

The Role of Islamic Government Sukuk in Financing Economic Development

Kouidri kouchih boudjemaa^{1*}

¹ University of Khemis Miliana , Algeria, b.kouidri-kouchih@univ-dbkm.dz

Received: 20/07/2025

Accepted: 27/12/2025

Abstract:

This study focuses on the importance of Islamic government sukuk in supporting economic growth and development. Islamic government investment sukuk have proven successful in financing development in many Islamic and non-Islamic countries. Their use became widespread following the global financial crisis, and they are now considered among the most innovative financing mechanisms in the world. The research is structured around three main themes: the nature and principles of Islamic sukuk, the types and mechanisms of sukuk issued by governments, and the contribution of sukuk to macroeconomic development—through an analysis of selected Islamic countries. The study also addresses the advantages of using Islamic sukuk to finance economic development projects. The findings highlight the effectiveness of sukuk in mobilizing idle capital, enhancing financial inclusion, and supporting infrastructure and public finance needs

Keywords: Islamic government sukuk ; economic development; Islamic finance; Financing Economic Development ; Securitization.

Jel Classification Codes: Z12; E62; G20

* Kouidri kouchih boudjemaa

1. INTRODUCTION :

Islamic economics has always been concerned with organizing and developing economic activity in terms of production, consumption, and distribution, all guided by Islamic principles and teachings. Consequently, Islamic financial instruments are grounded in the principles of the Islamic economic system, which distinguishes them from conventional systems.

Islamic sukuk offer many advantages, making them attractive to a broad spectrum of investors, businesspeople, and governments. These instruments are characterized by flexibility, ease of issuance and trading, and reduced risk. Furthermore, they are suitable for investors who avoid speculation in stock markets or interest-based transactions such as conventional bonds.

This study aims to examine the role of Islamic government sukuk in achieving economic development. The research problem can be outlined through the following questions:

- What are Islamic sukuk?
- What is the concept of Islamic government sukuk, and how are they implemented?
- What role do Islamic government sukuk play in economic development?

2. THE NATURE AND PRINCIPLES OF ISLAMIC SUKUK

2.1 The Emergence of Islamic Sukuk:

Islamic sukuk emerged as a response to the need within Muslim communities for Sharia-compliant financing instruments as alternatives to conventional interest-bearing bonds. Early proposals included "Muqarada bonds," a term introduced in 1977, which is now recognized as one of the types of Islamic sukuk. In 1983, Turkey issued a new kind of Islamic sukuk, called "participation bonds," to finance the construction of the second Bosphorus Bridge. In 1988, the Islamic Fiqh Academy under the Organization of Islamic Cooperation issued a resolution defining the Sharia rules governing Muqarada bonds and recommended naming this financial instrument "Sukuk al-Muqarada." (Al-Mahi, 2008., p. 17)

In 1995, Dr. Monzer Kahf published the first detailed study on Ijara Sukuk (lease-based sukuk), and in 2004, the Fiqh Academy issued a resolution establishing their Sharia principles. AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) also published a comprehensive Sharia standard for sukuk in 2003.

Islamic sukuk then spread across Islamic countries, with some, like Malaysia, leading in both issuance and diversity. Malaysia issued its first sukuk in 1995 to finance a \$350 million power plant. Bahrain began issuing Ijara and Salam sukuk in 2001.

Notably, Islamic sukuk have also been adopted in non-Islamic countries. In 2008, the UK government announced plans to issue sovereign sukuk to fund the national budget, becoming the first Western government to do so. Other countries like Germany, Japan, and Thailand have shown interest in similar moves.

The principle upon which Islamic sukuk are based is securitization, which refers to obtaining funds based on existing bank debts by creating new financial assets. Securitization involves converting the value of financial assets into marketable securities that can be traded. This process helps provide liquidity to banks and financial institutions that finance projects and purchase assets. (Abdullah, 2002, p. 13)

The concept of securitization developed during the 1970s, particularly in the American market, where it began with mortgages and real estate loans.

For example: A company or institution may sell one of its income-generating assets—separate from its other assets—to the public. Each individual investor would own a proportionate share of this asset through a financial security.

Therefore, it becomes clear that securitization differs from an initial public offering (IPO) of shares or bonds to raise funds. While both involve issuing securities to raise capital from the public, securitization is preceded by the institution already owning an income-generating asset. In contrast, IPOs are conducted to raise funds in order to acquire assets. (Dhubyan, 2002, p. 33)

Some scholars argue that securitization can more easily comply with Shariah principles than conventional banking concepts. In fact, the operations of Islamic banks are often closer to forms of securitization and portfolio management than to traditional banking methods.

2.2 Definition of Islamic Investment Sukuk:

The concept of Islamic sukuk is based on participation in financing a medium or long-term project or investment venture, in accordance with the Islamic principle of "al-ghunm bil-ghurm" (sharing in profit and loss). This is similar to the equity system in modern joint-stock companies and the unit system in investment funds.

For this purpose, a joint-stock company is established with its own legal personality, which issues the sukuk necessary for financing and offers them for public subscription. Each sukuk holder is entitled to a share in the capital, management, trading, gifting, inheritance, and other financial transactions. (Omar, 2019, p. 5)

2.3 Distinctive Features of Islamic Sukuk

Some of the most important features that distinguish Islamic sukuk are:

- a.** The capital of sukuk (the required financing amount) is composed of investment units of equal value. Each unit grants its holder a common share in the assets of the operation or project being financed, in proportion to the number of sukuk held relative to the total issuance. (Najia Sghir, 2022, p. 439)
- b.** The underlying assets may be tangible fixed assets, circulating assets, or intangible rights, according to usufruct arrangements (for fixed assets) or ownership of the corpus (for circulating assets).
- c.** Sukuk can be traded using any method that is legally and Shariah-permissible. The sukuk holder has the right to transfer, pledge, gift, or otherwise dispose of their sukuk through financial intermediaries or other legally recognized means.
- d.** Islamic sukuk fundamentally apply the Fiqh concept of profit and loss sharing, similar to shares.
- e.** The parties involved in an Islamic sukuk contract are:
 - The issuer of the sukuk: A company with legal personality representing the “working partner” responsible for managing the sukuk under the rules of partnership (musharakah).
 - The participants in the sukuk: The sukuk holders, who are the capital providers and are referred to as investors. The issuer may also engage consultants and experts in sukuk issuance, marketing, risk insurance, and other support services necessary for successful issuance and trading in financial markets.
- f.** Operational and capital returns generated from the project or investment in which the sukuk proceeds are used are distributed between the issuer and the sukuk holders according to a pre-agreed proportion stated in the offering prospectus. This ratio can be renegotiated periodically by mutual consent.

2.4 . Comparison Between Sukuk, Bonds, and Shares

a. Islamic Sukuk vs. Shares:

Islamic sukuk share several characteristics with corporate shares, such as:

- Both sukuk and shares represent a proportional ownership in the net assets of a company or project, which often includes tangible assets, usufructs, and rights, eventually translating into cash or debts. For both to be Shariah-compliant, the assets must not consist predominantly of cash or debts; otherwise, trading them would be subject to Islamic rules on monetary and debt transactions.
- Holders of both shares and sukuk are entitled to a share of the net profits of the company or project in proportion to their contribution to the total capital.
- Both instruments represent a common share in the net assets for purposes of delivery, possession, and transaction legitimacy.

b. Differences Between Sukuk and Shares:

- Shareholders participate in corporate governance by electing the board of directors. In contrast, sukuk holders do not typically take part in direct project management, have no voting rights, and do not form a general assembly for the project. Under Islamic law, this is consistent with the concept that the capital provider does not intervene in management decisions but only chooses a trustworthy and competent manager.
- Shares represent a permanent stake in a company and remain valid as long as the company exists, regardless of ownership transfer. Sukuk, however, are not necessarily permanent. They may finance a project under diminishing musharakah or Ijara ending with ownership, where the asset eventually transfers to the other party over time.

c. Islamic Sukuk vs. Bonds:

Islamic sukuk differ from conventional bonds in several fundamental ways:

- Sukuk, like shares, represent ownership in the assets of a project or a specific investment activity. The holder has a real, asset-backed right. Bonds, on the other hand, represent debt owed by the issuing entity, unrelated to asset ownership.
- Bondholders are unaffected by the financial performance of the issuing entity; they receive the bond's face value plus predetermined interest. In contrast, sukuk holders are directly impacted by the project's performance and share in the risk. They earn profit if the project succeeds and bear loss if it fails.

Some bonds—profit-sharing bonds—do not offer fixed interest but instead provide a share of the issuer's profit. These may later convert into shares and are considered a form of temporary equity participation. However, these instruments generally do not comply with Islamic law, as their investments are not Shariah-compliant.

Moreover, asset-backed bonds are considered loans secured by collateralized assets. The bondholder's right lies in the debtor's obligation, while the asset serves only as a guarantee. By contrast, sukuk holders' rights are strictly tied to the actual assets represented by the sukuk.

2.5 Importance of Sukuk:

They contribute to revitalizing the economy by utilizing capital that otherwise refrains from participating in interest-based financing projects. (Bouguessa Salima, 2021)

- They allow governments and corporations to access legitimate funding to expand their activities and finance budget deficits.
- They serve as a Shariah-compliant alternative to conventional investment certificates and bonds.

- They help in managing liquidity at the macroeconomic level.
- They assist in developing local and global Islamic capital markets by introducing Islamic financial instruments.
- They offer stable and real financing sourced from existing resources within the economic cycle, which helps minimize inflationary effects works. (Radman, 2019, p. 54)

3. GOVERNMENT-ISSUED SUKUK TYPES AND MECHANISMS.

Islamic sukuk can be used to mobilize the necessary resources to finance a wide range of government projects. This is achieved by governmental institutions selecting the fixed assets they need as part of their development programs, specifying their characteristics precisely. These assets can include a wide array of essential capital requirements such as government buildings, public universities, schools, roads, bridges, airports, satellite stations, aircraft, ships, land transportation fleets, and more.

This process is managed through an independent body (such as an Islamic bank, a financial institution, or a government entity) that receives funding requests from public institutions and acts as an agent on behalf of sukuk holders, managing all related rights, obligations, and procedures according to the terms of issuance.

3.1 Government Salam Sukuk:

These are short-term instruments representing an investment operation in which the government acts as the seller of a commodity or asset (e.g., oil), and the buyer is either a brokerage firm, a bank, or any entity appointed by the government. This buyer acts as the manager of the Salam Sukuk portfolio and the buyer (or holder) of the sukuk. The portfolio collects the value of the sukuk from the buyers and pays the government upfront, with the commodity or its value delivered at a later date.

Mechanism for Issuing Government Salam Sukuk:

The issuance mechanism for short-term government Salam sukuk includes the following steps:

- The agent (e.g., an Islamic bank or financial company), appointed by the Ministry of Finance, establishes a Salam Sukuk portfolio, obtains approval from the central bank on the issuance prospectus, and invites banks, individuals, companies, and financial institutions to subscribe. The collected funds represent a mudarabah contract between the investors (sukuk buyers) and the agent (portfolio manager), who invests the funds on their behalf to purchase a specific commodity from the Ministry of Finance, which will be sold at a later date.
- The agent, acting as portfolio manager, signs a Salam contract with the Ministry of Finance (representing the government, owner of the commodity—e.g., oil). The contract includes a commitment from the agent to purchase oil in a specified quantity, quality, and price paid immediately. In return, the government acknowledges receiving the funds and commits to delivering the commodity or its value at a later date (e.g., three-month delivery) at a predetermined profit margin. This is feasible because oil futures prices are typically known in advance.
- A third-party bank is designated to sign a binding purchase undertaking with the agent (portfolio manager) at a predetermined price based on international market prices for the three-month delivery, acting as a guaranteed buyer in case the government marketing entity fails to sell the commodity at the agreed price.

- Upon maturity, the agent collects the proceeds from the sale of the underlying commodity and distributes the returns to the investors who participated in the sukuk issuance

3.2 Government Participation Sukuk (Certificates):

These are sukuk or financial certificates backed by real assets representing the government's shareholdings in companies or institutions wholly or partially owned by the state. Investors in such sukuk are therefore considered partners with the government in the expected returns or profits from these institutions or companies.

These sukuk are based on Shariah principles, with each certificate representing a monetary value in the currency of the issuing country and reflecting a share in the government's net ownership in the designated companies.

They are issued by the Ministry of Finance on behalf of the government and marketed through an authorized agent, usually an Islamic bank or a financial company, appointed by the Ministry of Finance and the central bank.

Government participation sukuk are issued with various maturities (e.g., 6 months, 1 year) and come in different denominations and pricing categories.

The profits of each company or institution in the portfolio are calculated based on the government's net ownership allocated for this purpose. These profits are distributed to sukuk and certificate holders proportionally to their share in the average net equity of the portfolio over the partnership period.

Advantages of Government Participation Sukuk:

- They carry low investment risk because they are backed by profitable, efficiently managed economic assets from diverse sectors.
- They offer higher returns compared to other available investment options.
- They are liquid instruments, which can be sold in the financial market at any time.
- They can be used in financial settlements as a reliable and secured payment method.

3.3 Government Mudarabah Sukuk:

- This is an Islamic financial instrument developed in practical application. It refers to a contract between two parties: the government (or its appointed agent acting as the mudarib) and the investors (capital providers or rabb al-mal). Investors provide capital, which the government uses to finance a pre-agreed project. Profits are shared according to a pre-determined ratio, while losses are borne by the capital providers unless negligence or misconduct is proven on the part of the government.

a. Advantages of Government Mudarabah Sukuk:

- Suitable for income-generating projects such as power plants, ports, airports, etc. The government can gradually buy back the sukuk holders' shares under a defined program.
- More efficient in resource allocation.
- The government is not bound by fixed obligations to the funders since the arrangement is based on profit and loss sharing.
- The profit-sharing ratio for each party is clearly specified in the issuance prospectus.
- Guarantee arrangements can be made through a third party to provide assurance to investors.
- The government may buy back the sukuk and redeem the capital providers' shares.
- These sukuk can be issued to cover all sectors: agriculture, industry, services, real estate, and others.

- Easy to monitor by beneficiary entities, since the financing is tied to tangible assets

b. Mechanism for Issuing Government Mudarabah Sukuk:

This mechanism involves three parties:

- Investors (capital providers).
- A financial services company established by the government as a separate legal entity (mudarib), or an existing Islamic or investment bank appointed by the state to manage the issuance as the mudarib.
- The Ministry of Finance (the financing seeker).

The relationship between the investors and the financial company is based on a Shariah-compliant mudarabah contract, while the relationship between the company and the Ministry of Finance is governed by Ijara (leasing), Murabaha, Istisna' (manufacturing), or Salam contracts, depending on the nature of the project being financed.

3.4 Government Ijara Sukuk:

These are equal-value sukuk that represent ownership of leased tangible assets. They are issued based on an Ijara contract and signify a share in specific government-leased assets previously agreed upon by all parties and described in the issuance prospectus.

a. Characteristics of Ijara Sukuk:

- Tradable in financial markets.
- Low risk.
- Do not constitute debt on the state treasury, so there is no need to amortize them.
- Suitable for financing major infrastructure projects.
- Have medium- to long-term maturities.
- May be used by the central bank in open market operations, similar to conventional bonds.
- Allow the state to own the project at the end of the lease term.

b. Mechanism for Issuing Government Ijara Sukuk:

- The government sells a specified portion of its ownership in certain assets to an Ijara Sukuk portfolio owned by a financial company.
- The company owning the portfolio issues Ijara Sukuk equivalent to the value of the purchased assets, and ownership of the assets is transferred to the investors (sukuk holders).
- The government (represented by the Ministry of Finance) or a third party then leases the asset back from the new owners (sukuk holders) at a rental yield, under a medium- or long-term Ijara agreement.
- At the end of the lease period, the investors sell the sukuk (representing the asset) back to the government or another buyer at market price.
- The returns on the sukuk consist of the rental income plus any capital gains

3.5 Government Istisna' Sukuk:

Istisna' sukuk are based on an agreement between two parties, where the first party contracts the second to manufacture goods or construct infrastructure projects (such as bridges, roads, power stations, water desalination plants, etc.). The agreed-upon amount is paid after the goods are manufactured or the project is completed at a future date.

Usually, the contracted party subcontracts the actual execution to specialized factories or construction companies, in accordance with the technical specifications provided by the first party (the government or its agent).

3.6 Mechanism for Issuing Government Istisna' Sukuk:

- The government appoints a financial company or Islamic bank as its agent to establish a restricted Mudarabah fund with a specific purpose—typically to raise the required resources for financing development or infrastructure projects, such as roads, bridges, airports, hospitals, or seaports.
- The government sells tangible assets to the restricted Mudarabah fund.
- The fund then issues Istisna' Sukuk by securitizing the asset, and sells these sukuk to investors on the basis of temporary ownership. The fund receives the proceeds from the sale.
- An Istisna' contract is arranged and signed to build the specified project after agreeing on all technical requirements, specifications, and related procedures.
- The government leases the completed asset for a predetermined rental return and may purchase the asset after construction is complete. The difference between the purchase price and the total proceeds represents the investors' return.
- The fund is responsible for managing its own assets and liabilities.
- The government provides an unconditional guarantee to repurchase the assets from the owners/investors at the end of the issuance period. The repurchase is made at the nominal value of the sukuk plus the agreed return. The government also commits to continue leasing the asset throughout the sukuk's validity period.
- The returns on these sukuk (i.e., rental income) may be paid quarterly, offering investors a reasonable level of liquidity.

4. THE IMPACT OF ISLAMIC GOVERNMENT SUKUK ON ECONOMIC DEVELOPMENT

Islamic sukuk have the potential to serve as an alternative to conventional instruments in financing development projects.

4.1 International Experiences in Financing Development through Islamic Sukuk

Several Arab and Islamic countries have taken practical steps to finance their investment projects through Islamic sukuk. Some notable experiences are outlined below:

a- The Malaysian Experience:

Malaysia is the global leader in financing projects using Islamic sukuk, which has contributed to the development of its financial sector and increased its expertise in utilizing this type of financial instrument. Islamic sukuk have been used in Malaysia to finance infrastructure projects and power plants. Based on the available data on sukuk issuances from 2001 to 2023, Malaysia accounts for 60% of global issuances. One of the most important examples is the issuance of sukuk by Malaysia's Khazanah Nasional Berhad. (Boukhari, 2017)

b- The Sudanese Experience:

The Sudanese government used Islamic sukuk to address shortcomings in the country's public finance, such as covering budget deficits and financing government projects. Sukuk were also employed to manage liquidity in the Sudanese banking sector. Sudan's share of global sukuk issuances stands at 3%. Among the most notable issuances are:

- **Government Participation Certificates (Shahama)** to finance the budget deficit,
- **Ijara Certificates from the Central Bank of Sudan (Shihab)**, based on the concept of sale and leaseback,
- **Government Investment Sukuk (Sarh)**, which are based on the *mudarabah* structure for resource pooling, and on *ijarah*, *istisna'*, and *murabaha* for deployment.

c- The Bahraini Experience:

The Government of Bahrain is a pioneer in issuing *ijarah* sukuk, as well as *salam* sukuk. As of 2023, Bahrain's share of total global sukuk issuances was 2%. Notable examples include:

- *Ijarah* sukuk linked to Bahrain International Airport,
- *Salam* sukuk issued by the Central Bank of Bahrain to absorb excess liquidity in the market,
- Utilization sukuk for Bahrain facilities worth USD 340 million,
- *Ijarah* sukuk for Durrat Al Bahrain worth USD 153 million,
- Participation sukuk for Dar Al Istithmar worth USD 250 million.

d- The Pakistani Experience:

The value of Islamic sukuk issuances in Pakistan accounted for 2% of global issuances in 2023. One of the most significant issuances was by the Government of Pakistan, worth USD 600 million

4.2 Advantages of Using Islamic Sukuk to Finance Development

Investment is one of the fundamental pillars of economic growth, particularly in developing countries, as it leads to an increase in productive capacity. It is also considered an effective tool for transforming the structure of the national economy to address structural imbalances. (Al-Hunayti, 2015, p. 560)

As investment volume grows, so does the economic growth rate, driven by increased value-added, productivity, and employment. Through sukuk, idle financial savings held by individuals—previously unutilized for economic or developmental purposes—can be mobilized and redirected into agricultural, industrial, and commercial sectors, which are key indicators of a country's level of development.

Based on the types and characteristics of Islamic sukuk discussed earlier, Islamic government sukuk provide a range of economic benefits, summarized as follows:

- Securitization operations help align sources of funds with their uses, thereby reducing the risks associated with mismatches in the maturity of resources and their applications.
- Securitization enhances an institution's ability to expand its activities without the need to increase its capital base.
- The securitization process creates diversified investment opportunities for individuals, institutions, and governments, allowing them to manage their liquidity profitably.
- Securitization contributes to GDP growth without requiring additional investment, by optimizing the use of existing financial assets.
- It helps to deepen financial markets, improving their efficiency and reach.
- Unlike debt-based instruments, sukuk encourage the widespread circulation of equity-based instruments and foster real economic transactions, linking the real economy to the financial economy.
- Sukuk can help reduce inflation by providing the long-term liquidity and financing needed to create new investment opportunities.
- Sukuk offer an effective channel for investors seeking to invest their surplus funds while maintaining the ability to liquidate their holdings when needed, thanks to the existence of secondary markets.
- Sukuk allow adaptation to global changes in the financial sector, helping to retain domestic investors who might otherwise seek such services abroad.
- They offer tremendous opportunities for addressing budget deficits, by providing real financial resources that do not negatively impact general price levels, thus enabling governments to finance essential development projects at low cost.

- The diversity of sukuk types—including donation-based, charitable, and partnership-based models—opens more avenues for financing small and medium enterprises (SMEs).
- Investment sukuk are based on economic feasibility studies and Shariah-compliant principles, ensuring that projects are aligned with Islamic priorities and achieve optimal resource allocation.
- Sukuk contribute to reducing unemployment, increasing employment rates, and utilizing idle funds, meeting the objectives of both investors and savers.
- Islamic sukuk serve as a powerful tool to finance infrastructure and large-scale development projects that require substantial capital, delivering benefits to both the issuer and the investor.

5. CONCLUSION

The model of Islamic government investment sukuk has proven successful in financing development in many Islamic and non-Islamic countries, such as the Gulf states, Malaysia, Sudan, Pakistan, Bahrain, and even some European countries and Turkey. Its use became more widespread after the global financial crisis, and today, it is considered one of the most modern financing instruments in the world. This sukuk model offers numerous advantages that make it suitable for a wide range of investors, businesspeople, and governments. It is characterized by flexibility, ease of issuance and trading, and low risk. Furthermore, it attracts investors who avoid stock market speculation and those who wish to steer clear of interest-based transactions, such as conventional bonds.

6. LIST OF REFERENCES:

1. Abdullah, K. A. (2002). *Asset and Liability Management, and Mortgage Financing*,. Union of Arab Banks.
2. Al-Hunayti, H. M. (2015). The Role of Islamic Sukuk in Economic Development (Case Study). *Journal of Administrative Sciences Studies* .
3. Al-Mahi, I. A.-Z. (2008.). Islamic Financial Sukuk and Their Role in Developing and Deepening the Financial Market, . *4th Investment and Financial Markets Conference*. Syria.
4. Bouguessa Salima. (2021). sharia and legal problems of islamic sukuk. *The Creativity Journal* .
5. Boukhari, F. (2017). The Role of Islamic Sukuk as a Mechanism for Activating the Financial Market: The Malaysian Experience in the Islamic Financial Market. *Journal of and Economics of Business and finance* .
6. Dhubyman, M. H. (2002). *Studies in Securitization, Asset and Liability Management, and Mortgage Financing*. , Union of Arab Banks.
7. Najia Sghir, ". S. (2022). Islamic Sukuk: Prospects and Challenges. *Journal of Human Sciences* .
8. Omar, M. A. (2019). Islamic Sukuk (Securitization), Contemporary Applications, and Trading. *19th Session of the International Islamic Fiqh Academy*.
9. Radman, M. O. (2019). Islamic Sukuk and Liquidity Management,. *the 4th Islamic Banking Conference*. Syria.