

***Thoughts from Islamic Capital Markets for  
Sustainable Development in Asia and the Pacific.***

*First High-Level Follow-up Dialogue on Financing for  
Development in Asia and the Pacific.*

**Incheon, Republic of Korea 30-31 March 2016**

**Obiyathulla Ismath Bacha**

## **The Problem.**

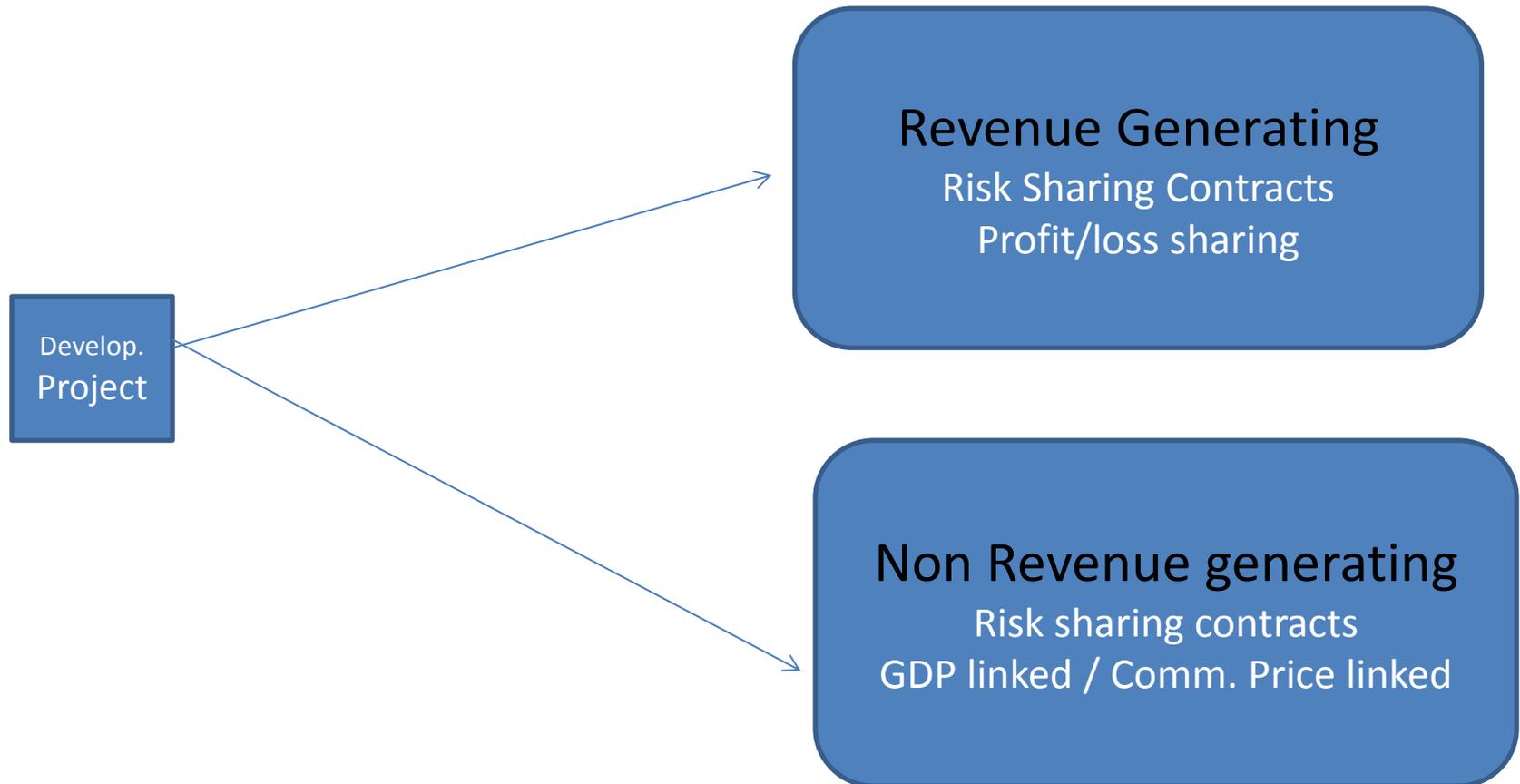
### **How do we fund new development without more debt?**

- The world now appears to have worked itself into a corner.
- Infrastructure is needed for growth, job creation, poverty alleviation and overall competitiveness, yet, many nations have hit very high levels of debt and need to deleverage.
- deleveraging will mean cutbacks, additional strain on societies and sacrificing new growth.

## **Potential solution.**

- The risk sharing instruments of Islamic Finance, offer a way out.

- Infrastructure projects two broad categories, revenue generating and non-revenue generating.

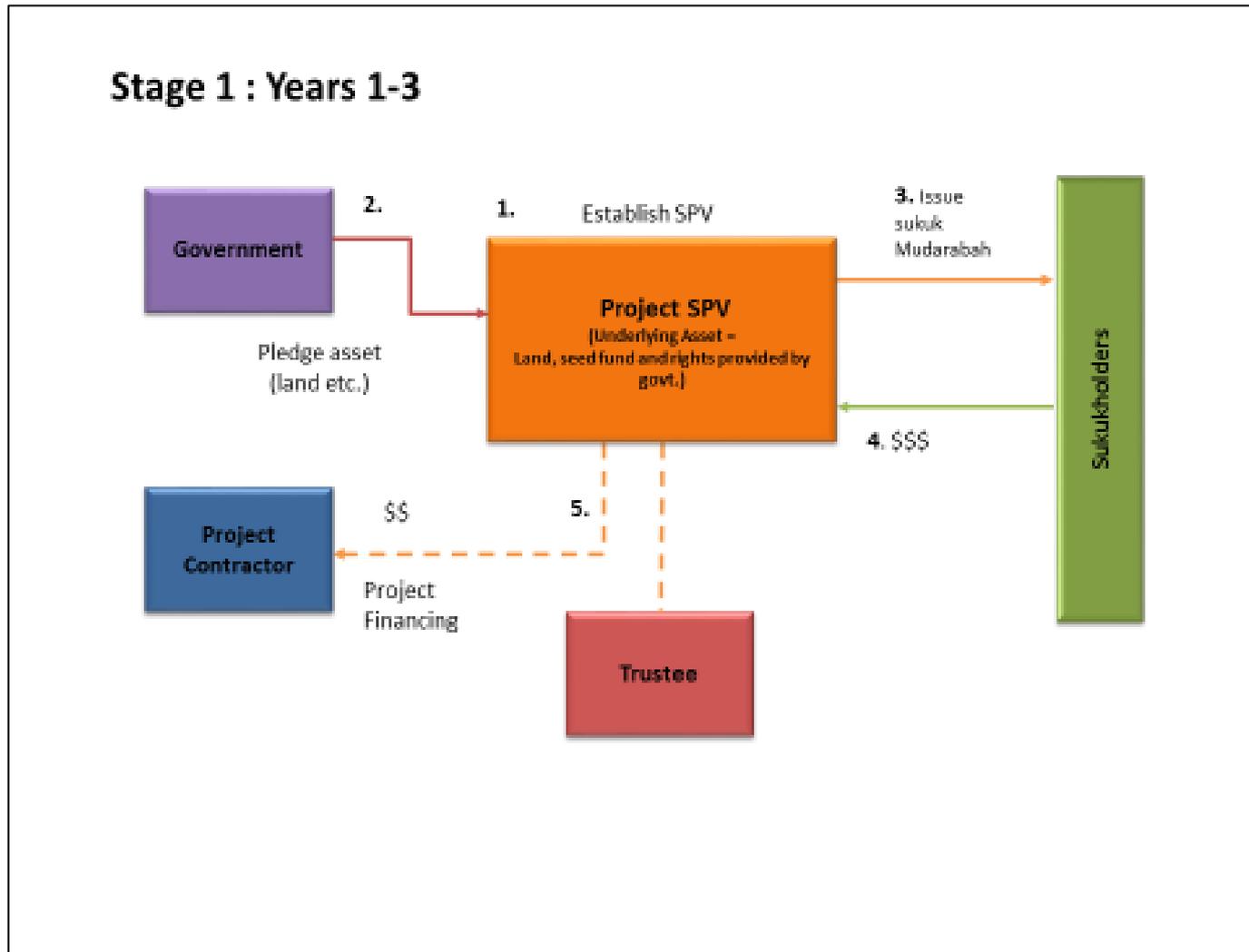


- Mudarabah and Musharakah are essentially quasi equity contracts. Financier provides the funding and agrees on a profit sharing ratio (PSR).
- The risk-sharing, terminality, specificity of claim and limited dilution are important advantages that the Mudarabah has relative to debt.
- Aligns 'repayment' to ability to pay. "stabilizer"
- Avoids pro cyclical behavior.
- Avoids leverage and macro – economic vulnerability to sudden stops/external shocks.

## Using Mudarabah to Fund Infrastructure Project – Illustration

- A developing country is in need of a new power generation plant to serve a region that has been suffering brownouts. The government has negotiated with a foreign contractor who has the expertise to design and build the plant.
- The total investment needed for the project is \$750 mil.
- The government will provide land and other basic infrastructure and will also provide seed funding of \$20 million. The total value of the government's investment is \$75 million or 10% of needed total investment.
- Construction will take 3 years with production/revenue beginning in early year 4.

# Figure 3. The sukuk issuance process.



- Being anchored in real sector returns would not only be more stable but higher relative to debt instruments
- A new asset class. - little correlation with conventional portfolios.
- Designed to enable even small retail investors to participate, promotes financial inclusion and brings investment possibilities to a larger portion of the population.
- Besides giving the small investor a stake in the nation's growth opportunity, secondary market trading develops domestic capital market.
- Savings that may otherwise go into speculative assets, or disintermediated can now be harnessed for development.
- As a risk-sharing instrument it raises the threshold of prudence in evaluating projects - reduce moral hazard and lead to better allocation of resources.
- Though the above proposals come from Islamic Finance and may be easier to initiate in Muslim countries where the concepts are more familiar, there is no reason why they cannot be adopted universally.

*Thank You*

*Obiyathulla Ismath Bacha*

*obiya@inceif.org*