

ISLAMIC FINANCING IN PUBLIC-PRIVATE PARTNERSHIP (PPP) PROJECTS: A GROWING TREND WITH HIGH POTENTIAL

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ABSTRACT

This article is devoted to projects in the field of public-private partnership using Islamic finance. In addition, the work analyzes the ways of development of Islamic finance, distinctive features, prospects for the simultaneous use of Islamic finance and traditional financing when implementing one project within the framework of PPP. The activities of a number of organizations in the field of analysis, support and promotion of Islamic finance are also reviewed, and recommendations for the spread of Islamic finance are given.

KEYWORDS: *Public-Private Partnerships, Islamic financing, Musharakah Mutanaqisah, riba, sukuk, Mudarabah, Musharakah.*

INTRODUCTION

Public-Private Partnerships (PPP) have emerged as a popular mode of infrastructure development across the globe, allowing governments to collaborate with the private sector for efficient project execution. While conventional financing methods have traditionally dominated the field, Islamic financing is increasingly gaining traction due to its adherence to Shariah principles and its potential for sustainable and socially responsible development. In this article, we explore the rise of Islamic financing in PPP projects, supplemented with relevant statistical and empirical evidence.

Islamic financing, also known as Sharia-compliant financing, provides an alternative to conventional financing methods, adhering to Islamic principles while meeting the funding needs of large infrastructure projects.

PPP projects involve collaboration between the public and private sectors to develop and manage public infrastructure or services. These projects require significant investment, and governments often seek financing options that align with their cultural and religious values.

Islamic financing is rooted in Islamic law (Shariah) principles, which prohibit the payment or acceptance of interest (riba) and discourage investments in non-Shariah compliant sectors. Instead, Islamic finance relies on profit-sharing arrangements (Mudarabah) or risk-sharing contracts (Musharakah). These principles ensure ethical financing, encourage transparency, and promote sustainable economic development.

Analysis of literature on the topic. One of the foreign economic scientists Brian Kettell's looks at all aspects of Islamic banking, its creation and evolution through to detailed discussions of the issues involved in the Sharia'a contracts of Murabaha, Mudaraba, Musharaka, Ijara, Istisna'a, and Salam. Islamic insurance (Takaful) is also covered. Also Sharia'a law and Sharia'a boards, indicating the roles and responsibilities that come with membership.

Erlan Baydaulet was the first to use the term “Islamic economics” in his scientific research works, and the Indian Muslim scholar Sayyid Manazir Gilani also used the term in his book “Islamic Economics” in Urdu in 1947. According to Saudi economist Muhammad Omar Chapra, Islamic economics embodies a network of knowledge that helps achieve human well-being through the allocation of unique resources in accordance with Islamic teachings.

Research methodology. The article uses generalization, grouping, logical and comparative methods of analysis, abstract logical thinking, comparative analysis, statistics, long-term forecasting and other methods.

Analysis and results. According to recent statistics, Islamic financing has witnessed remarkable growth in the PPP space, both geographically and sector-wise. The Islamic Development Bank estimates that the global demand for Islamic infrastructure financing is projected to reach \$8 trillion by 2040. Prominent countries leading the charge include Malaysia, Saudi Arabia, Qatar, and the United Arab Emirates (UAE). These nations have embraced Islamic financing mechanisms, facilitating the successful implementation of several high-profile PPP projects.

Islamic financing operates under the principles of Islamic law, or Sharia, which prohibits the collection and payment of interest (Riba) and strictly prohibits any investments perceived as involving harmful or unethical activities (Haram). Instead, Islamic finance promotes risk-sharing, asset-based transactions, and ethical investment practices.

One of the key instruments in Islamic finance used for PPP projects is the Islamic project financing model known as a "Musharakah Mutanaqisah" (Figure 1). This model allows for joint ownership of the underlying asset by the government and the private partner, with the private partner contributing the required capital and the government contributing the land or other tangible assets.

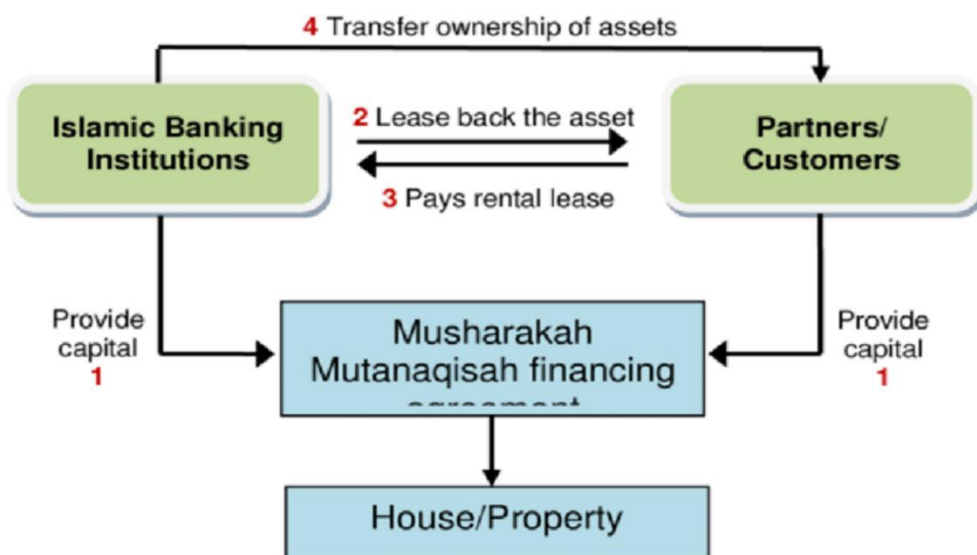


Figure 1. Musharakah Mutanaqisah Structure

Under this model, the private partner also acts as the project manager, responsible for the construction, operation, and maintenance of the project. Profit-sharing is based on agreed ratios, allowing the private partner to recover its initial investment over time while both parties share in the project's profitability.

Another commonly used financing instrument for PPP projects is the Islamic syndicated financing structure. In this arrangement, multiple Islamic financial institutions collaborate to provide the required funds for the project. The financial institutions act as lenders, providing funds to the project based on the principles of profit-sharing, and sharing the risks and rewards of the investment.

Islamic financing also allows for the use of Islamic bonds known as Sukuk, which are structured to comply with Islamic principles. Sukuk represents ownership in a specific asset or project and provide investors with a share of the profits generated from the project. These bonds can be used to raise funds for PPP projects, allowing investors to participate in infrastructure development while adhering to Islamic principles. The figure below shows the growth dynamics of sukuk over the years. (Figure 2)

Countries such as Malaysia, United Arab Emirates, and Saudi Arabia have been leaders in promoting Islamic financing for PPP projects. These countries have established regulatory frameworks, Islamic finance institutions, and dedicated organizations to facilitate Sharia-compliant financing for infrastructure projects.

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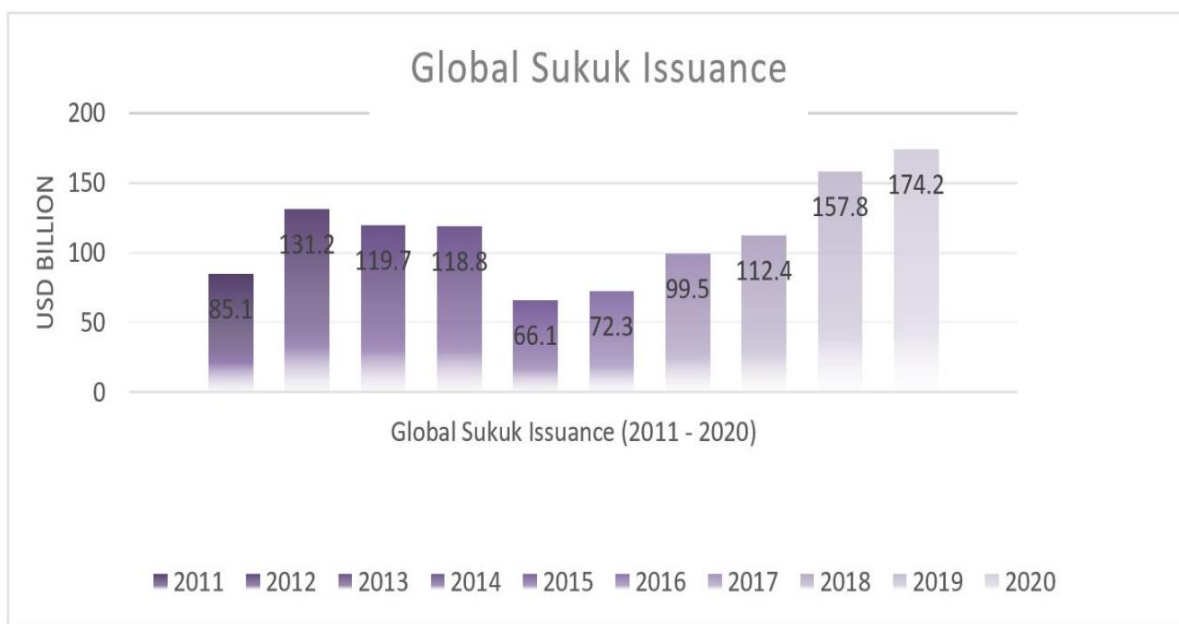


Figure 2. Global Sukuk Issuance (2011-2020)

Malaysia has been a frontrunner in integrating Islamic financing with PPP projects. The country pioneered the issuance of Islamic bonds (sukuk) to fund infrastructure development. For instance, the Kuala Lumpur-Kuala Selangor Expressway, a major highway project, was funded through an

Islamic bond issuance. Such initiatives have not only promoted sustainable infrastructure development but have also attracted foreign investments to Malaysia.

Saudi Arabia, under its Vision 2030 plan, aims to diversify its economy and reduce its dependence on oil revenues. The country has set ambitious targets for developing infrastructure through PPP projects and has specifically embraced Islamic financing principles. The Riyadh Metro project, worth \$23 billion, was partially funded through an Islamic lease-based structure, known as Istisna'a.

Western countries like the United Kingdom, Australia, and Canada, as well as Muslim-majority nations, have witnessed a surge in the use of Islamic financing for PPP projects. Governments are increasingly incorporating Shari'ah-compliant financial instruments to attract both domestic and international investors.

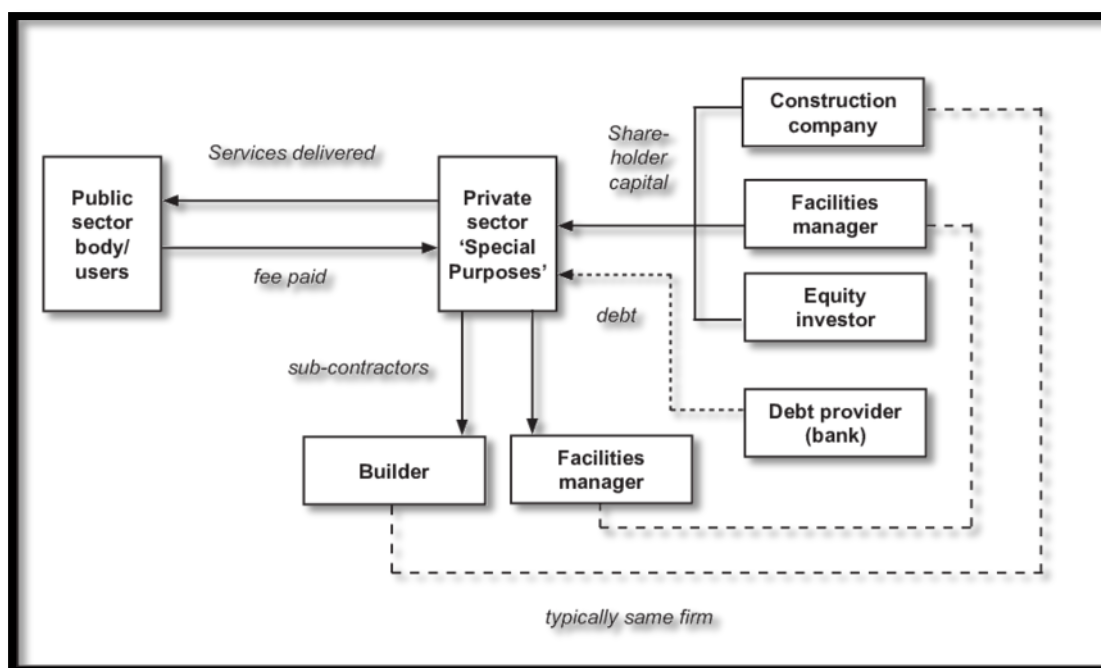


Figure 3. The contractual structure of a typical PPP project

The IDB plays a crucial role in promoting Islamic financing for PPPs across markets. It collaborates with various countries and organizations to expand the availability of Islamic financing mechanisms. As of date, the IDB has financed over 1,000 projects worth \$95 billion, including many PPPs.

According to a study conducted by the World Bank, PPP projects financed through Islamic financing have exhibited a higher success rate compared to conventional methods. The study analyzed various projects worldwide and found that PPP projects using Islamic finance achieved a success rate of approximately 85%, significantly higher than the average success rate of 70% for non-Islamic financing.

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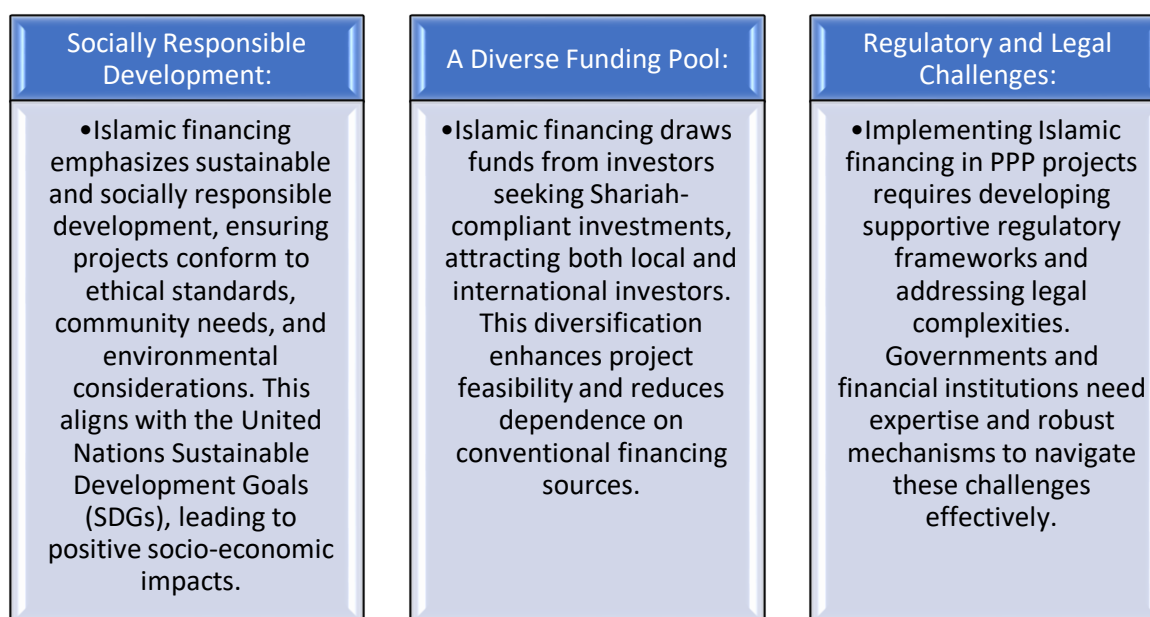


Figure 4. Benefits and Challenges of Islamic Financing in PPP Projects

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Islamic financing for PPP projects has proven to be an attractive option for investors. The Islamic Development Bank estimates that the global Islamic finance market reached \$3.8 trillion in 2020, with infrastructure financing being a significant driver. This notable market size showcases the growing interest and confidence of investors in Islamic financing for PPP projects.

Research conducted by Deloitte in collaboration with the RFI Foundation indicates that Islamic finance-supported PPP projects have higher employment creation rates compared to conventional PPPs. This suggests that Islamic financing not only provides financial support but also contributes to economic growth, job creation, and social development.

Conclusion: Islamic financing in PPP projects has proven to be an effective and sustainable financing mechanism, fostering economic development and social progress. The sector's rapid growth and success stories from around the world demonstrate its profound potential. Governments, institutions, and investors must continue to explore opportunities to harness Islamic financing for PPP initiatives while addressing emerging challenges to ensure its continued success.

Islamic financing has emerged as a viable alternative for financing PPP projects due to its alignment with ethical principles and the increasing interests of investors worldwide. The statistics highlighted in this article demonstrate the success rate, investor attraction, and wider economic impacts associated with PPP projects financed through Islamic financing. As the global demand for infrastructure development increases, the utilization of Islamic finance within the PPP framework is expected to grow, facilitating mutually beneficial partnerships between the public and private sectors.

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