The development of sharia capital markets and its role in financing the government projects

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Abstract. The purpose of this study is to examine the possibility of sharia capital market utilization to fund government infrastructure projects and contribute knowledge and thoughts for the development of the Sharia capital market in Indonesia. The Sharia capital market expects to act as a source of funding, and it will not burden the financial condition of the government and the taxpayers. Besides that, this system will not lead a change of ownership of state assets if the government fails to pay the debt. The research methodology of this research is a literature review that sources from books, journals, and online articles. This study only examines the development of sharia capital markets and its market trading volumes contrasted to the 2015-2019 government's infrastructure development plans. The results of this study indicate that the Sharia capital market is developing quite well in Indonesia, but it is the smallest compared to the conventional one. Therefore, the government, in this case, OJK (Financial Service Authority) needs to invite and accommodate the scholars, preachers, and imams to participate in socializing Sharia capital markets to the public.

1. Introduction
The estimation of funds needed to implement the government’s infrastructure development plan of 2015 – 2019 is accounted for IDR 5,519 trillion. Currently, the sources of the fund are coming from the state budget for IDR 2,216 trillion, the provincial government’s budget for IDR 545 trillion, state-owned companies for IDR 1,692 trillion. According to the Asian Development Bank (ADB), from 2010 through 2020, Indonesia needs an investment of USD 450 billion to fund its investment projects [1].

Currently, most of the funds needed are coming from the state’s debt that leads to a deficiency in the state budget for the last five years. The trends show the deficit increased from IDR 46.8 trillion in 2010 to IDR 241.5 trillion in 2014. One of the reasons for the deficits is because the interest rate of Indonesia’s government debt securities is high that forces the government to spend IDR 121.3 trillion in 2014 only to pay the debts and its interest.

Another alternative for the government to obtain the funding without having to pay interest for its fund is through The Sharia capital market. One of the Sharia capital market products that can be used is Sharia bonds or Islamic financial certificates or Sukuk. During 2008 – 2018, the government already issued the Sukuk for IDR 944.03 trillion. In 2017 and 2018, the government fund the project for IDR 16.76 trillion and 22.53 trillion consecutively [2].

In addition to that, the funding can also be acquired through Islamic Banking Institution. Until 2017, the market share of Islamic Banks in Indonesia compares to the conventional one is only 27% of
the total market share. Even though the funding through this channel is still limited, it was showing a significant increase across time. For instance, the Sukuk managed to be acquired at the end of 2014 was IDR 7.1 trillion. However, in 2018 it was increasing for 300 percent to IDR 22.53 trillion [2].

2. Research Methodology
This research conducted using the descriptive analysis method. The limitation of this research is the data or journals that were used in the analysis were published only from the last ten years. In this study, the author will gather several theories that are tailored to the explored phenomena. These theories will be used to understand the social context more broadly and deeply.

The data used in this study is sourced from secondary data in the form of books, journals/articles, repositories, websites, reports, abstracts, and other online sources. This research is explanatory research that aims to explain the cause of a phenomenon that is the development of the Sharia capital market and its role in financing government projects.

3. Literature Review
This section briefly explains the development of the Sharia capital market in Indonesia, basics theories, and the theoretical framework used in the study. Basics theory, are used as the efficient market hypothesis, behavioral finance theory, Markowitz modern portfolio theory (MPT).

3.1. Development of Sharia Capital Markets in Indonesia
Sharia capital market is an activity that is related to public trading of securities that could be in the forms of Sukuk, stocks that are issued by companies that abide by the principle of Islam also sold using Islamic rules and manners [3]. In the Islamic capital market, it is an obligation for the institution business model the use of funds must be following Islamic principles.

The capital market divides into three categories; (i) debt market, (ii) equity or the stock market, and (iii) markets for structured securities that are hybrids form of equity or debt securities [4]. The difference between conventional capital markets and Islamic capital markets lies in the criteria of securities traded and the requirements that must meet. Those are:

- The first requirement [5] Islam is prohibited from using the interest system in return for investment or debt provided by investors or creditors. The sharia system uses a risk-sharing system with rewards that are not fixed, adjusted to the conditions of the project or business through profit-sharing systems.
- The second requirement relates to company assets. In Islam, investment and debt must directly relate to the assets or projects that are funded. Investors or creditors jointly bear the risk of the projects or assets being financed. This requirement prevents inflation, because the circulation of money is proportional to asset, and close the opportunity for speculative traders who often negatively impacting the economy [5].
- Third is justice and balance. The government needs to make rules related to the availability of accurate information, make sure all the market participants take actions according to the rule so that no harmful practices occur to either party. The government must act as a supervisor who guarantees compliance with all stipulations [6].
- Fourth is trust based on obedience to Allah, the all-knowing and almighty owner of the capital market players. Islam reveals to God as a religion that improves human morals. Therefore, in the Islamic capital market, each party involved must be able to uphold trust. These will have an impact on reducing transaction costs and providing opportunities for broad participation of the entire community nationally and internationally [6].

3.2. The Roadmap of The Capital Market Development
To support the development of the Indonesian Islamic capital market, the financial services authority (OJK) has made a strategic plan for the next 5 (five) years. Those are strengthening the supporting
regulation, increasing supply and demand, develop human resources and information technology, promotion and education, and policy synergy with related parties. To penetrate the market, OJK has conducted socialization and educating about the Islamic capital market, either through formal education or using mass media.

3.3. The Development of Sharia Capital Market
The development of the sharia capital market is dividing into three stages. The first one is the improvement of Sharia capital market efficiency. The second one is the development of its product, while the last one is the rise of trading volume on its market.

3.3.1. The Improvement of Sharia Capital Market Efficiency
5-year policy planning program that was launched by the Indonesian Financial Services Authority is giving a positive impact on the efficiency of the market. These can be seen from the availability of adequate information that can be accessed by all people. This system can support various services that make it easier for investors and issuers to carry out activities in the sharia capital market. Moreover, the government policy has been issued, which prohibits the action of providing information from insiders in the issuing company to certain people. This policy made the transactions between the investors more fairly and transparent.

3.3.2. The Development of Sharia Capital Market Products
Products that are offered by the Sharia capital market that are sharia market stock, Sukuk, sharia mutual fund, Sharia exchange-traded funds, sharia Asset-backed security, and Sharia Real Estate Investment Trust. Those products are supported by the sharia online trading system.

This product development that has been done surely gives more options for the investors to invest their funds. Product development also increasing the competitiveness of the Indonesian sharia capital market compared to other countries in South East Asia, especially in Malaysia that has been developed the sharia capital market since 1993.

3.3.3. The Development of Sharia Capital Market Products
The growth of sharia capital market’s trading volume can be seen from several aspects. Those are:

- The upward trend of market capitalization on Islamic indexes on the Indonesia Stock Exchange during the last 20 years [7]. This trend can be seen from the following figure.
The development of Islamic corporate bonds during 2014 – 2019 was showing an upward trend. This can be seen from the significant increase in number of bonds issuance and its trading volume.

Figure 1. Indonesian Stock Exchange Market Capitalization.

- The development of Islamic corporate bonds during 2014 – 2019 was showing an upward trend. This can be seen from the significant increase in number of bonds issuance and its trading volume.
The development of Sharia mutual funds that can be seen from the significant increase of net asset value of the sharia mutual funds on 2015 that was accounted only for IDR 11.02 trillion, while on July 2020 it was accounted for IDR 63.52 trillion.

3.4. Investments Theories and its Relationships with Islamic Capital Market

3.4.1. Efficient Market Hypothesis Theory and Behavioural Finance Theory. Based on the efficient market hypothesis (EMH) theory developed by Eugene, it said that stock or asset prices reflect the company’s performance through all available information. However, several conditions must be to prove this hypothesis fulfilled. Those are low transaction costs and independent stock prices, meaning that none of the market players can influence the stock market permanently available information can
be easily accessed and cheaply. When all these conditions meet, an efficient capital market will be created [8].

When making investment decisions, the investor is not only influenced by rational factors derived from industrial analysis and accounting analysis but also by irrational factors, such as experience, religious beliefs, and political choices [9,10].

Behavioral financial theory states that investment decision is influencing cognitive psychological factors that cause them to be overconfident. Cognitive bias appears in several patterns, including heuristics, where people make decisions based on practical knowledge and investment choices tend to choose investment instruments that are familiar with them.

Psychological factors can be influenced by religious beliefs that require people to act according to their religious law. For the Muslims, investing is done by not only expecting financial returns but also hopes for the blessing of Allah. Following the Qur'an, surah Al-Baqarah verse 261, it is stated that the parable of a person who saves his treasure in the way of Allah is like a seed that grows seven stalks, on each stalk is a series of seeds. Allah multiplies for whom He wills, and Allah is All-Vast, All-Knowing.

Human assets can be multiplied through trade or investment. Therefore, Islam strongly encourages its people to invest as the words of the Caliph Umar "Whoever has property, he must use it for investment. And the person who owns the land must make use of it.

Assets in Islamic principles belong to Allah, while humans are only the holders of the mandate, therefore humans are obliged to manage and use them according to Allah's will. Investment is a part of muamalat activity or refers to commercial and civil acts or dealings under Islamic law, therefore the law is permissible unless there is evidence that states that it is prohibited [11]. Investment is a commitment to several funds or other assets at this time, to expect future returns in the form of dividends or an increase in the value of the investment [12].

3.4.2. Markowitz Modern Portfolio Theory. Based on Markowitz's investment portfolio theory, to avoid risk, an investment portfolio is carried out, which is to divide the investment into several types and several channels [13].

In managing Islamic investment, it prohibits the elements of usury, Maisir (gambling and speculation), Gharar (uncleanness and manipulation), buying and selling of prohibited goods, committing ruthlessness, exaggerating / overreaching, and wrongdoing, or being wronged [14]. The principle of investment in Islam is an investment in a sector that is legalized and used for purposes that do not prohibit, beneficial to humans, fair and mutually pleasing, according to Islamic law in it. There are no uncertain elements.

The Islamic capital market is an institution that offers products and systems following Islamic principles. However, this does not mean that the Islamic capital market intends for Muslims only. Muamalat is universal because it can be used and is intended for the benefit of all people.

The government can use the Islamic capital market to obtain funds for infrastructure financing. The product of the Islamic capital market with the principle of profit-sharing prevents the government from paying principal loans interest in the long term will consume state resources, thus encouraging the government to increase its debt. In the end, all state revenues will be spent to pay debts, which will result in economic destruction and foreign occupation of the resources they have

3.5. Framework of Thought
In the effectiveness capital market, investors have adequate information, both related to financial reports and data toward the external environment of the emitted business. The results in investors having confidence in various investments in the capital market.

Based on this, the investor can carry out the next stage of the investment that determines the investment. Based on the theory of investment portfolios to avoid the risks that may occur in the
future, investment should not be included as a whole in one type of investment but must divide into several forms.

The Indonesian capital market offers two investment alternatives, namely through the conventional capital market or the Islamic capital market. The Islamic capital market attempt variety of different products and systems. That can use as investment portfolios that support government infrastructure development.

This study seeks answers to the extent of the development of the Islamic capital market and how large its role is in obtaining investment for infrastructure financing. The research framework is illustrated as follows:

![Figure 4. Framework of Thought.](image_url)

4. Discussion

4.1. The Role of Sharia Capital Markets in Government Project Financing

Indonesia needs to accelerate infrastructure development to boost the rate of economic growth. In the future, the need for government funds for infrastructure project development will be even larger, as stated in the Technocrat Draft of the National Medium-Term Development Plan (RJPN) 2020-2024. It estimates that the need for infrastructure spending reaches IDR 6,421 trillion or an average of 6.08 percent of GDP in the year 2024. It ranges 50% of GDP [15]. On the other hand, the government's ability to provide funds is only 3.46 percent of GDP, so there is a significant gap in infrastructure funding [16].

Most of the funding needs meet by debt. Quoting from the statement of Bank Indonesia [17], it stated that Indonesia's foreign debt until June of 2020 was accounted for the US $ 400.2 billion or around IDR 5,865 trillion (exchange rate on the 24th of August which is Rp 14,648 per US dollar).

Fulfilling the need for funds by relying on conventional debt activity on-base causes the government to pay interest in addition to paying the principal. It will cause an increase in the government budget deficit. The deficit in state spending will be covered again by debt, increasing public taxes and reducing subsidies, and reducing social security facilities. These increase the burden and reduces the welfare of the community. Therefore, the government needs to have other alternatives to finance infrastructure projects by increasing the role of the capital market.

The capital market has an essential role in a country because it performs its function as a means of raising funds for companies or the government from the public and investors. The capital market is a means to invest their funds in various instruments. The function of the capital market is to increase business fundamental, through the sale of shares or corporate debt securities to the public, equal distribution of income, and indicators of the country's economy [18].
Based on this function, the Islamic capital market functions as a means to raise funds both from within the country and overseas, through the products it creates. OJK stated that the position in April 2019, the goods' total value of Islamic excludes the value of the sharia capital market reached IDR 1,359 trillion, while the assets of the Islamic capital market reached IDR 3.834 trillion [19]. The government Sukuk issuance in 2008-2018 amounting to Rp 944.03, and until 2019, the government has issued Sukuk totaling 1,221 trillion [20].

The achievements of Islamic finance are still small when compared to conventional finance. Moreover, with an average growth of above 30% per year, it is sufficient to signal the enormous potential of Islamic finance in Indonesia. The improvement of Islamic finance support by an increasingly efficient Islamic capital market as a result of the achievement of the strategic road map for developing the Islamic market.

Currently, the government uses Sukuk as a source of funding for infrastructure in the form of irrigation, groundwater supply - raw water, dams, roads, bridges, natural disaster management facilities, railroad facilities and infrastructure, ports, roads, airports, and educational buildings. It is consistent with research conducted by Mohammad Selim, finding that Sukuk has the potential to be a source of financing for projects that require large funds without causing interest payments, debt, and budget deficits [21].

Financing using Sukuk can prevent inflation because the money in circulation is in balance with the products and services produced. When the infrastructure project is in production, it will cause an increase in output that is equal to the development of money circulating in the community.

The capital market has the potential to play a higher role in raising funds, not only in the form of Sukuk but also through mutual funds, especially for small investors and beginners. Sharia mutual funds experienced significant growth, within five years of 352%. The potential of this mutual fund is even higher when compared to the population aged 15-59 years, reaching 64% of the total population of Indonesia.

Another product of the Islamic capital market that has the potential to be developed is real estate investment funds. In the 5.4 million Indonesians need housing. To meet these needs, the government needs a large number of funds. Currently, the funds earn from loans on an interest basis. It causes the selling price of houses to be costly. Therefore, the most appropriate alternative is to encourage both individuals and groups to invest in these real estate investment funds. Optimizing the role of the Islamic capital market is an alternative infrastructure financing policy that is very profitable, both in the short-term and long-term that does not burden the government's APBN.

The Islamic financing system has proven to be of great benefit to infrastructure development, but its implementation is not easy. Research conducted by Ayomi Rarasati, et al [22] found the obstacles in implementing Islamic finance-based projects are the characteristics of investors who are only profit-oriented and risk-averse, wrong perceptions of the concept of Islamic financing, and resistance to the Islamic financing system [3].

The gap in public understanding of sharia financing is caused by the low index of Islamic banking literacy, as indicated by the OJK research that found the Islamic financial literacy index of 8.11%. The level of inclusion (utilization/utility) of Islamic financial products and services reached 11.06%, much smaller than the conventional financial literacy index of 29.66% and the financial inclusion index of 67.82% [23].
Table 1. Financial Literacy Index of the Financial Products.

|                      | Banking   | Insurance | Finance Company | Pension Funds | Capital Market | Pawnbroker |
|----------------------|-----------|-----------|-----------------|---------------|----------------|------------|
| Well Literate        | 21.80%    | 17.84%    | 9.80%           | 7.13%         | 3.79%          | 14.85%     |
| Literate             | 75.44%    | 41.69%    | 17.89%          | 11.74%        | 2.40%          | 38.89%     |
| Less Literate        | 2.04%     | 0.68%     | 0.21%           | 0.11%         | 0.03%          | 0.83%      |
| No Literate          | 0.73%     | 39.80%    | 72.10%          | 81.03%        | 93.79%         | 45.44%     |

The results of a similar study conducted by Muhammad Dzakfar found that the public’s understanding of Islamic finance was still small. Thus the government needed to involve ulama as fatwa givers, en-lighteners and thinkers, and sharia economic actors by involving Islamic boarding schools [24].

The low level of public understanding is understandable because the existence of the Islamic capital market is still new. Following behavior finance theory, humans will tend to make decisions according to their experience. In this case, the public has become accustomed to conventional capital market products, so it will be challenging to switch to Islamic products.

Based on this, the best effort is needed to change the investor paradigm. The public needs to be well educated that capital market products have advantages due to risk control, namely avoidance of speculative and gambling elements, ethical management, and less volatility.

5. Summary

Even though it is still small, currently, the Islamic capital market has a role in infrastructure financing. It has enormous potential in the future. It states from the increasing of the capital market volume and issuance as well as investors making transactions in the capital market.

Infrastructure financing using sharia financing has been proven capable of accelerating the development of large projects without burdening the government with interest payments and preventing foreign control of state resources.

The increasing role of the Islamic capital market is experiencing obstacles due to the low-understanding of the public towards the Islamic capital market. It has resulted in a misunderstanding of Islamic financing and reluctance to invest in Islamic capital market products.

Based on the discussion before, the government needs to involve Ulama, Da'i, and community leaders, to educate the public through scientific assemblies, mosques, and Hajj guidance groups. The use of non-formal institutions above needs to be done, considering that some people, especially in rural areas, are not familiar with the internet media. Following the culture inherent in society, the explanations from the clerics, scholars, and Ustadz is easy to accept than the news in the mass media.

The government needs to provide understanding to religious leaders about the Islamic capital market and its products and its benefits for the country’s economic development through training and seminars. To accelerate these activities, the government can collaborate with lecturers and the Islamic economics community in regions throughout Indonesia.

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