

Islamic Finance Based on Sukuk Approach: The Roadmap for Economic Development in Tunisia

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Abstract

This research seeks to engage a little focus on a different type of capital market in Muslim countries where the emergence of the Islamic finance industry could offer a system of tools to promote social and economic justice and stimulate economic development. The research briefly defines a coherent plan in Tunisia for unlocking the potential of Sukuk which has been identified as an important avenue to plug the Tunisian government's deficit, and raise financing for the country's infrastructure and development needs. The current situation in Tunisia, however, poses many challenges for Sukuk issuance planned to support economic development. The research precisely identifies and assesses the opportunities, risks and hurdles in attempting such a plan. The findings and recommendations of this case study offer as so different interpretations as to help guide measures that target a standardised approach towards a vital, important, and viable role of Sukuk in today's economic development.

Keywords: Sukuk , Tunisia , Economic development

Introduction and Rationale

Islamic Finance, beyond its economic sphere, is supposed to be linked to social and political considerations of the state. In this regard, Iqbal and Ahmad (2005) supported this argument saying that a financial system consistent with the Shari'ah refers to a financial system which considers the human well-being and justice while providing benefit which may not always be fully reflected in the rate of return but felt by society as a whole.

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Therefore, Asutay and Zaman (2009) recognized that political vision, will and leadership through civil society based political settings are the pre-requisites for major institutional implementation of a conceptual model of development in Islam that goes beyond mere economics and Fiqh considerations.

Most importantly, Feldman (2012) noted that recent public debates in Tunisia which was the first Arabic country holding free elections have shown that the future will bring more open and democratic discussions of Islamic finance and that the religio-ethical dimensions of the field will be at the center of this debate.

To stick to the point, Bennet and Iqbal (2011) "believe the *Sukuk* market has great potential to function as a bridge between the growing pools of *Shari'ah-compliant* capital, on one hand, and the massive need for poverty alleviation funding, on the other. In lack it would be a great missed opportunity if a thriving socially responsible *Sukuk* market fails to develop, given that the explicitly ethical nature of Islamic finance creates a natural rationale for using *Sukuk* as a development tool".

In Tunisia, we think that these requirements must be considered and we will focus on the reactions of concerned entities in the field to these pulses to judge the opportunity of *Sukuk* issuance and the development of such a market which shall not be only on how to raise the funds, but to be *Shari'ah* compliant first and foremost to help in the growth of real economy and socio-economic development of the society.

Furthermore, it seems more realistic in the future that the most attractive potential *Sukuk* markets planning to develop rapidly growing economies with a newly liberated political atmosphere and a developing free market are in Turkey and Tunisia. Even if Tunisia is small so there may be trouble to go out into the capital markets to raise funds, it may be argued that Tunisia case is the most interesting in the region of North Africa.

This perspective is given weight by the situation of Tunisia with its homogenous society, with a larger entrepreneurial middle class and its ability for recovery which are factors in the favor of its transition from lagging to leading and the big prize is going to be the region.

Research Questions and Objectives

This research therefore focuses on this main question: Is Sukuk based approach the relevant way to unlock their potential in financing an ambitious development model in Tunisia?

And could such a model avoid the fundamental problems and shortcomings of the former model that brought about unoptimality and disequilibrium, which led Tunisia into instability?

In other words, this research is an attempt to place an intermediation system whereby Sukuk market will meet these requirements that could serve as a best alternative solution to usuary-based financing in Tunisia which mobilises efficiently long term funds into productive investments.

Literature Review

By reviewing the existing Islamic economics literature that investigates the features that distinguish Islamic finance from conventional finance, Nagaoka (2011) classified it into two types:

- First, those who study from a theoretical viewpoint emphasize that the very essence of Islamic finance is “a sort of the sharing system”.
- The second type of literature examines the feature of Islamic finance from the practical standpoint from its industry which stresses “its direct link to the real economy” in accordance with Islamic teachings.

To get a better understanding of theoretical and practical aspects, only few researches using quantitative methodology, all conducted in Malaysia leads to different interpretations:

First, Fenech & Watson (2009) found in their study on the construction of an efficient portfolio by means of Modern Portfolio Theory (MPT) that by using Sukuk bonds, one may still achieve the same expected return and what is better is that same return can also be achieved by exposing oneself to less risk.

However, another investigation launched by Godlewski, Ariss & Weill, (2010) of the investors' reaction to the announcements of issues of *Sukuk* and conventional bonds revealed in the other research that an increasing use of *Sukuk* may be detrimental to the firm and eventually to economic development, at least in the short run. Nonetheless, before arguing in favor of the large-scale adoption of Islamic finance, additional research is needed to assess the long run implications of using *Sukuk* financing to finance for development.

Finally, the empirical analysis of another research conducted by the IMF researchers Krasicka & Nowak (2012) suggests that even though conventional and Islamic financial instruments are fundamentally different, they perform similarly in a competitive market with no statistically significant downside or upside effects on investors' wealth.

What we may conclude from these controversial empirical results is the importance of interpretations and the approach adopted in response to the increasing demand for Islamic financing. In the international market, the use of *Sukuk* based on risk sharing for fund raising is required for daunting financing of infrastructure, but it is still to be enhanced. That's why innovations in *Sukuk* structure will continue to be the motive force in real expansion of the Islamic Financial Industry and synergies can be built with the international capital markets if tried.

Research Methodology

Case study research methodology as a qualitative research is a very useful tool to investigate why and how the decisions about a possible *Sukuk* issuance are made so this methodology is used when "what happens" and "how it happens" are asked about this contemporary phenomenon. (Louise Muhdi&Michael Daiber, 2008).

The environment in Tunisia is different from other countries and the context prevails in such as research as there is standard procedure for issuance of *Sukuk* and their applicability in Islamic capital markets.

That's why, **interview methodology** in this research is taking into regard characteristics of *Sukuk* in order to avoid contradictory statements framework and practices in the issuance of *Sukuk*.

Particularly in such a new field as Sukuk market, where almost no research into first issuance of Sukuk has to date been conducted in Tunisia, I took the opportunity offered by the dynamic period of post-revolution by following a network sampling with contacts in seminars and associations newly created in the Islamic finance field. Besides, I preferred using a judgemental sampling for the research which is non-probability sampling believing that the sample of experts I select will meet the requirements of the study but findings will be reliable in the present scenario keeping in mind all the limitations I had.

List of Questions

- To what extent is Tunisia a “test-case” for Islamic finance in North Africa?
- To what extent is Tunisia a priority for Sukuk implementation in the region?
- What are the key issues in Islamic finance framework draft (legal and regulatory),
- How will Tunisian policy choices seek to overcome strongly structural concerns regarding:
 - ownership rights in contemporary *Sukuk*, , in particular the civil law jurisdictions not recognizing beneficial ownership?
 - Shari’ah acceptability of Sukuk, in particular the criticism about asset-based and asset-backed Sukuk and the divergence between the *Shari’ah* treatment and tax treatment
- Will the framework draft provide protections and equality for investors?
- What will the new framework say—if anything—regarding the relation between conventional finance, the Islamic finance, securitization and project finance?
- What will the future Tunisian government and political order towards Islamic law in the financial field at least look like?
- Is a consensus among Islamic and secular finance industry deciders possible?
- Will there be a regulatory and supervision process for Islamic finance in Tunisia?
- Which investors currently enjoy significant presence in Tunisia,
- What are their likely potential investments?
- What kinds of finance and Sukuk modelling are likely?
- What is the potential medium-term impact of recent Islamic finance development on foreign investment and economic development in Tunisia and the region?

- What steps should be taken in Sukuk implementation to promote economic development and job creation, and to address socioeconomic criticism and regional economic disparities?
- What will be the impact of Sukuk development?
- What are the prospects for a future Sukuk market on the evolution of a financial hub Tunisia?
- How should the Sukuk investors' strategy shape its future targets?
- What course of government action is most likely to fulfill Islamic finance implementation and Sukuk potential goals?

List of Interviewees

- Mr. Ridha Saidi, the Acting Minister in charge of the economic and social profile
- Dr. Mohamed Nouri, President of the advisory firm called French Council of Islamic Finance COFFIS (France)
- Dr. Abdul Sattar Khuwaildi, Secretary-General of the International Islamic Centre for Reconciliation and Arbitration (Dubai)
- Dr. Mohamed Damak Associate – Co-Chairman of Islamic Finance Workgroup Standard & Poor's Financial Services (African Development Bank, Tunisia)
- Dr. Ridha Chkoundali, professor of economy (lecturer at ISG de Tunis) and Co-architect of Ennahda's economic program (Islamic political party)
- Dr. Mouldi Jlassi, professor of economy (lecturer at ESSEC de Tunis) and member of the Tunisian association of Islamic economy
- Mr. Lotfi Zairi, Acting Head of Risk Management and Assistant to CEO, Islamic Finance and Technical Affairs at Islamic Corporation for Insurance of Investment & Export ICIEC/IDB Group
- Mr. Walid Hbaieb CFO Chief Financial Officer co-interviewed with Mr. Mounir Fakhet Chief Risk Officer (CRO) of Zitouna Bank (the only on-shore Islamic bank in Tunisia)
- Mr. Mhamed Ben Mansour CFO Chief Financial Officer of the TIFERT (the biggest project Islamically financed in Tunisia)

In order to make the outcome of the interview more relevant and logical I have divided the outcomes of the interview in different parts. Each part is focusing on a specific research area.

In this respect, two aspects of economic and legislative application of this substantive theory will be dealt with in this empirical part gathering the legal, regulatory, supervisory and Shari'ah examinations to the economic examination through the transcript of interviews by finding key words and the fine tuning of questions.

Finally, the enabling environment for Islamic finance involving the IDB, the Government and local banks paving the way to sovereign Sukuk will be described and a summary of the recommendations that are crucial for development of the first Tunisian sovereign sukuk and the Islamic financial hub with full speed will be developed.

Results, Findings and Recommendations

1- Legal and Shari'ah examination of Islamic finance and Sukuk in Tunisia:

On the one hand, all interviewees have confirmed that a specific legal framework will have an important impact on the development of Islamic finance and Sukuk market because the current legal framework is not very specific regarding all contracts and they confirmed also that there is a lack of training in supervisory and regulatory disciplines. On the other hand, most of the interviewees have asserted that complying with Shari'ah requirements will not be in conflict with preparing a legal framework for Islamic finance transactions including Sukuk in Tunisia as long as relevant statutory rules are in respect of a liberal and secure Tunisian legal environment. Consequently, the favourite solution is to establish a special law for Islamic banking besides a regulation of a dual system by the Central Bank.

Additionally, the national constitution assembly adopted a legislation for sukuk on July 17, 2013 (Law No. 30 dated July 30, 2013) in order to introduce sovereign sukuk, and this legislation calls for some new regulations to be put in place, such as the need to establish a company with a special status attached to the Ministry of Finance to guarantee circulation of sukuk without any constraints, and the identification and fulfilment of certain specific conditions which are appropriate for assets to be leased (equipment, buildings or other facilities). This last consideration is especially pertinent for ijara Sukuk, what with the government mainly concerned with plugging its liquidity gap in the budget deficit.

2- Economic examination of Islamic finance and Sukuk in Tunisia:

First, all interviewees have highlighted that infrastructure needs, particularly on the regional front, remain high, making Sukuk an attractive financing vehicle to tap investors that would not invest in conventional products (for example, Gulf investors) and a rescue to help the country find a way out of the liquidity gap, urgent financing needs, crises in international markets and scarcity of resources. For instance, assets seized from the Ben Alis are priorities to be used as seed money for a Sukuk market. Besides, Sukuk funds for infrastructure projects would contribute to the interior development and reducing its dependence to the eastern coast.

Second, most of the interviewees have drawn attention to problems faced by national banking to finance projects which did not seem to offer anything with respect to prudential rules regarding the client risk concentration and the adequacy to maturities. Another problem is the project structuring complexity, especially regarding heavy documentation and long preparation.

Third, experts are in favour of a progressive process to implement a plan for Sukuk issuance. The needs for liquidity and project financing are to be identified by choosing advantageous sectors and taking account of the benefits of diversity. In this turn, it should be emphasized that selection, monitoring and control in project feasibility studies are so important. Indeed, the majority of investors have, at best, put their non-committed Tunisian projects on stand-by, except for the less integrated or less risky sectors (hydrocarbons, ore, etc.); but promoters of projects are waiting to see what the future has in store.

Last but not least, it is very important that Islamic Development Bank (IDB), Government and local banks should be involved in facilitating such a process to provide a higher rating which could reduce financing costs.

3- Enabling Environment for Islamic finance: the Government Sukuk Market

Actually, Tunisia's use of Islamic finance is increasing, with primary focus on financing for development although the country's established partnership strategy agreements with the Islamic Development Bank (IDB), also extends to the development of Islamic finance in the private sector. Through agreements with the IDB Tunisia will receive nearly US\$ 1.2 billion during the period 2013-2015, funds that are to be used for cooperation in priority areas based on a planned program.

Tunisia received \$200 million for the C Rades- Combined Cycle Power Project and the IDB raised its shareholding, under a memorandum of understanding signed in april 2014, to 21% in Zitouna Bank, the first Islamic bank in the country that was established in 2009, to create a specialised joint institution in Islamic micro-finance that would allow both partners to expand to Africa.

The IDB has also pledged its support for the country's first ever sukuk program worth US\$ 600 million, by offering financial guarantee for the sukuk. This has been planned by the IDB's credit and political risk insurance arm the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC). ICIEC's guarantee will help ease investors' concerns about Tunisia's financial position, and enable the sovereign sukuk issuer to raise financing from international financial markets for infrastructure investment and other development projects.

What to expect by the end of 2014

- The IDB will offer a practical and sharia-compliant form of guarantee with regards to AAOIFI standards (17) since it is given by an independent party but the Tunisian government has yet to make a formal application to take up this offer and to issue a sovereign sukuk as planned because of the current political transition which has taken longer than expected.
- The Government has yet to establish an independent entity attached to the ministry of finance which is wholly-owned by the Republic in accordance with, and to operate in conformity with, Article 7 of Law Number 30 for the purpose of participating in the issuances of sukuk to the extent authorized by the Finance Act for the current year.
- The issuance of sovereign Sukuk by the Government of the Tunisia will create a benchmark and activate a serious plan for the further development of a Sukuk capital market in the Tunisia and the further development by the regulators of a standard approach for Sukuk issuance which enables environment for Islamic finance in the country.

4- Recommendations

Our recommendations are summarized as follows:

- i. The set up of the legislation to organize Sukuk and the need for financial infrastructure that underpins Sukuk issuance and trading via Special Purpose Vehicles are prerequisites for the successful issuance and management of Sukuk. Therefore, key regulatory institutions and industry associations in Islamic Finance have to play an important role. It also means that plans for the first Tunisian sovereign sukuk will develop with full speed.
- ii. The creation of a financial infrastructure for the promotion and emergence of Sukuk markets, the expansion of the potential Islamic finance market and the ability to provide sustainable long term stable transfers and FDI are valuable opportunities for the Tunisia as a whole to reinforce its strength in capital markets and financial business: the Ministry of Finance, the Central Bank should review their debt financing policies. Furthermore, the Ministry of Development and the Ministry of Foreign Investment should explore the potential of many Sukuk structures.
- iii. The contribution of Islamic institutions of Golf countries investing in the country in leveraging the issues and values of Sukuk would enhance in pushing forward the ability of Sukuk in covering the financial deficit and the movement of economic development through financing the large scale projects and the infrastructure projects. Leading countries in Islamic finance experience should cooperate with Islamic Development Bank to help Tunisian financial system to become a motor of an Islamic financial Hub.
- iv. The establishment of Tunisian Finance Harbor could play an important role in developing Tunisia via the bank financing on Islamic basis and also would contribute in issuing Sukuk to finance the infrastructure projects within the Tunisia.
- v. The increased involvement of western regulators and credit rating agencies, the increased protection of stakeholders, the government support and the conformity to risk mitigation procedures would impact the growth of Islamic Finance sector and Sukuk market development.

- vi. The lack of Shariah advisors within the country and the scepticism generated in practitioners towards the conflict between the provisions of S_hari'a law and the performance of Sukuk should be removed.

Conclusion

Islamic finance initiative is being led by ad hoc advisers which lack the in-depth knowledge of the dynamics of Islamic finance and Sukuk markets because Tunisia still lacks a sufficiently large body of professionals with expertise in this field. Much more proactive role should be played by the Central Bank and other government departments as the Central Bank does not have a similar organization in place. In this regard, the priority functions of the government is to provide an Islamic banking law and promote the development of a comprehensive legal framework related to Project Finance and Asset Securitization, useful tools to encourage investors and even a quick recovery of the Tunisian economy.

The preconditions that the legal framework must be acceptable legally and sociologically are the result of the inexistence of law pertaining to Islamic finance, the utilitarian factor of the law in response to the need of the Muslim majority and the element of justice for Tunisian society to restore its neglected rights of the Muslim majority to be ruled by *the principles of Shariah*.

Most importantly, it is essential to bring out a deep thought to contribute to the current arsenal of regulations for the development of Islamic banks and Sukuk market to reduce the huge divergence of real assets and real liabilities in banking sectors which in time will create a robust financial environment more resistant to financial shocks and banking crises.

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