means that certain Western-style debt products are more amenable to being considered Shariah compliant in certain parts of the Islamic world.

Broadly, Islamic finance involves three key principles with which all sukuk must comply:

1. **Riba** (interest) – interest whether fixed, floating, simple or compound interest is prohibited because ‘no one should be able to earn an income from money alone’; and
2. **Gharar** (excessive or deceptive uncertainty or risk) – excessive risk or uncertainty that may void a transaction or contract, particularly with regard to future events and qualities of goods, also includes deceit; and
3. **Maysar** (gambling) – it is forbidden for one party to gain significantly at the expense of another. This includes borrowing money to speculate on currency movements or similar activities.

Moreover, in any Shariah compliant financial transaction, certain products are prohibited. For example, it is forbidden to purchase, invest in, negotiate or trade with or in any way involve products related to alcohol, tobacco, pork, pornography, gambling or weapons.

### **Islamic Versus Conventional Financing**

In addition to Shariah compliance, a key difference between sukuk and conventional bonds is that the former is based on the income of a tangible asset/s or rights to a business generating an income, which in turn is supposed to benefit the real economy as well wider society. Therefore there must be a sharing of risk, profit and loss between the parties.

“A key underlying aspect of sukuk that makes them different to conventional bonds is that they should be based on a tangible asset,” said Harris Irfan, Managing Director at Rasmala. “A key differentiator of Islamic versus conventional finance is that it is supposed to finance transactions in the real economy so that there is a one-to-one correlation with the financial economy.”

### **Growing Popularity of Sukuk**

Whilst the concept of sukuk as a form of financing has existed throughout Islamic civilisation, its present day form only emerged in the early 1990s with the first sukuk issued in Malaysia, by Shell MDS Malaysia with a MYR 125m (USD 30m) issuance. Other jurisdictions such as Bahrain and Sudan have developed their own local markets and issued short-term domestic sukuk.

Following the 2008 financial crisis, issuers in several Muslim majority countries including Malaysia, the UAE, Saudi Arabia, Sudan, Pakistan, Bahrain, Iran and Qatar have turned to sukuk as an alternative source of financing.

For potential issuers, one of the key advantages of issuing sukuk is the cost-efficiency in structuring the deal. “From an issuer perspective it is cheaper to issue sukuk, despite the added documentation requirements” said Khalil Belhimeur, Director, Bonds Syndicate at Standard Chartered Bank in London. The pricing difference in sukuk is cheaper because of the investor profile and lack of supply for sukuk paper. “Sukuk yields and spreads are generally lower than conventional bonds due to the investor demand in the Gulf region and to a lesser extent from South East Asia,” said Belhimeur in London.

However, sukuk is by no means mutually exclusive to issuers in the Muslim world, issuers from outside of the Muslim world can and have issued sukuk. For some issuers, like corporate (particularly non-Islamic ones) issuing sukuk presents them with the opportunity to reach investors from the oil-rich Persian Gulf countries and Malaysia seeking Shariah-compliant investments. “For non-Islamic issuers, sukuk is a form of investor diversification,” Belhimeur in London explained. For example, in November 2009, General Electric, a major US company, sold USD 500m five year of ijara sukuk to attract investment particularly from Islamic investors in the Middle East and Asia.

Moreover, some non-Muslim sovereigns have also tapped the market and issued sukuk. “Shariah-compliant financing is becoming popular with a lot of issuers, particularly sovereigns not just in the Muslim world, but also globally,” said a regional a region market participant. “It opens a new investor base and new sources of finance for the issuer,” he added. Examples of non- Muslim jurisdictions issuing sukuk include the governments of the United Kingdom, Luxembourg, Hong Kong and South Africa.

Others explain sukuk is important for Islamic banks to manage their liquidity. “Sukuk are a way for Islamic investors to invest in yielding Shariah-compliant investments, and in particular for Islamic banks to manage their liquidity through liquid assets without taking equity risk,” said Hani Ibrahim, Managing Director Head of Debt Capital Markets at QInvest in Qatar.

Investors have also commented on the benefits of investing in sukuk. “From an investor perspective there is a good level of transparency underlying a Sukuk transaction as compared to conventional bonds,” said Abdelhak El Kafsi, Managing Director at Islamic Finance Consultants in Bahrain. “This is because the sukuk being asset backed, the deal is ring fenced for the purpose of the transaction,” he explained.

To further highlight the growth of sukuk as a mainstream fixed income asset class, last October, JP Morgan included eight sukuk into their Emerging Markets Bond Index (EMBI). This exposure will likely expand investor interest beyond the traditional sukuk investor pool. “In the GCC, sukuk tend to be priced tighter, whereas in Turkey or Indonesia sukuk are usually priced wider than conventional bonds due to the investor profile,” added Belhimeur at Standard Chartered. “Investors in Turkey are usually US and European and investors in Indonesia are indeed very global as well; however, given the recent inclusion of Sukuk in the JP Morgan Emerging Market Bond Index [EMBI], we have seen the pricing differential tighten notably’.

There are different sukuk structures such as equity, agency or joint-venture-like, which issuers can use. Others structures are more debt focused, or mixture of

the two (hybrids) as well as newer structures which enable sukuk holders rights to assets, among others. “It’s important to take into consideration the type of issuers, the nature of their funding needs are and the type of market they’re operating in,” said El Kafsi in Bahrain.

Asset availability is an important consideration for any potential sukuk issuer. “The two biggest factors affecting the type of Sukuk structure applied are the industry or sector of the issuer and the type and availability of assets,” said Hani Ibrahim at QInvest. “Another key consideration in Sukuk structuring is the taxation on the assets being used in the transaction,” he added.

Islamic finance practitioners explain that tax regulations in different jurisdictions can make it difficult for sukuk issuers to structure the transaction. “There are certain challenges for issuers regarding how assets used in sukuk and are treated from a tax perspective in different jurisdictions,” said Issam Al Tawari at Managing Partner at Newbury Consulting in Kuwait. “Different jurisdictions have different definitions of what is understood as a normal buy and sell transaction. Some countries may not have specific rules and regulations around assets used in sukuk and therefore this remains a challenge,” he added.

## **Sukuk Structures-A Breakdown**

### **Ijara**

Ijara is a lease financing structure whereby a bank or financial institution purchases an asset or item (usually property or real estate) on behalf of the customer and leases it to them for an agreed sum over a specified period of time, transferring ownership of the asset or item upon maturity. Ijara is the most well known and most widely accepted sukuk structure in the Islamic finance industry. “Ijara is the most straight forward structure for sukuk,” said Debashis Dey, Partner at White & Case in Dubai. “It is the most acceptable structure from a legal and Shariah perspective, as long as the issuer has enough tangible assets,” he added. “However, one of the biggest challenges for issuers, particularly sovereigns in issuing ijara sukuk is the availability of sufficient assets of the right value and eligibility for an Ijara structure.”

### **Murabaha**

Murabaha is a financing agreement whereby one party purchases an asset or item and sells it on a deferred basis for an agreed marked-up rate, to cover cost and profit margins.

Murabaha is to be subject to much scrutiny as to whether it is acceptable sukuk structure or not. In Malaysia, Murabaha is a popular and widely used sukuk structure. However, in the Gulf and Pakistan, where the Shariah interpretation of debt and the trading of debt is different from Malaysia; Murabaha is not used as a single sukuk structure.

29% 13% 47% 6% 5% Wakala Hybrid Ijara Musharaka Murabaha Source: International Islamic Financial Market (IIFM) sukuk database International sukuk structures Jan 2009 - Dec 2012 38% 4% 42% 4% 1% 9% 2% Wakala Hybrid Ijara Mudaraba Musharaka Murabaha Islamic exchangeable Source: International Islamic Financial Market (IIFM) sukuk database International sukuk structures Jan 2013 - Dec 2014 63% 12% 14% 8% 3% Wakala Hybrid Ijara Mudaraba Murabaha Source:

International Islamic Financial Market (IIFM) sukuk database International sukuk structures Jan 2015 - Dec 2015

“Although Murabaha is a widely used as a financing tool by Islamic banks across the world, in the Gulf it is not used as a standalone sukuk structure primarily because it is not tradable in the secondary market (unless at par). The Shariah interpretation on debt and the trading of debt is more conservative than in Malaysia,” said the regional market participant. The Bahrain based Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), an Islamic finance standards body, considers Murabaha not to be Shariah compliant as a standalone sukuk structure unless used as part of a hybrid sukuk structure, of which 51% must be tangible assets. “Murabaha has at times been a controversial contractual structure in the industry,” said Irfan. “Whilst all scholars accept it is a valid contractual structure, in practice some forms of murabaha have been used by some bankers as a proxy for loan financing, in ways that many scholars have expressed reservations,” he added.

#### **Musharaka**

Musharaka is an Islamic joint venture or partnership, limited to a particular purpose or project. Benefits include the pooling of resources and capital and in particular, the sharing of risk, profit and losses. This is more of an equity type investment.

#### **Mudaraba**

Mudaraba is a financing structure between two parties, where by one party provides the capital for the other party who manages the project. The profit is determined by a pre-agreed ratio. However, if the project encounters losses, the party providing the capital is solely responsible for those losses. “Mudaraba and Musharaka are equity-based risk from the perspective of Shariah and require higher risk appetite for investors,” noted Dey of White & Case.

#### **Wakala**

Wakala is a contract between two parties in which a principal nominates or hires an agent to manage and/or work on a project. “Wakala is more favoured by financial institutions because they appoint an agent to manage projects or investments,” said Dey. “They don’t have to own buildings or similar leasable assets but have income generating business lines.” Hani Ibrahim at Qinvest notes, “

Islamic banks and financial institutions tend to apply Wakala and Mudaraba structures frequently”. He adds, “Musharaka and Mudaraba structures are closer to equity type risk and Mudaraba in particular is used for subordinated perpetual Tier 1 Sukuk”.

Despite the growth and development of the sukuk market, some challenges remain, such as the lack of cross-border standards for sukuk. For example, whilst some sukuk structures may be acceptable in one country, they may not be acceptable in another jurisdiction from a legal and Shariah perspective. “More work is needed in further developing Islamic finance standards,” said Bashar Al Nator, Global Head of Islamic Finance at Fitch Ratings in Dubai. “There needs to be more standardisation and more harmonisation of sukuk in terms of legal structures and Shariah compliance. Whilst lots of new debt issuers also have the potential to issue sukuk, it will take time to develop the market and infrastructure on a domestic and

international level,” he added. Others have accused sukuk of being modelled on conventional bonds and forsaking the spirit of the Shariah principles of Riba, Gharar and Maysar. “Although the sukuk market has grown significantly over the last few years, there has been little focus on the social and moral impact on the economy and society”, said Mehmet Asutay, Professor of Middle Eastern and Islamic Political Economy & Finance at Durham University Business School. “The Islamic finance industry has not addressed key challenges such as the inner workings of sukuk structures and their impact on economic development including UN Sustainable Development Goals as well as issues related to legal, regulatory, Shariah and accounting standards,” he said. “The market-driven nature of Islamic finance has impacted the development trajectory of sukuk market resulting into lesser appreciation of fundamental Islamic moral economy principles in the construct, issuance, practice and impact of sukuk,” he added. Investors have also expressed concerns the challenges over the recourse of underlying assets used in more equity-based sukuk structures, as a key risk factor. “The recourse to the physical assets underpinning the sukuk structure is a key consideration for investors. The vast majority of sukuk issuance is asset-based rather than asset-backed,” said Doug Bitcon, Head of Fixed Income Funds and Portfolios at Rasmala in Dubai. “There is no recourse to the sukuk assets embedded in the structure, particularly national or sensitive assets. In a liquidation scenario, investors are expected to rank pari passu with senior unsecured conventional bond investors. Primary market sukuk transaction aren’t priced as asset-backed transactions, rather they are priced as unsecured liabilities of the obligor” he said.

### **Financing infrastructure projects based on risk sharing model: Istisna sukuk**

Here are some reports from international institutions which indicate developing countries have issue to financing their infrastructure projects. These types of project have two key elements: long-term and high cost. Generally, there are two methods to financing projects. 1. Debt financing. 2. Equity financing. The states of these countries usually provide funds based on debt financing. Unfortunately, the states make a lot of problems in their economy by choosing this approach. Nowadays, the main problem has involved the global economy is increase in unrestrained debt and the more important factor is risk of repayment by the states.

The risk of payment by the state not only has bad effect on recession, but also it can create a systemic risk and by contagion exposes the other sectors of economy. According to the unfavourable terms prevailing in economic growth, the ability to repayment 73 Davood Manzooret al./Journal of Emerging Economies and Islamic Research (2017) Vol.5, No.3 debt is suspected. Regarding to this point 75% of financial products are debt based. Usually the states face budget deficit and they cannot settle their commitments. In this situation they choose borrowing by the debt instruments or print the money. For the first option, the consequences are explained earlier.

The second one creates some problems in the economy as well as the first one. It means that by printing new money, it increases inflation in the economy and the consequence is the loss of fixed income instrument owners. This is only one of the effects of the high inflation in the economy and other effect are ignored here.

Therefore, The evolution of Islamic finance is based on the concept of developing new financing techniques and instruments which are compatible with market acceptable banking and securities products. In doing so, the central idea is to ensure that newly developed products are in compliance with Sharia. Therefore it is extremely difficult to determine whether a product is Sharia compliant or not, under the multiple schools of thought.

In addition to the recourse of assets, investors also note the inability to trade certain sukuk structures is a draw back. "Sukuk tradability is important to many investors and there are certain constraints in Islamic finance," Bitcon explained. "For example, Islamic investors cannot trade murabaha sukuk in the secondary market other than at par," he added. "Sukuk buyers don't have the risk appetite for risk on equity structure investments like Musharaka and Mudaraba they have risk for debt investments. Therefore, the majority of sukuk are debt based.," explained the regional market participant.

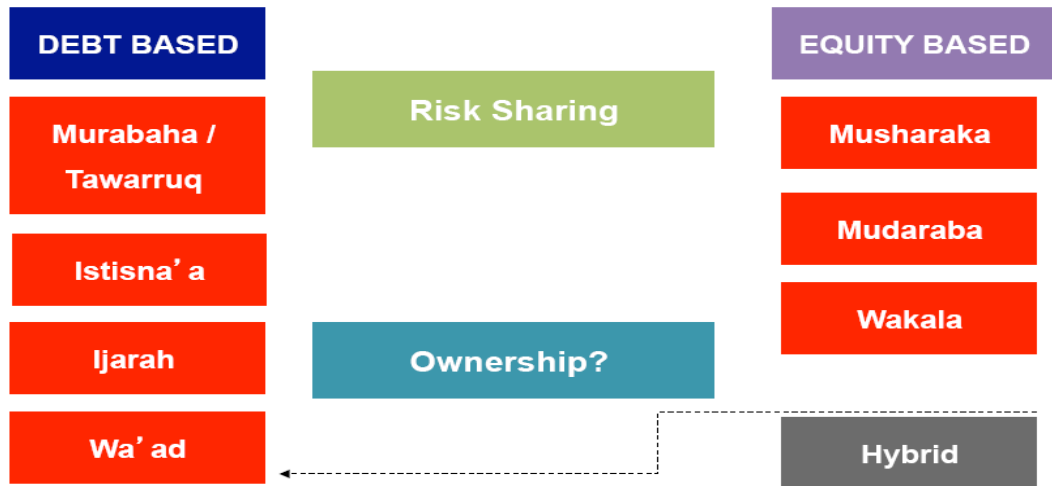
Others point to the fact that investors need further persuading before investing in other sukuk structures.

States in developing countries have so far preferred to raise fund based on debt, ignoring the fact that this kind of financing and choice of this method will cause many problems for the stability of the economy. Considering the issues of financial crises and economic stability, creating a leverage in the economy, budget deficit, inflation and the distribution of risk among economic agents are the issues that affect the structures and models of financing. Istisna' Sukuk is an Islamic instrument which has the potential to be used to infrastructure project financing. Istisna' Sukuk is based on the asset and the return of the project it is completely compatible with the infrastructure project specially in developing countries.

Therefore, by presenting these considerations, the various models presented will be examined and we will show that by adapting the financial flows of state-owned projects with real economy, especially in the field of infrastructure, the macro economic imbalances can be avoided. This is most relevant in the "Istisna-Musharakah-Stock" model.

The presented model is a sustainable option, could be chosen. Generally speaking, the main problem of debt financing is disconnecting between repayments of loan on one side and the risk of the project and cash flow of the asset on another side. It looks like the states and the authority of the financial markets should choose different approach. To conclude the best way for financing infrastructure is using risk sharing financial instruments. By this approach these securities not only are the beneficiary instruments for the real economy, but it can also stop the current procedures of creating and accumulation of debt. In addition, they operate counter cyclical instead of procyclical operation by the bonds and debt instruments.

Gambar 1. Islamic Contracts in Sukuk



### Using Islamic Finance for Infrastructure projects in non-Muslim Countries

Using Islamic project finance is the solution to fill the gap between infrastructure demand and available finance. This study aims to investigate if it is appropriate to use Islamic finance to fund the infrastructure project, as one specific sector that is facing major challenges in long-term financing, and it intends to select the most appropriate instrument that is inconsistent with non-Muslim countries' law and culture.

The methodology and approach that will be used is a qualitative method which is used to study the Islamic financial tools, compare them with other financial instruments, and discuss the potential implementation of Islamic project finance structure to fund the infrastructure project in Italian environment. The study concentrates on exploring the Italian laws that are resembled to Shariah principle in order to make it more acceptable for the Italian culture.

The study concludes that using Islamic finance can be used to finance infrastructure projects by using existing laws and regulations. This study is also expected to benefit the Italian government and investors in making their financial decision, and it will be a new experience for Europe countries.

The global *sukuk* market is poised for exciting new developments, not only in its traditional Middle Eastern and Asian markets, but also in the UK, the acknowledged Western hub for Islamic finance.

Supply of *sukuk* has been driven primarily by the entry of Saudi Arabia into the market in 2017, Malaysia's pioneering socially responsible *sukuk* investment strategy and, more recently, the world's first three green *sukuk* issuances. In addition, there is a continuing spate of government participants, such as Saudi Aramco and Emirates Airlines, and corporate issuers, both repeat and new entrants.



### **The role of Islamic finance in economic development**

Islamic financial institutions have been growing rapidly in the past few years. Islamic finance refers to investments that are permissible in accordance with Sharia, the Islamic law. Sharia law views money as a measuring tool for value and not an “asset” in itself. “It does not permit receipt and payment of *riba* (interest), *gharar* (excessive uncertainty), *maysir* (gambling), short sales or financing activities that it considers harmful to society” (IMF website). Interest, a form of income from money, is therefore prohibited.

For example, the income obtained from banks must come from the gain or loss of the enterprises they underwrite and not from interest obtained from loans granted. Sharia-compliant finance is thus often viewed as a unique form of socially responsible investment. Islamic finance exists to further the socio-economic goals of Islam. The question is: How can Islamic finance contribute to economic development? This essay explores its contribution to economic development through micro finance and the use of *sukuk* (Islamic bond). It will also explore the main opportunities and challenges for Islamic finance today. In order to facilitate the following reading, all Islamic terms used in this essay will be defined in the glossary (Appendix I).

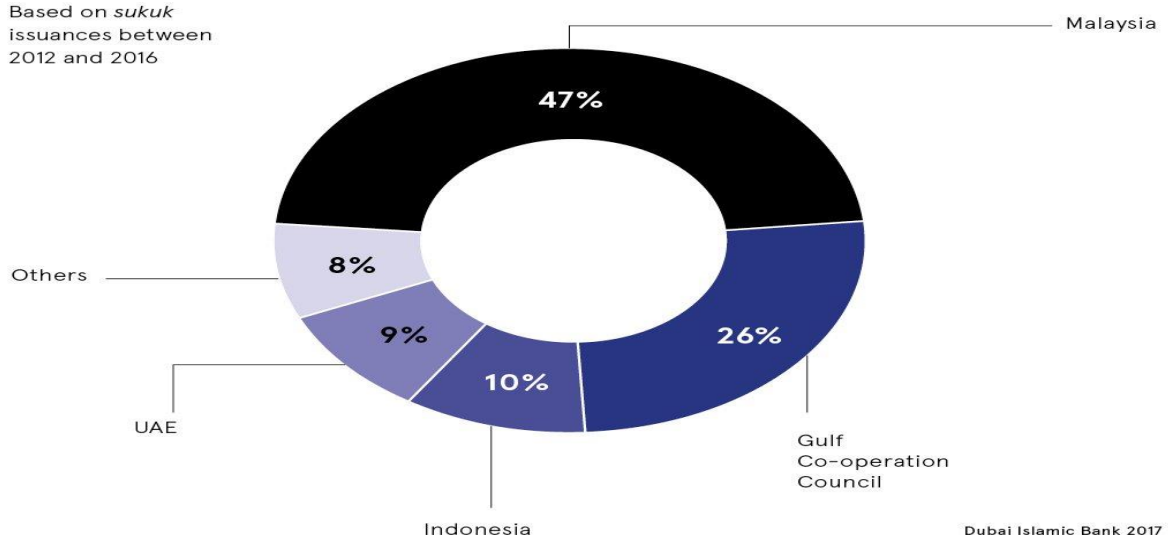
### **Support for Islamic finance is a perfect example of our ambition to promote London as the financial centre of the world**

On the demand side, *sukuk* is now an established financial instrument for financing government budget deficits and liquidity management of Islamic financial institutions, corporate refinancing of existing debt and business expansion. This boosts bank capital and liquidity, under Basle III provisions, financing infrastructure, especially in renewable energy, transport, healthcare, and oil and gas sectors, and in social finance to fund education and vaccination programmes, as well as monetising *waqf* (trust) assets for the benefit of the community it serves.

*Sukuk* is also issued to serve as an investment instrument for retail, and high-net-worth and institutional investors. It is an essential component of a mixed Sharia-compliant investment portfolio together with equities and real estate.

## Global sukuk issuance by region

Based on *sukuk* issuances between 2012 and 2016



Market traction in 2017 saw primary *sukuk* issuances touch \$100 billion compared with \$88.28 billion the previous year. This figure could top \$200 billion in 2018. In February, the Saudi Ministry of Finance, for instance, issued its eighth consecutive domestic *sukuk* (\$1.93-billion tap issuance) bringing the total Saudi domestic *sukuk* issuance to a staggering \$19.07 billion for the period July 2017 to February 2018.

Saudi Arabia issued its maiden international \$9-billion *sukuk* in 2017, with another offering due this year, thus bringing the total volume of sovereign *sukuk* issued by Riyadh between April 2017 and February 2018 to \$28.07 billion.

Also in February, Indonesia issued the first sovereign green *sukuk* totaling \$1.25 billion, the proceeds of which, according to the Indonesian Ministry of Finance, “would be used to invest in environmentally friendly projects such as renewable energy plants, green tourism and waste management”.

Similarly, Mali became the fourth Central Bank of West African States (BCEAO) member country after Senegal, Ivory Coast and Togo to issue a debut *sukuk* raising \$285 million.

Dr Bandar Hajjar, president of the Islamic Development Bank (IsDB), the 57-member multilateral bank with a subscribed capital of \$33 billion, would like to see *sukuk* become a common feature in the global market.

According to Dr Hajjar: “We have a real opportunity to realise the potential of Islamic finance and build a truly global marketplace, starting right here in the UK. Although the international *sukuk* market is in its nascent stages, there is enormous potential for growth. I truly believe that *sukuk* can change the world for the better; for investors, but also for the billions of people who benefit from the growth it drives.”

*Sukuk* has already made an impressive economic impact in infrastructure and more recently in green *sukuk*. These range from financing refineries, roads, hospitals, power stations and housing, among others. The G20, International Monetary Fund, World Bank, and the Basle Committee for Banking Regulation and Supervision have

all recognised the potential and promotion of *sukuk* in financing infrastructure in Africa, Asia and the Middle East.

The IsDB alone has so far earmarked \$2.5 billion of development finance for projects in member countries in 2018. In March, it mandated eight banks to arrange roadshows for its latest benchmark *sukuk* offering under a \$25-billion programme.

Malaysia set the pace with the world's first two green corporate *sukuk* in 2017, the proceeds of which will fund the construction of solar power plants in Malaysia. They were issued by Chinese-owned companies under the socially responsible *sukuk* framework, established by the Malaysian Securities Commission in 2014.

The IsDB's ambition to globalise *sukuk* has been met with equal gusto by the UK's Treasury economic secretary and City minister John Glen, who says: "Britain is open for business and our support for Islamic finance is a perfect example of our ambition to promote London as the financial centre of the world. We're already recognised as the Western hub for Islamic finance and we're committed to ensuring this continues."

As such the £250-million debut *sukuk* issued by the UK-authorized Al Rayan Bank in February puts down a number of important markers. It is the largest sterling *sukuk* to date, the first bank in the world to issue a public *sukuk* in a non-Muslim country and the first Sharia-compliant residential mortgage-backed securitisation in the UK.

A *sukuk* is an Islamic financial certificate, similar to a bond in Western finance, but which complies with Islamic religious law, or Sharia. Since the traditional Western interest-paying bond structure is not permissible, the issuer of a *sukuk* sells an investor a certificate and then uses the proceeds to purchase an asset, of which the investor has partial ownership.

### **Turkey builds up new Islamic finance tools**

Turkey builds up new Islamic finance tools. ISTANBUL – Reuters Available at: As Turkey seeks to boost political and commercial ties with the Gulf and diversify its borrowing, one of the Muslim world's most dynamic economies is developing an Islamic finance industry which could rival current volumes in Malaysia – the world's top *sukuk* issuer – within a decade.

The new rules, which were sent to Turkish Prime Minister Recep Tayyip Erdoğan's office for approval this week, will allow Turkish corporates and banks, as well as the Treasury, to issue the world's most widely used types of *sukuk*, giving them access to a wider pool of investors via a global market estimated at more than \$100 billion. "Islamic finance is just like halal food, there may be two reasons to choose it," said Mustafa Cetin, head of financial institutions at the Turkish arm of Bahrain-based Islamic lender Al Baraka.

"Either you prefer interest-free products or you find the cost of borrowing, the taste, attractive."

Turkey's islamic banks are known locally as 'participation banks' in part reflecting public sensitivities. But nervousness about Islamic finance has eased in recent years, helped by growth of the sector in Western economies. Just over a year after its debut dollar-denominated *sukuk* issue, Turkey's Capital Markets Authority

(SPK) is finalising regulations on five new types of Islamic bond as the country aims to become a major issuer of Islamic debt.

Turkey aims to turn its economic and cultural capital Istanbul into a major financial centre. It foresees \$350 billion of infrastructure spending on the project, with Islamic finance expected to be one of the major sources.

Turkey has begun to open the doors to giving new banking licenses after the 2001 banking crisis, with no exception for interest-free Islamic banks, called participation banks.

As of now four banks have operated in the participation banking industry: Bank Asya, Türkiye Finans, Albaraka Türk and Kuveyt Türk. They constitute 5.3 percent of the Turkish banking industry. The state-run banks, Ziraat Bank and Halk bank, will also establish new participation banks.

Al-Baqarah, 2:275

Those who devour usury will not stand except as stand one whom the Evil one by his touch hath driven to madness. That is because they say: "Trade is like usury," but God hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for God (to judge); but those who repeat (The offence) are companions of the Fire: They will abide therein (for ever).

### **The rise of sukuk and Islamic investment in the West**

Islamic law prohibits *riba*, or interest, therefore prohibiting traditional Western debt instruments as investment vehicles, but the *sukuk* is used to link borrowing with the purchase of a specific asset.

The global *sukuk* market is poised for exciting new developments, not only in its traditional Middle Eastern and Asian markets, but also in the UK, the acknowledged Western hub for Islamic finance.

Supply of *sukuk* has been driven primarily by the entry of Saudi Arabia into the market in 2017, Malaysia's pioneering socially responsible *sukuk* investment strategy and, more recently, the world's first three green *sukuk* issuances. In addition, there is a continuing spate of government participants, such as Saudi Aramco and Emirates Airlines, and corporate issuers, both repeat and new entrants.

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