

Financing in the Islamic System and Sustainable Economic Development of Selected Islamic Countries

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Abstract— Financial markets have the obligation to support the real economy has become the development and sustainable economic growth. Capital is an indispensable tool for economic growth and prosperity, which is accelerated through the financial markets, and Islamic finance tools have developed significantly in Islamic countries in recent years. Promoting macroeconomic objectives such as sustainability and achieving endogenous and viable economic growth are the purposes of all economic systems. Increasing growth of financial methods and development of these systems drives from this reality that the sustainable development of the financial system is an integral part of economic system development. Islamic financing has emerged in the world financial literature, intending to provide a new model for replacing conventional financial plans and providing financial, commercial and investment facilities and opportunities by the principles of Sharia. This system has been able to identify its various dimensions. Due to the benefits and advantages of Islamic financing, the issue of Islamic financing has become critical in the international arena. By assuming Islamic financial systems, it can be concluded that they do not permit the use of current financial methods since usury is forbidden in Islam. So, they attempt to create Islamic financial instruments. As an Islamic and non-usury financial instrument, Sukuk has found a suitable position among Islamic governments and companies. Islamic financing has emerged in the world financial literature to provide a new model for replacing traditional and conventional financial systems and providing financial, commercial and investment facilities and opportunities under the principles of Sharia. The purpose of the present study is to investigate the role of Islamic financing of Sukuk on the economic growth of Malaysia, Iran, Pakistan, Qatar, Bahrain, Turkey, Indonesia, UAE and Saudi Arabia; applying the panel data, will be analysed the variables affecting economic growth (government spending, gross capital formation, labour force, exports and Sukuk).

Keywords: *Financing, Islamic Financing, Economic Growth, Sustainable Development, Islamic countries, Sukuk*

Introduction

Financial markets, as the flow of financial resources from the non-productive sector to the productive sector, have a valuable role in economic growth, stabilization of monetary and financial variables, investment, increasing employment and improving the welfare of society. Due to the high importance of these markets, they are referred to as the main arteries of the economy [1].

Financial markets have to support the real sectors of the economy to pave the way for sustainable economic development and growth. Financial markets must support the real sectors of the economy to pave the way for sustainable economic development and growth. Organizations, companies, institutions need financial resources to establish, equip or expand their activities, that in conventional financial markets, this need is met by issuing interest-bearing bonds. From the Islamic point of view, interest rates (usury) are forbidden, and these bonds cannot be used for financing in Islamic society. Muslim philosophers, considering the importance of financing companies through Islam, first thought of creating an Islamic banking system and then launching a capital market. The role of Islamic financial instruments or Sukuk in the Islamic financing system is significant and prominent [2]. Islamic financing has emerged in the world economic literature to provide a new model for replacing traditional and conventional financial systems and providing financial, commercial and investment facilities and opportunities following the principles of Sharia [3]. This system has been able to identify its various dimensions. Due to the benefits and advantages of Islamic financing, the issue of Islamic financing has now become critical in the international arena [4; 5]. Today, the benefits of Islamic financing have led to its expansion and growing importance. A wide range of Islamic financial institutions is active not only in Islamic countries but also in some European countries [6]. In this vein, the scope of activities of financial

institutions and banks providing Islamic financial services is increasing; today, about 150 financial institutions in more than 45 countries worldwide are developing and expanding and implementing various forms of Islamic financing. Islamic financial instruments (Sukuk) are securities with the same financial value and tradable in financial markets, designed based on one of the contracts approved by Islam, and bondholders jointly own one or a set of assets and benefits derived from them [7].

The present study investigates the role of Islamic financing of Sukuk on the economic growth of selected countries, including Malaysia, Iran, Pakistan, Qatar, Bahrain, Turkey, Indonesia, UAE and Saudi Arabia. After the abstract and introduction, the theoretical foundations of the research; in the next section, the research method is examined, the research findings are analysed, and the final part of the research result is expressed.

I. THEORETICAL FRAMEWORK

The most accurate definition of financing theory is provided by Merton: The study of the behaviour of brokers in the process of allocation and distribution of resources from both dimensions of place and time in uncertain conditions forms the basis of financing [8]. Time and uncertainty are the main elements influencing financial behaviour [9]. In the economic literature, capital is a critical factor in economic growth. Increasing the volume of capital, both directly as a factor of production and through increasing the efficiency and productivity of other factors, increases the level of employment, production and welfare of society. Therefore, financing investment projects is critical because of the great importance of capital formation in the economy. Financial development is one factor that diverts resources from savers to investors [10], and plays an essential role in financing projects for optimal resource allocation and investment risk sharing. Financial development is defined through four channels: risk management, financial deepening, financial liberalization, and financial innovation [11].

Diversification of financial instruments is, in fact, one of the factors affecting the development of financial markets and their efficiency. Since financing encourages better savings and investment and is an objective facilitator for production and consumption, it is essential and done better through financial innovation [12]. The relationship between financing development and economic growth has been a controversial topic that has been widely analysed in the economic literature, and Some experts consider financing to be an essential element of economic development [13; 14; 15]. For other scholars, financing is only a small factor in economic growth. Schumpeter cognises the banking sector as the engine of economic growth that finances the production investment budget [16].

Financial development implements efficiently through channels of conversion of savings into investments. This channel performance via increasing profit margins and financial intermediaries, which has led to an increase in the diversification and specialization of banks [17]. These costs are affected by inefficiency in providing financial services,

redistribution of financial intermediaries' profits through taxation, and risk compensation by financial intermediaries. Financial development also leads to increased productivity of capital [18]. An efficient financial system increases capital productivity and affects economic growth by selecting the most profitable investment projects, risk sharing, providing the required liquidity for investment projects [19]. Financial development will also positively affect savings rates because an efficient financial system offers a better combination of returns and risk for savers, and early patterns of economic growth emphasize higher savings rates and higher economic growth rates [20].

Economic growth is the primary manifestation of the performance of governments; Economists try to help policymakers improve the index by accurately recognizing the dynamics and factors affecting the change and evolution of this index. In the economic literature, the accumulation and storage of physical capital have been expressed as a vital factor to achieve more outstanding production and productivity and to create a continuous flow of additional income for society [21]. To achieve the theoretical relationship between financing and economic growth, the production function should be utilised because, in the production function, the relationship between investment and economic growth is stated and investing in any institution without financing that institution is considered impossible [22]. In the 1940s, Haroud and Dumar used the most famous production function to analyse the process of economic growth. The central assumption of their model is that the amount of production in each economic unit, whether firm, industry or the whole economy, depends on the amount of investment in that unit [23; 24]. Islamic financial instruments play a significant role in the growth and development of banking and the Islamic capital market. They have an essential role in achieving the Islamic goals for the economic and livelihood of Islamic societies [25]. Islamic financing is the best way to finance large economic projects and activities beyond the financial capacity of an individual or a private company, or even the government [5]. The main aspects of the distinction between Islamic-based financing and conventional financing are based on five principles [26], three of them include the prohibition of usury, the ban of risk and uncertainty, and the prohibition of financing the illegal sectors of weapons, drugs, etc.). Also, the two principles, profit and loss sharing and transaction based on an asset, are influential aspects of distinguishing between these two types of financing [27]. Global banks and Islamic financial institutions can expand around the world [28; 29].

This capacity is due to the capabilities of this system, as well as the structural problems and weaknesses of usurious financing [30]. The inefficiency of the conventional economic system (interest-bearing system) is not only proposed among Islamic doctrines, but many economists, such as Fisher, Simmons, and Friedman, have argued that the one-sided, interest-bearing debt system is fundamentally insecure [31]. The process of globalization, to have global scope for the activities of Islamic banks and the expansion of global communications, including financial communications, has created new perspectives in Islamic banks [32]. Islamic financing leads to financial stability and development due to

the transparency of contracts by covering inflation and trying to reduce it [33]. The existence of non-fixed profits in Islamic agreements that lead to Islamic financing excludes financial repression. It leads to endogenous economic growth by preventing the increase of intermediary financial expenses.

II. LITERATURE REVIEW

Goldsmith was the first scholar to point to the positive relationship between financial development and economic growth [34]. In a study based on empirical evidence and using statistical data from 35 countries in the period 1963-1860, he realised if periods of several decades are considered, an approximate symmetry between economic and financial development [35]. It can also be seen that for a small number of countries where statistical data are available, rapid economic growth has been accompanied by high financial development rates. Rousseau and Vuthipadadorn, Has examined the relationship between financial system development and economic growth using VAR and VECM models for 10 Asian countries in 1950-19000 .The study results confirm the long-term relationship between financial and real economic variables and show that in many countries, the causal direction is from the financial sector to the real sector of the economy. The research results confirm the weak externalization of the financial sector compared to investments in 5 countries [36].

Colombages, in a study entitled "Financial Markets and Economic Performance", found that the issuance of Sukuk has no effect on economic growth, but in a long time, will have a positive impact on economic growth. This relationship may be one-way, meaning that the issuance of Sukuk bonds will improve economic growth. However, he stressed that the relationship between these two variables depends on the economic structure of each country [37].

Lawal and Imam, investigated banking and economic growth based on Nigerian empirical observations; the primary purpose of the study is to examine the financial contribution to Nigeria's economic growth and its direct relationship. Experimental results of research using quarterly data from time series during 2015-2015 show a strong positive relationship between financing of Islamic banks and economic growth in Nigeria, which results in the theory of an efficient banking system leading to economic growth [38].

Abdelghani Echchabi, conducted a study to determine whether Sukuk financing affects the economic growth of large exporting countries. The research findings show that the issuance of Sukuk can affect GDP and gross capital formation if all countries cooperate; otherwise, it will not affect the growth of Saudi Arabia and the GCC [39].

Smaoui and Khawaja, studied the emergence of the Sukuk market and its economic effects. They state that the lack of interest in Sukuk markets is one of its essential features. What distinguishes it from other financial markets is that all developed Islamic countries use Sukuk but it's also used as a financial instrument, especially in European countries and the United Kingdom. The value of Islamic financial assets is estimated at \$ 3.2 trillion by 2020, the Sukuk market share of total assets is about 10%, which is increasing every year, and this shows the importance of the Sukuk market [40].

Nawaz et al., examined the impact of Islamic financing on Pakistan's economic growth quarterly using time series data from 2006-2015. This study shows that in the long run, there is a positive relationship between Islamic financing and economic growth in Pakistan, and this strengthens the theory that "good performance and functioning of the Islamic banking system leads to economic growth." Meanwhile, in the short term, there is no relationship between economic growth and Islamic banking [41].

Abdelghani Echchabi et al., examined Sukuk financing on the economic growth of GCC member countries using the test Toda and Yamamoto Granger. The study results indicate that Sukuk financing does not affect the economic growth of these countries, which has significant consequences [42].

III. METHODOLOGY

This research method is descriptive-explanatory, and the data panel method is used according to its statistical data. According to the study of the role of Islamic financing of Sukuk on the economic growth of selected countries, the method of collecting information and statistical data based on the library method and searching the World Bank and the United Nations website, testing research hypotheses and related analyses using econometric models (data panel); to estimate the model, first the F test to select the combined method or data panel, and then the Hausman test is performed to determine its fixed effects, and Eviews8 software will be used to test and estimate the model.

The statistical universe in the current study of selected countries includes Malaysia, Iran, Pakistan, Qatar, Bahrain, Turkey, Indonesia, UAE and Saudi Arabia. This study aims to investigate the role of Islamic financing on the economic growth of selected countries, which is analysed using data from selected countries. The model used in this study is adapted from the Drissi and Angade [43], and the general formula of this research is:

$$LGDP_{it} = \beta_1 + \beta_2 LExport_{it} + \beta_3 LGCF_{it} + \beta_4 LLF_{it} + \beta_5 LSukuk_{it} + \beta_6 LGE_{it} + \varepsilon_{it}$$

LGDP; GDP logarithm (economic growth)

LExport; Export logarithm

LLf; Logarithm of the labors

LGCF; The logarithm of gross capital formation

LSukuk; Logarithm sukuk

LGE; Logarithm of government expenditures

First, the unit root test is performed to check the significance of the model variables. The F-Limer test is performed to select the combined method or data panel, and then the Hausmann test is performed to determine the fixed or random effects for estimating the model. The research variables are logarithmically entered into the model to compare the estimation coefficients with each other. All data for this study were collected from the World Bank and the United Nations (UN) website.

IV. FINDINGS

A. Evaluation of the reliability of research variables

Before estimating the model, it is crucial to test the reliability of all variables used in the model; because the instability of variables in both time series data and panel data causes false regression problems to evaluate the statics of variables, Levin, Lin and Chu (LLC) tests are utilised, which are more used to assess the reliability of variables in composite data. Examination of tests is determined through the Iy 8 platform and significance based on prob at the level of 5%. Given that the H0 test hypothesis indicates the existence of a unit root for each variable, if the calculated p-value is less than 5%, the hypothesis of a unit root for that variable is rejected. In other words, the probability value less than the value of 0.05, H0 is denied based on a unit root at the 95% confidence level, and the model variables at the (10) level are stable or static.

TABLE I. TESTING THE RELIABILITY OF RESEARCH VARIABLES (LLC)

Variable	Statistics value	Level	Prob < 0.05
LGDP	-5/24463	I (0)	0/0000
Lexport	-11/7279	I (0)	0/0000
LGCF	-4/0137	I (0)	0/0000
LLf	-9/5391	I (0)	0/0000
LSUKUK	-4/518	I (0)	0/0000
LGE	-15/7984	I (0)	0/0000

B. Estimation of research models

First, are estimated the Chu test and the Hausman test, then the Sukuk model. For the Chow test, estimated the time-constant effects model is and evaluated the Panel or Pool based on the F-Limer test.

TABLE II. CHOW TEST FOR POOL AND PANEL DATA

Chow test	F- statistic	Prob < 0.05	Effect
time-constant effects	65/5511	0/0000	Reject H0

The table shows the confirmation of the fixed effects against the least-squares aggregation method. In simpler terms, the validation of composite data versus integrated data, because the probability is less than 5%.

After verifying the panel data, the Hausman test is applied to detect the difference in the intercept of the cross-sectional units is constant or random operations can express this difference between units more clearly. In this test, we examine the H0 based on the consistency of random effect estimates instead of the H1 hypothesis based on the inconsistency of random effect estimates or fixed effect consistency.

TABLE III. HAUSMAN TEST TO DETECT THE MODEL OF FIXED OR RANDOM EFFECTS

Hausman test	Statistics value	Prob < 0.05	Effect
	12/5491	0/0280	Reject H0

The results of the Hausman test indicate the rejection of the H0. Because the probability is less than 5%. Based on the results in Tables (II) and (III), the pattern of this research for the studied countries and the Sukuk variable is estimated using the design of fixed effects and the estimation results are reflected in Tables (IV):

TABLE IV. TABLE 4- RESULTS OF ESTIMATING THE MODEL WITH ISLAMIC FINANCING VARIABLE (SUKUK)

Variables	Test panel data (random effects)		
	Coefficient	T-statistic	Prob < 0.05
Y-intercept	3,475645	0,403980	0/0000
Lexport	0,218808	0,059970	0/0010
LGCF	0,371525	0,031908	0/0000
Llf	0,267126	0,095576	0/0091
LGE	0,156678	0,066109	0/0000
LSUKUK	0,007042	0,003671	0/0650
R ² = 0/99			
DW = 1/63			
F-statistic = 5018,505			
Prob (F-statistic) = 0/0000			

Growth studies usually use the logarithmic form of variables. This is because the model will be a constant tensile model, and the estimated coefficients will be interpreted directly as tensile. Stable tensile models are also more appropriate for policy recommendations. Sukuk coefficients have a positive sign and are statistically significant at less than 10% and with 94% confidence. Accordingly, Sukuk has a positive and significant effect at 90% on the economic growth of the studied Islamic countries during this period.

The outcomes of Table (IV) show that the estimation model is in a good position in terms of statistical indicators. The F statistic indicates the significance of the complete regression. In other words, the hypothesis that the coefficients of the model-independent variables can be 0 is rejected, and the complete regression is significant. Also, the statistical value of R2 is 0.99, which shows that the explanatory variables describe 99% of the changes in the dependent variable. The lack of autocorrelation in the remnants of the model was investigated using the Durbin-Watson, which is 1.63. This value is between 1.5 - 2.5, which is acceptable [44].

Among the variables affecting economic growth in this estimation model, gross capital formation, labor, exports, government expenditures and Sukuk, respectively, had the most significant impact on economic growth, and all variables had a significant effect on growth at 90%.

V. CONCLUSION

In recent years, the expansion of Sukuk markets has been rapid. The development and prosperity of the Sukuk market depends on the standardization and coordination of the structure of Islamic securities with the global securities standard. To achieve this, the basic requirements include creating a legal framework and establishing support institutions. Regulations in the Islamic world will undoubtedly welcome the entry of sukuk into the market, and this new product will help the market formation process by collecting private savings and directing it to investment opportunities and will lead to the deepening of the capital market.

Due to the advantages of these securities, diversified sukuk design with different risks and returns, has a very important role in expanding the sukuk market. Just as in today's world of capital markets, investors welcome securities that have been certified by reputable international rating agencies. Providing the possibility of ranking Islamic securities will help in expanding its market.

All companies and investors consider financing as their most important goal and plan to provide it. Financing is essential for profitable projects; financial managers must attempt to give the company's financing sources and measure the company's financial risk and profit because the company's potential financing for investment and appropriate financial plans are among the factors of the company's progress.

Islamic financing has emerged in the world financial literature intending to provide a new model for replacing traditional and conventional financial systems and providing financial, commercial and investment facilities and opportunities following the principles of Sharia [45; 46]. This system has been able to identify its various dimensions. Due to the particular benefits and advantages of Islamic financing, the issue of Islamic financing has now become critical in the international arena. In this regard, various financial institutions and tools have been invented and used. Nowadays, the benefits of Islamic financing have led to its expansion and growing importance; a wide range of Islamic financial institutions are operating not only in Islamic countries but also in some western countries. In addition, the number and scope of activities of financial institutions and banks providing Islamic financial services are increasing.

This study aims to investigate the role of Islamic financing of Sukuk on the economic growth of Malaysia, Iran, Pakistan, Qatar, Bahrain, Turkey, Indonesia, UAE and Saudi Arabia. Findings indicate that Sukuk coefficients have a positive sign and are statistically significant at a level of less than 10% and with 94% confidence. Sukuk has a positive and significant effect at 90% on the economic growth of the studied Islamic countries during the period.

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