



ISLAMIC DEVELOPMENT BANK

# **The Role of Islamic Finance in Achieving Sustainable Development Goals**

Ramadan 1436H (July 2015)



TOGETHER WE BUILD A BETTER FUTURE

## Introduction

Sustainable Development Goals (SDGs) -- the new global development blueprint and the successor to the Millennium Development Goals (MDGs) expiring at the end of the year 2015 – are composed of 17 goals and 169 targets.

The SDGs cover a wide spectrum of development challenges including poverty, inequality, climate change, planetary body, sustaining ecosystem and cities, health, education, shelter etc – all in the realm of social, economic and environmental sectors; the pillars of sustainable development.

The SDGs are ambitious and formulated to “leave no-one-behind” in both developed and developing countries with “common but differentiated responsibilities”.

Historically, the SDGs were formulated under global-spanning series of open, transparent and inclusive parallel processes – the largest participative consultations in the long history of UN.

The processes have involved heads of state (UN High-Level Panel), private sector (UN Global Compact), UN agencies (UN System Task Team), regional organizations (coordinated by UN Commissions), UN member countries and those with observer status (Open Working Group on Sustainable Development Goals), individual citizens (“My World” global online survey), governments and civil society (UNDP-

led consultation meetings), science and technology community (Sustainable Development Solutions Network), and multi-stakeholders (11 thematic consultations on key sectors).

The key challenge is how to mobilize resources to effectively implement and achieve by 2030 the SDGs whose goals and targets outnumbered those of MDGs by a factor of 2 and 8 respectively.

Traditional development finance has remained the main tool for financing development in most developing countries. With resources allocated to development by donor countries remaining insufficient coupled with the headwinds of financial and economic crises affecting many countries worldwide, it is important to explore alternative and complementary innovative financing mechanisms such as Islamic finance.

## Islamic Finance

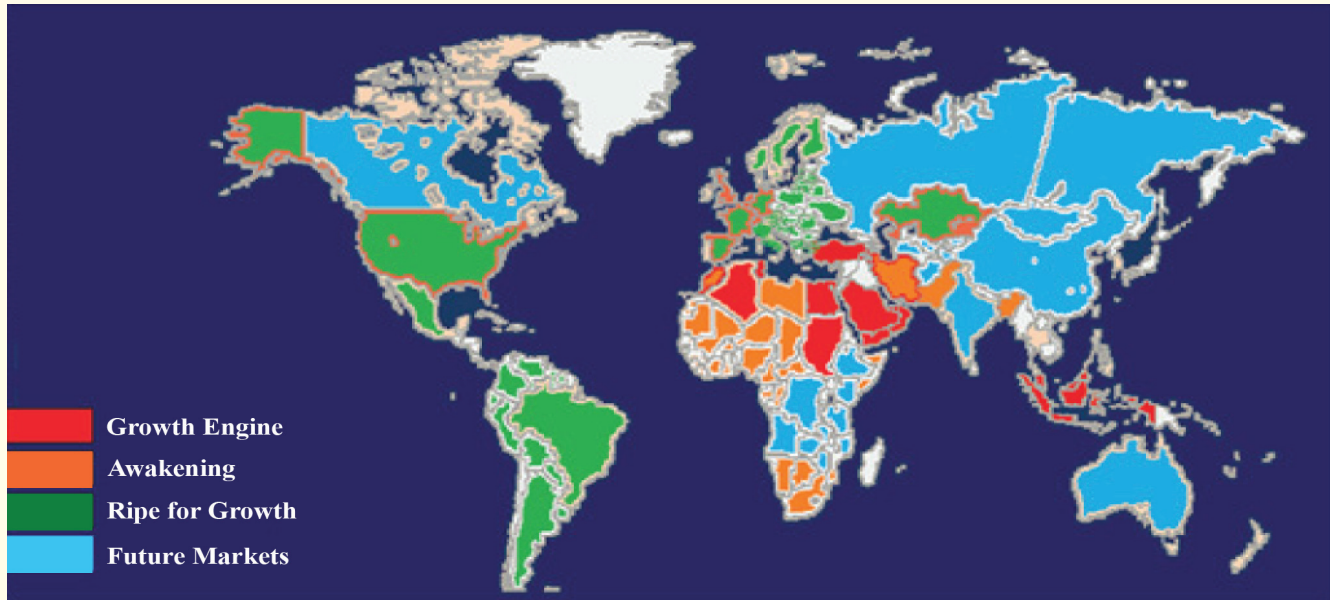
Islamic finance is a model that balances rewards and risks in a fair and transparent manner. It links finance with the real economy and maintains link at each point in time in a fair and transparent manner.

As a system, it helps to stimulate economic activity and entrepreneurship towards addressing poverty and inequality, ensures financial and social stability, and promotes comprehensive human development and fairness-all are relevant to SDGs. The Islamic financial services industry has gained traction around the

world especially in recent years. It has footprint in Asia and Middle East; ripe for growth in South America and Europe; and has future markets in North America, Central Asia and Australia (Figure 1).

Additionally, innovative Islamic financial instruments especially for infrastructure development such as Sukuk can be used to mobilize resources to finance water and sanitation projects (SDG-6), sustainable

**Figure 1: Global Kaledeiscope of Islamic Finance**

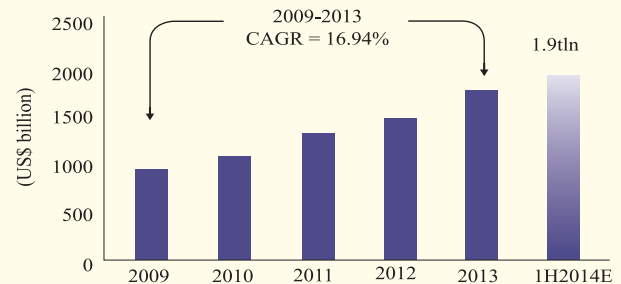


Source: Standard and Poor's 2012

Its global assets have grown considerably and estimated to reach US\$2 trillion by 2014<sup>1</sup> with compounded annual growth rate of about 17 percent (Figure 2).

The major areas of contribution of Islamic finance – financial stability, financial inclusion and shared prosperity– can be instrumental in the successful implementation of policies on ending poverty (SDG-1), achieving food security (SDG-2), ensuring healthy lives (SDG-3), achieving gender equality (SDG-5), and promoting peaceful and inclusive society (SDG-16).

**Figure 2: Global Islamic Finance Assets Growth Trend (2009-1H2014E)**



Source: Various, KFH Research Database

and affordable energy (SDG-7), build resilient infrastructure (SDG-9) and shelter (SDG-11).

In today's world, the global financial order needs to adopt a new banking and finance paradigm, one that is built on

<sup>1</sup>KFH 2014: Islamic Finance and the Real Economy

the principles of justice, risk sharing and direct linkages with real economy and avoidance of excessive speculation. This is necessary so that the world economy, in general, and the financial services sector in particular will achieve greater stability and sustainable growth trajectory.

---

**“...the principles we’re fighting for are very well inscribed in Islamic finance.”**

*Managing Director of the IMF Ms. Christine Lagarde, then French Finance Minister.*

---

For more than four decades, the Islamic Development Bank Group has successfully pioneered and promoted the development of the Islamic financial services industry for financing long- and short-term development activities in various sectors of the economies of our member countries. Islamic financial services industry has now financed many projects of considerable size in social, economic and environmental sectors and will be instrumental in funding many components of the SDGs as well.

### **Key Contributions of Islamic Finance**

Islamic finance has strong potential in promoting financial stability, financial inclusion and shared prosperity, and infrastructure development which will set an enabling environment for timely implementation of SDGs<sup>2</sup>.

---

<sup>2</sup> Habib Ahmed et. al. (May 2015): On the Sustainable Development Goals and the Role of Islamic Finance; World Bank Policy Research Working Paper 7266

### **Financial Stability**

Renewed efforts in the wake of the current global financial crisis in search of a more resilient and robust financial system based on stronger links between credit and the real economy have brought attention to Islamic finance.

---

**Islamic finance is an ethical financial system bridging the gap with the real sector and potentially contributing towards global financial stability.**

*Source: Kuwait Finance House, 2014*

---

The principles of Islamic finance can minimize the severity and frequency of financial crises by introducing greater discipline into the financial system and requiring the financier to bear or share in the risk of the underlying economic activity. Islamic finance also requires the creditor to bear the risk of default by prohibiting the sale of debt, thereby creating a proper and sound due diligence by those who extend credit.

---

**“What is more, Islamic banking is not just for Muslims. Nor is it in any way arcane or esoteric. At its core, it is banking that follows a stringent set of principles, aims to be socially and ethically responsible and embraces high transparency and shared risk.”**

*Source: Boston Consulting Group, 2008*

---

Islamic finance emphasizes the full integration of finance with the

real economy. Debt creation must be contractually linked with trade and production. Islamic financial instruments, (e.g. sale with a deferred price) make debt inseparable from real transactions. Accordingly, debt cannot grow beyond real resources. This is vital for sustainable development as uncontrolled debt is not sustainable and can be a heavy burden on natural resources and the environment.

---

**With its potential of being a shock absorber to external shocks, Islamic finance can help in achieving SDG-8 and other growth-related SDGs.**

---

The de-linking of profit-making from the real economy is a major cause of excessive lending. It is important to underline the imperative of risk-bearing that Islamic finance encourages through its emphasis on real economic activities, including equity and partnership, sales-based and lease-based financing instruments. While debt is allowed in Islamic finance, it is not allowed to grow on its own. It can grow only in step with the growth of the real sector. Thus by integrating debt creation with wealth creation, finance is properly positioned as a means for promoting productive activities and cannot be used for speculation or be an end in itself. This prevents the creation of an inverted debt pyramid and, thereby, largely mitigates financial instability.

## **Financial Inclusion and Shared Prosperity**

Islamic principles require an annual donation (Zakat) to the poor and the needy as an essential obligation of all Muslims who possess a minimum level of wealth. In addition, it strongly encourages establishing endowments (Awqaf) the return on which is dedicated to social objectives. These two institutions have historically played a major role in serving the social needs of Muslim communities. When fully utilized, they can be of great value in fighting poverty and achieving SDGs.

---

**With enhanced financial inclusion and shared prosperity, Islamic finance can be instrumental in the realization of the objectives related to SDG-1, SDG-2, SDG-3, SDG-5, SDG-8 and SDG-16.**

---

The small and medium enterprises (SMEs) are source of job creation and economic growth. The partnership financing, the core element of Islamic finance, provides an important source of funding for SMEs that might not be able to take on debt financing.

---

**Re-distributive instruments such as zakat, waqf (endowment) and sadqaat (charity) have played vital role of social protection and alleviating poverty in a dignified manner and have led to wider social and financial inclusion.**

---

Despite its relatively small size, the Islamic microfinance industry has shown a significant growth. The elements of just, ethical and pro-real sector development have interested many parties around the world in seeking to promote financial inclusion to support socio-economic development.

### Infrastructure Development

Infrastructure deficit is a main challenge facing many countries. For developing countries, infrastructure gaps is estimated to be in the range of \$1-1.5 trillion annually<sup>3</sup>. At global level, investments in infrastructure is estimated to be US\$ 100 trillion over the next two decades<sup>4</sup>. Sukuk (Islamic capital market instrument) have successfully been used to finance large-scale infrastructure all over the world and could be utilized for SDGs.

Sukuk are securities that comply with Islamic law and its investment principles. A Sukuk represents proportionate beneficial ownership in the underlying asset<sup>5</sup>.

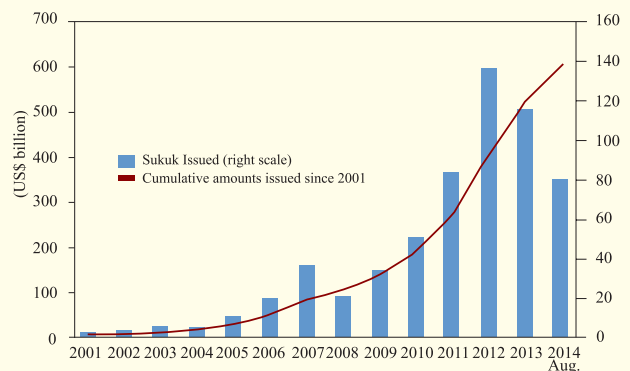
The emergence of Sukuk has been a significant development in Islamic capital markets in recent years. Funds raised through Sukuk can be allocated in an efficient and transparent way

to infrastructure initiatives and other deserving projects related to SDGs.

**With its strong resource mobilization potential especially for infrastructure development, Islamic finance can pave the way for the realization of the objectives related to SDG-6, SDG-7, SDG-9, and SDG-11.**

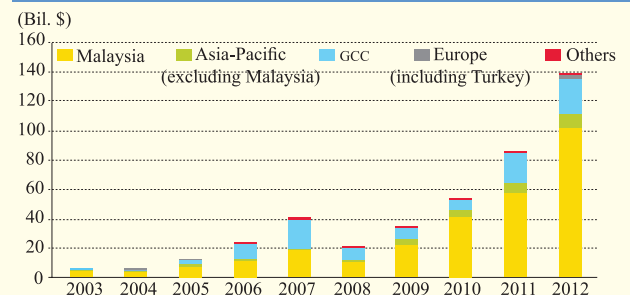
Sukuk issuance has proven its resilience during recent periods of turbulence in global capital markets. Sukuk issuance increased from US\$2 billion in 2001 to US\$80 billion in 2014 (Figure 3) with Asia showing particular strength (Figure 4). The Sukuk growth rate is currently 10-15% in global financial markets.

Figure 3: Trends in Global Sukuk Issuance



Source: IMF Research Bulletin, June 2015

Figure 4: Total Sukuk Issuance by Major Region



Sources: Standard & Poor's, Zawya Sukuk Monitor Database. ©Standard & Poor's 2013

<sup>3</sup> Revised Draft Report of the Addis Ababa Accord of the Third International Conference on Financing for Development, issued May 2015 (p.3, paragraph 13).

<sup>4</sup> Habib Ahmed et. al. (May 2015): On the Sustainable Development Goals and the Role of Islamic Finance; World Bank Policy Research Working Paper 7266

<sup>5</sup> Salman A. S and Shan S.: Sukuk Bond: The Global Islamic Financial Instrument

# Corporate profile of the Islamic Development Bank

## Establishment

The Islamic Development Bank (IDB) is an international financial institution established pursuant to Articles of Agreement done at the city of Jeddah, Kingdom of Saudi Arabia, on 21<sup>st</sup> Rajab 1394H corresponding to 12 August 1974. The Inaugural Meeting of the Board of Governors took place in Rajab 1395H (July 1975) and the IDB formally commenced operations on 15 Shawwal 1395H (20 October 1975).

## Vision

By the year 1440H, the Islamic Development Bank shall have become a world-class development bank, inspired by Islamic principles, that has helped significantly transform the landscape of comprehensive human development in the Muslim world and helped restore its dignity.

## Mission

To promote comprehensive human development, with a focus on the priority areas of alleviating poverty, improving health, promoting education, improving governance and prospering the people.

## Membership

The membership of the IDB stands at 56 countries spanning many regions. The basic condition for membership is that the prospective country should be a member of the Organization of the Islamic Cooperation (OIC), pays the first instalment of its minimum subscription to the Capital Stock of IDB, and accepts any terms and conditions that may be decided upon by the Board of Governors.

## Capital

At its 38<sup>th</sup> Annual Meeting, the Board of Governors of IDB approved the 5<sup>th</sup> General Capital Increase whereby the Authorized Capital was increased to ID100 billion and the Subscribed Capital was increased to ID50 billion. By the same Resolution, the Board of Governors agreed to the calling in of the

callable (in cash) portion of the 4<sup>th</sup> General Capital Increase. As at the end of 1435H, the subscribed capital of the IDB stood at ID49.86 billion.

## Islamic Development Bank Group

The IDB Group comprises five entities: the Islamic Development Bank (IDB), the Islamic Research and Training Institute (IRTI), the Islamic Corporation for the Development of the Private Sector (ICD), the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), and the International Islamic Trade Finance Corporation (ITFC).

## Head Office, Regional and Country Offices

Headquartered in Jeddah, the Kingdom of Saudi Arabia, the IDB has four regional offices in Rabat, Morocco; Kuala Lumpur, Malaysia; Almaty, Kazakhstan; and in Dakar, Senegal and Country Gateway offices in Turkey (Ankara and Istanbul) and Indonesia.

## Financial Year

The IDB's financial year is the lunar Hijra Year (H).

## Accounting Unit

The accounting unit of the IDB is the Islamic Dinar (ID) which is equivalent to one Special Drawing Right (SDR) of the International Monetary Fund.

## Language

The official language of IDB is Arabic, but English and French are used additionally as working languages.



**ISLAMIC DEVELOPMENT BANK**

P. O. BOX 5925, JEDDAH-21432 - KINGDOM OF SAUDI ARABIA

 Tel: (966-12) 6361400 |  Fax: (966-12) 6366871 |  Email: [idbarchives@isdb.org](mailto:idbarchives@isdb.org) |  Website: [www.isdb.org](http://www.isdb.org)