Islamic Banking and Finance Review

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Sheila Ainon Yussof
Assistant Professor at Institute of Islamic Banking and Finance, International Islamic University Malaysia

Razali Haron
Deputy Dean Research and Publication, Institute of Islamic Banking and Finance, International Islamic University Malaysia.

## Research Paper Information:

**To cite this article**

Yussof, S. A., & Haron, R. (2017). The ASEAN market: Cross-border collaboration in Islamic finance between Malaysia and Thailand. *Islamic Banking and Finance Review*, *4*, 21–39.
Crossref

**Access this article online**

Article

https://doi.org/10.32350/ibfr.2017.04.02

**Contact Information**

INSTITUTE OF ISLAMIC BANKING (IIB)
UNIVERSITY OF MANAGEMENT AND TECHNOLOGY
C-II, Johar Town, Lahore +92-42-3521-2801-10 (Ext – 3418)

Volume 4 1438-H/ 2017
ISSN (E): 2413-2977
ISSN (P): 2221-5239

Journal
https://doi.org/10.32350/ibfr
Issue
https://doi.org/10.32350/ibfr.2017.04

This is an Open Access Journal

Published By
Institute of Islamic Banking
University of Management and Technology (UMT)

https://iib.umt.edu.pk/ibfr/home.aspx

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**The ASEAN Market: Cross-Border Collaboration in Islamic Finance between Malaysia and Thailand**

*Sheila Ainon Yussof[1] Razali Haron[2]*

## Abstract

Islamic finance offers a viable and moral-ethical alternative when the world economy suffers from global financial crises due to high debt-gearing and excessive speculations leading to liquidations and losses. In the casino-like scenario of the conventional order, Islamic finance is viewed as a game-changer, setting new rules and behavioral patterns that appeal to humanity and other civilizations due to its adherence to the universal principles of justice, equity and good conscience. In the beginning, Islamic finance may have started off with a nationalistic or religious fervor due to independence from colonialism and reassertion of an Islamic identity. But it has become evident to the world that its core principles, if implemented sincerely, can prevent exploitation, monopoly, bribery and corruption, excessive spending and hoarding of wealth, high debt- gearing and speculation. Ideally, Islamic finance should be promoting values such as entrepreneurship, transparent dealings, risk sharing, profit and loss sharing rather than making profits from a predetermined return. Islamic finance is also based on ethical principles such as trustworthiness and honest dealings, sanctity of contracts, moderate and pragmatic behavior and equitable treatment of stakeholders. This paper examines the role of Islamic finance in developing the ASEAN financial market through cross- border collaboration, specifically with Thailand, through three engines of growth: the Sukuk market, Halal market and Waqf. Islamic finance has opened up many opportunities to the minority Muslims in Thailand and has helped speeded up the integration process. As the world becomes smaller and cross-border players increase, there is a need to have greater legal and regulatory certainty. To ensure Islamic finance is on a level playing field with conventional finance as it crosses borders, the present authors recommend a mutual relaxation of taxation laws and a trade liberalization policy. Lastly, a unified and concerted effort is needed to promote equitable development of ASEAN member nations within the Islamic framework of "prospering thy neighbors".

***Keywords:*** Cross-border trade, ASEAN, Islamic finance, global financial crises, Islamic worldview.

[1] Assistant Professor at Institute of Islamic Banking and Finance, International Islamic University Malaysia.

[2] Associate Professor, Deputy Dean Research and Publication, Institute of Islamic Banking and Finance, International Islamic University Malaysia.

## Introduction

Malaysia took the lead in influencing the growth of Islamic finance in South East Asia since the 1980s and is now the model for all ASEAN and other regions to follow. In relation to cross border collaborations, there are divine principles in Islamic finance which can be incorporated under the ASEAN umbrella. These are mutual cooperation and brotherhood (*ukhuwah*) and where trade relations should be based on the spirit of "prospering thy neighbors". In Islam, we are required to look after the rights of the neighbor through mutual cooperation and solidarity in a spirit of brotherhood.

It is exhorted in the Qur'an that to care for the rights of the neighbor is one of the essentials of the Faith, and it is forbidden to harm him or ignore his rights, as God says: "*Ascribe no thing as partner unto Him. (Show) kindness unto parents, and unto near kindred, and orphans, and the needy, unto the neighbor who is of kin (unto you) and the neighbor who is not of kin*…" And to this I will include our non-Muslim neighbors who form the human race with Muslims. The Holy Prophet (pbuh) said: "*Whoso has faith in Allah and in the Hereafter, should honor his neighbor"* (Bukhari and Muslim). And if you behave nicely to your neighbor, you would become a true Muslim.

However, these principles are in direct conflict with the capitalistic principles of competition which believes in competition and not mutual cooperation and "survival of the fittest" based on greed and selfish behavior of men. This creates a gap between the two worldviews. But at the same time the Islamic worldview provides an alternative to stakeholders to choose which system is relatively more beneficial for them in terms of realization of commercial and social objectives. It is recommended in this paper that greater collaboration should come in the Islamic spirit of "prospering thy neighbors" through three markets: Sukuk, Halal industry and Awqaf.

Investors and industry players in the regional and global market who participate in cross-border trading require legal and regulatory certainty to protect their overseas investments. Laws need to be mutually relaxed and liberalized for a meaningful collaboration. A unified and concerted approach by cross-border trading partners should not only fulfill commercial but also social goals such as alleviation of poverty and economic empowerment of ASEAN member nations. By infusing Islamic principles in existing conventional systems, Islamic finance is offering an alternative framework that will appeal to humanity due to the universal principles of justice, equity and good conscience and mutual cooperation in the spirit of prospering thy neighbor's.

Islamic finance is also known for its core principles which are to prevent exploitation, monopoly, bribery and corruption, excessive spending and hoarding of wealth whilst promoting values such as entrepreneurship, transparent dealings, fair distribution of risks, and profit and loss sharing principles. The Islamic world view and foundational philosophy of Islamic finance provide the basis for honest dealings, sanctity of contracts, moderate and pragmatic behavior, and equitable treatment of stakeholders which lead to social justice. If ASEAN were to achieve the ‘One Vision, One Identity and One Community’ goal, then it must ensure that Islamic finance, when adopted in the emerging economies, is on a level playing field with conventional finance as it crosses border.

## 2. The Foundational Philosophy of Islamic Finance as an Islamic Alternative to Conventional Financial Markets

Islamic finance consists of four principal markets: Islamic banking, Islamic insurance (Takaful), Islamic capital market and Islamic wealth management. To this we may add Islamic Endowment or Awqaf, which has been said to be the missing piece in Islamic finance. All the above components/markets are underpinned by Islamic principles or the Shari‘ah. The word Shari‘ah literally means “the way to a watering place”. It is the path not only leading to Allah, but also believed by all Muslims to be the path shown by Allah the Creator, through his Messenger the Prophet Mohammed (PBUH). In Islam, Allah alone is sovereign and it is He who has the right to ordain a path for the guidance of mankind. Thus it is only Shari‘ah that liberates man from servitude to anyone other than Allah. This is the central reason why Muslims are obliged to strive for the implementation of that path and no other.

*Al-Tawhid* (or the unity of God) is thus the key element in the conceptualization and definition of Islamic worldview. Naquib Al-Attas (2008) defines Islamic worldview as “the vision of reality and truth that appears before our mind’s eye revealing what existence is all about; for it is the world of existence in its totality that Islam is projecting…which includes the “seen” and “unseen” worlds. It is not a world view that is formed merely by the coming together of various cultural objects, values and phenomena into an artificial coherence; it is not one that is formed gradually through a historical process of philosophical speculation and scientific discovery; it is not a worldview that undergoes a dialectical process of transformation repeated through the ages, from thesis to anti-thesis then synthesis”. The oneness of God is revealed in the Quran:

“*Say He is Allah, the One, Allah-us-Samad (the self-sufficient Master, whom all creatures need, He neither eats nor drinks). He begets not, nor was He begotten; And there is none co-equal or comparable unto him”* (Quran: 112)

Thus to be a Muslim is to believe in the Oneness of God and to have God constantly present in one’s life. In the Shari‘ah there is an explicit emphasis on the fact that Allah is the Lawgiver, and the whole Ummah, the nation of Islam, is merely His trustee. It is because of this principle that the Ummah enjoys a derivative rule-making power and not an absolute law-creating prerogative.

The Islamic State consists of one vast “homogenous” commonwealth of people who have a common goal and a common destiny and who are guided by a common ideology in all matters both temporal and spiritual. The entire Muslim ummah lives under the Shari‘ah to which every member has to submit, with sovereignty belonging to Allah alone. The laws of Islam are firmly based upon the Shari‘ah and are therefore deemed to be in the interest of the people as a whole.

The difference between other legal systems and the Shari‘ah is that the fountainhead of the Shari‘ah is Qur’an and the Sunnah. The Quran and the Sunnah are the gifts given to the entire Ummah. Therefore the Ummah as a whole is collectively responsible for the administration of justice. And under the Shari‘ah, justice is administered in the name of Allah and not by human definitions of justice.

The Islamic Worldview thus moulds the foundational philosophy of Islamic finance. It is centered on “*Tawhidic* paradigm”, that is, belief in the oneness of Allah and that human beings are subject to His judgment in the Hereafter. The Islamic worldview thus offers a universal worldview as well as provides rational and scientific evidences for its claims. The underlying principle of shariah law relevant to Islamic finance as sourced from the Quran (the sacred book that records the word of God as revealed to the Prophet Mohamed) is that interest (*riba’*) is prohibited: “*God has permitted trade and forbidden interest* (Quran: 2:275). The second source is the Hadith: the body of documents that records the *sunnah*, the practice or life example of the Prophet Mohammed. From these two sources there are five main prohibitions that must be observed in the creation of a shari‘ah-compliant financial services model and other principles which are mutually supportive towards a just economic system envisioned by Islam:

a. *Riba’*: the payment and receipt of interest are prohibited and any obligation to pay interest is considered void.

b. *Gharar* or uncertainty is forbidden as there must be a full and fair disclosure. For instance there must be certainty in the fundamental terms of the contract such as the subject-matter, price and time for delivery.

c. *Maysir*: the prohibition of speculation or gambling which is based on zero- sum game, where no effort is exerted to become rich, or gaining something by chance rather than productive effort.

d. *Unjust enrichment* contracts where one party gains unjustly at the expense of another are considered void.

e. *Unethical or haram investment*: Islam prohibits investing or dealing in certain products such as alcohol, armaments, and pork, and in activities such as gambling, entertainment and hotels.

f. *Debt-trading is prohibited*: Islamic finance encourages productive trading. Trading in debt is perceived as another form of *riba’*.

g. *Underlying assets*: Islamic finance is based on underlying asset transaction which contributes towards real economy. Tangible underlying assets/enterprise forms the basis of most Islamic Finance transactions.

h. *Sellers must own assets* prior to sales: Sharing of risks & rewards, elimination short selling, future sales (only in exceptional situations) via Salam or Istisna contracts.

i. *Genuine trade transactions*: Strong link between finance and actual economic activities whereby finance must be supported by economically productive activities and excessive debt leveraging is prohibited

j. *Profit and loss sharing (PLS)* principles: the Islamic financier should only generate benefit from the project in which they invest and must take some risk, since risk equates to effort and potential loss.

k. *Entrepreneurship* is encouraged in Islam.

l. In Islam *money is not a commodity* but a medium of exchange and so it is not allowed to make money on money, but it is permissible to make money on the use or the exchange of an asset.

m. Islam allows the *use of securities* to support a transaction, which guards against the willful wrongdoing or carelessness of partners.

n. *Higher level of disclosures*: Further need of transparency to provide comfort about Shariah-compliance and also other risks which are unique to Islamic Finance

o. *Currency Speculation*: Trading in currencies is prohibited due to its speculative nature.

To ensure IFIs adherence or compliance to these underlying principles, there must be a board of Shari‘ah scholars and/or experts in Islamic finance and law established within the organization to monitor and supervise Shari‘ah compliance through a Shari‘ah governance framework. It is hoped that this community or neighbor lines spirit is within the Vision-Mission-Goal (VMG) of ASEAN.

## 3. Malaysia and Thailand as Cross-Border Partners in ASEAN

The Association of Southeast Asian Nations (ASEAN) is a political and economic organization of ten (10) Southeast Asian countries, which was formed on 8 August 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Since then, membership has expanded to include Brunei, Cambodia, Laos, Myanmar and Vietnam. Its aims include accelerating economic growth, social progress, and socio-cultural evolution among its members, protection of regional peace and stability, and opportunities for member countries to discuss differences peacefully. When emerging economies like Vietnam, Laos, Myanmar, and Cambodia joined ASEAN in the late

1990s, concerns were raised on the developmental divide between older and newer members with reference to the gap in average per capita GDP. In response, the 'Initiative for ASEAN Integration (IAI') was formed by ASEAN for regional integration with the principal goal of bridging this developmental divide, which, in addition to disparities in per capita GDP, is manifested by disparities in dimensions of human development such as life expectancy and literacy rates.

It is recommended here that greater cooperation should be harnessed amongst ASEAN member nations in the area of Islamic Capital Market (especially the Sukuk market), Halal industry and Islamic endowment (waqf), as these sectors represent engines of growth. Through a. concerted effort to alleviate poverty, it can economically empower the ASEAN community and the Muslim Ummah, whilst ensuring equitable distribution of wealth within member nations and among member nations. Through this "unifying factor" trading nations in the ASEAN community can achieve the following goals:

- Socio-Economic Development
- Regional Peace and Stability
- Opportunities to discuss differences peacefully due to "common interests"

Under *maqasid al-Shari'ah*, in which the objectives of Shari'ah are focused on human welfare and protection of essential needs revolving around faith, life, intellect, family and wealth, the *maqasid* of wealth requires that wealth must be circulated in the hands of as many people as possible. The wealth created through sukuk, halal markets and waqf developments can fund infrastructural developments within the state and across borders, to help bridge the gap between developed and newly emerging economies. All trading nations depend on local and foreign investments for them to grow or expand. Investing in sukuk, the halal industry and corporate waqf will provide the unifying factor, promoting unity among ASEAN nations based on trade that eliminates interest from their financial systems [*God has permitted trade and forbidden interest* (Quran:2:275].

## 4. Growth Trends of Islamic Finance in the ASEAN Market

The Islamic financial market started much earlier in Malaysia with the establishment of the Pilgrim's Fund Board (Lembaga Tabung Haji) in 1969. This was an idea hatched by the former prime minister of Malaysia (Tunku Abdul Rahman) who wanted to have a systematic mobilization of funds that could assist the Muslim community to perform pilgrimage as well as participating in investments and other economic activities. This initiative was savings-based with no intermediatory role undertaken by the Pilgrim's Fund Board. Then in 1980, triggered by a growing revival of Islamic values amongst the Muslim population and reinforced by the successful implementation of Islamic banks in the Middle East, the Bumiputra Economic Congress proposed the setting up of Islamic banks in Malaysia. In 1981 the National Steering Committee undertook a study and made recommendations for the formation and operations of an Islamic bank. In 1983, the Islamic Banking Act (IBA, 1983) was enacted and Bank Islam Malaysia Berhad was incorporated as Malaysia's first Islamic bank which was subsequently listed on the KLSE in 1992. To complement the operations of Islamic banks, Takaful companies were set up under the Takaful Act, 1984. In 1999 Bank Muamalat Malaysia Berhad was incorporated to be the second full-fledged Islamic bank, as a result of a merger between Bank Bumiputera Malaysia Berhad (BBMB) and Bank of Commerce Berhad (BOCB).Under the Central Bank of Malaysia Act (2009), the dual banking system of Malaysia was given legal recognition (Section 27 of CBA 2009) where Islamic banks and conventional banks were allowed to co-exist, running parallel with one another and to give parity to the regulatory developments in both systems. With the liberalization of laws in Malaysia, conventional banks were allowed to offer Islamic banking windows and today are able to set up Islamic subsidiaries through conventional parent companies. With the introduction of the Islamic Financial Services Act 2013 (IFSA), greater oversight and tighter controls of Shari/ah compliance were put into place to deter Islamic financial institutions from violating the Shari'ah principles. A punitive section was introduced to show the seriousness of the regulators to statutorily enforce Shariah compliance through stiff measures where offenders can be fined RM25 million or 8 years imprisonment or both. The Islamic financial services industries are now given a more effective payment system with greater protection accorded to consumers and the law has expanded the avenues for greater access to justice.

In the neighboring ASEAN nations, like Thailand, Singapore, Indonesia and Brunei, the Islamic finance experiment of Malaysia was followed with the same fervor. Singapore had ambitiously declared itself to be "the regional hub for Islamic finance" at the time when Islamic finance in the Island republic was still at its infancy and lacked the critical mass for retail banking. As a consequence, the Islamic finance experiment in Singapore is said to have failed. The development of Islamic banking in Indonesia followed the Dual banking system and the vision of Malaysia by setting out their VMG in 2002 in "The Blueprint of Islamic Development in Indonesia". Thailand was convinced that Islamic banks are a viable alternative to conventional banks as they had experienced the negative effects of conventional financial philosophies and practices. The global financial crises had swept away a large number of their banks and financial institutions and affected the world economy, but they observed that the Islamic banks of Malaysia and other Islamic countries managed to stay afloat during the same crisis. This made it easy for Islamic finance to enter a Buddhist majority country and in 2002 the Islamic Bank of Thailand was set up by the Islamic Bank of Thailand Act B.E. 2545 (2002). Today there are 26 branches of the Islamic Bank of Thailand, scattered in all regions of the country in a Muslim minority country. The Tabung Amanah Islam Brunei was the first financial institution to offer savings and financing in accordance with Islamic principles when it was launched in 1991, followed two years later by the Islamic Bank of Brunei. They were joined in 2000 by the Islamic Development Bank of Brunei and today with the merger Bank Islam Brunei Darrusalam stands out as the sole Islamic bank in Brunei. Sitting on the fringes of ASEAN are countries like Kampuchea, Laos and Vietnam which do not have the necessary infrastructure to participate in Islamic finance as the ethical alternative to conventional finance.

Keeping in view the ASEAN financial market and the member nations currently participating in Islamic finance, the question is what do they have in common in terms of issues and challenges? Can Islamic finance be used as a vehicle to promote unity amongst trading nations and cross-border partners? Do ASEAN members subscribe to the philosophy of "prospering thy neighbor's" which appears to be in conformity with the ASEAN VMG? What are the common aspirations of the ASEAN members? Using the collaboration of Thailand and Malaysia as a case study, it is hoped that this paper will answer these questions. The study will highlight the areas where greater cooperation can be harnessed among member nations in the area of Islamic capital market (especially the Sukuk market), halal market and Islamic endowment (waqf) market and the legal and regulatory architecture needed to make it a reality. Wealth should be circulated in the hands of as many people as possible to ensure an equitable development among member nations.

## 5. Current Status of Thailand's Cross-border Collaborations with its ASEAN Neighbours

Cross-border trade is one of the key indicators of closer economic interdependence between Thailand with its neighboring countries. Cross-border trade is defined as all forms of trade or exchange of goods transacted through border checkpoints by both sides of local people or traders, who reside in provinces or communities along the border. Thailand's cross-border trade expanded rapidly due to the relaxation of border restrictions stemming from occasional political conflicts (TDRI 1997). Amongst Thailand's four bordering countries[3], Malaysia is the most advanced developing market economy. Out of the 77 provinces in Thailand, 32 provinces share a common border with four neighboring countries – a river border with Lao PDR and a land border with Cambodia, Malaysia and Myanmar.

Over the years, extensive cross-border infrastructure linkages have been developed by Thailand for its neighbors. Thailand as an emerging donor country in 2005-2009 has extended cumulative grants to Cambodia, Lao PDR and Myanmar with a total of 201.87 million USD to develop cross-border rail links, interprovincial roads and airports under the 'Neighboring Countries and Economic Development Cooperation Agency' (NEDA, 2011). Thailand participates in the GMS Information Superhighway Network (ISN) which strengthens the GMS-wide networks so as to support regional integration ((Asian Development Bank, 2007). Thailand has contributed in two other overlapping regional highway networks, notably the ASEAN

[3] The four countries are Cambodia, Lao PDR, Malaysia and Myanmar.

Highway Network signed in 1999 and the Asian Highway Network signed in 2005, which have been extended over the country along 12 routes with a total road length of 3.430km (Department of Highways of Thailand, 2011).

The cumulative cross border trade value between Thailand and neighboring countries significantly reached 170.33 billion USD with a share of 57.69% of total international trade value with neighboring countries. The cumulative share of cross border export to these neighbors was as high as 59.16%. The cumulative share of cross border import was at 40.84%, contributed by Malaysia (55.73%); Myanmar (35.92%); Lao PDR (6.89%); and Cambodia (1.44%). As a result, Thailand gained significant cumulative balance of cross border trade at 31.23 billion USD. The annual average growth of cross border trade from 1996-2001was 16.98% despite the fact that Thailand had faced severe financial crisis during 1998-2001. During enforcement of AFTA from 2002-2012, it significantly kept increasing to 24.28% per year (Table 1).Above all, when the specified AFTA tariffs became 0% in 2010, its annual cross-border trade growth considerably increased to 32.08% compared with 2009. With the increasing trend of international trade of Thailand, the intra-ASEAN trade and cross border trade are also gradually rising though the proportion of their share is low. Cross-border trade during 2008-2012 reached a significant level sharing an average of 30.97% of intra-ASEAN trade reflecting the convergence effects of bilateral and regional trade agreements and regional trade facilitation initiatives.

During the last 17 years, the bilateral cumulative cross-border trade value between Thailand and Malaysia was 97.94 billion USD. The aggregate bilateral cross border trade value expanded from 0.82 billion USD in 1996 to 16.60 billion USD in 2012, which represents 56.6% of the aggregate cross border trade value with four neighbouring countries (fig 5). As a result, Thailand gained favourable cumulative balance of cross border trade of 20.37 billion USD. The aggregate cross-border trade export sharply escalated from 0.54 billion USD in 1996 to 9.75 billion USD in 2012. For almost two decades, the annual average growth of cross border exports has been 22%. In 2012, Padang Besar border checkpoint was the key export platform facilitating a high share of 50.18%, followed by Sado border checkpoint (47.6%); Betong (1.73%) and Sungai Golok (0.33%). The rest was contributed by four other checkpoints. The major exported goods through Sadao border checkpoint were natural rubber, parts and accessories of machinery, electrical parts, processed parawood, particle board, rubber hand gloves and print circuit board. For almost two decades, the annual average growth of cross border imports has been 22%. Sadao border checkpoint dominated with 77.88% share, followed by Padang Besar border checkpoint (20.04%), and Sungai Golok border checkpoint (1.13%) and the rest was shared by four other border checkpoints. The major imported goods through Sadao border checkpoint were electrical parts, parts and accessories of machinery, auto processors, plastic products, synthetic rubber and chemical fertilizers.

## 6. Thailand's Cross-Border Collaboration with Malaysia on Sukuk Issuances

Malaysia and the GCC are reputed as the two traditional sukuk powerhouses. In fact Malaysia is home to 69% of the total number of sukuk issued from 1996 to third quarter of 2013; this adds up to 2,438 (over $325 billion) international and domestic Islamic papers issued. GCC total issuance accounts for 12.7% of global aggregate sukuk with 451 sukuk issued (over $123 billion). In the last three to five years new entrants such as Pakistan, Indonesia and Turkey have slowly made their presence felt in the global sukuk market. There are many other countries that are not regular sukuk issuers; there have been a handful of corporate sukuk issuances out of the UK, France and Germany, for example, and on October 29, 2013 the UK government announced plans for a debut £200 million sovereign sukuk targeted for 2014 issue.

There are several reasons for investors shifting towards the sukuk market - sukuk is said to be a relatively safer investment than buying stocks or shares or even investing in the real estate. Besides this, sukuk as an asset-class, is based on Islamic securitization principles or asset-backed securitization.[4] Most governments now depend on structuring of sukuk to raise funds for infrastructural developments. Corporations use this avenue or asset class to finance expansion programs. The quality of the assets in the asset-backed securitization is also important to sukuk holders as they are entitled to realizable proceeds upon maturity or redemption upon default. As a whole, most investors prefer asset-backed sukuk, which is secured and gives investors recourse to both asset and obligor guarantee. Asset-based sukuk gives recourse to only the obligor's credit quality. Project-based sukuk gives investor recourse only to the asset and is least preferred by investors. Conventional bonds on the other hand are debt-based securitization where the returns are predetermined and interest-based. Sukuk however adds to the real economy in the form of infrastructural developments etc. and the revenues should be based on the performance or quality of the sukuk assets and not on creditworthiness of the obligor or originator. By pooling assets, it spreads the risks based on the law of large numbers.

## 7. The Securitization Process

What is required in the structuring of sukuk and conventional bond is Special Purpose Vehicle (SPV), which is a trust company established to become an intermediary or broker between the seeker of funds (the originating company) and provider of funds (sukuk investor). It also acts as a trustee for sukuk holders. The SPV will issue sukuk (investment certificates) for investors to take up. The sukuk project has a long

[4] Companies make use of idle assets that are lying on their balance sheet to transform them into securities (liquid assets). This could be the case where the company is strapped by Basel 2 requirements which does not allow debt-equity ratio to exceed 30%. As the company which is poised for growth is prevented from taking a loan from the bank, it seeks funds by converting illiquid assets to liquid assets (securities) or securitization.

investment period (3–5 years). There will be income streams accruing to the sukuk holders as profits. And upon maturity, sukuk assets will be sold back to the originating company for sukuk holders to realize the capital or funds used by the originating company.

To illustrate the securitization process of sukuk, the authors have used the example of a sukuk issued by the Government of Luxembourg. In 2014, three government properties – two towers of the Gate of Europe in Kirchberg and the Gutenberg building in Strassen were sold to a Luxembourg SPV in which the Luxembourg Government was the single shareholder. The SPV was securitized by means of the sukuk holders investing €200 million who whilst receiving this value back at maturity (when the Government buys back the properties from the SPV), would receive a benchmark-linked profit rate of 0.436% to be generated from the rental income received by the SPV from the tenants of the three properties securitized. This asset linked profit generation means investors get to understand the underlying asset and are more involved in the project. All money raised has to be accounted for as it is used by the SPV to purchase the properties and the funds cannot go missing or be wasted.

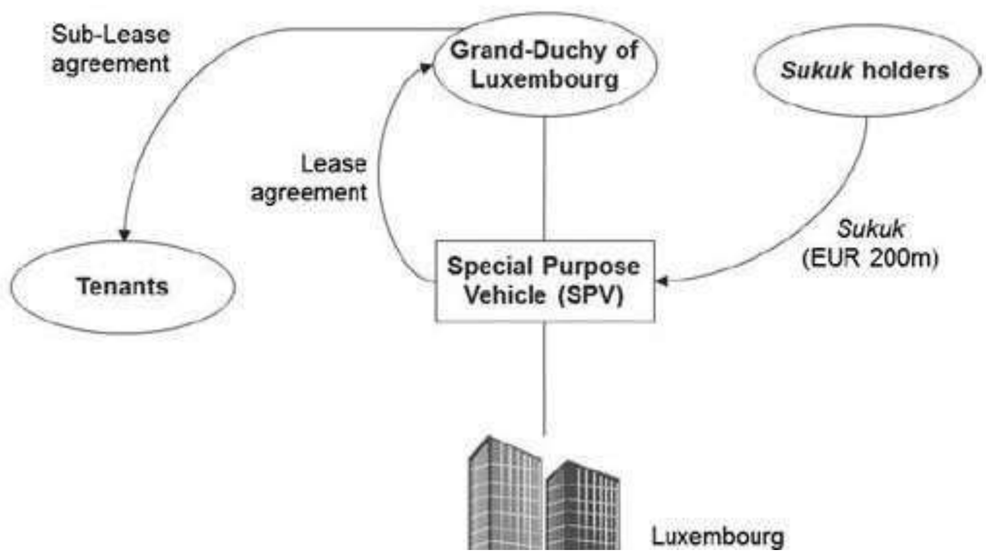


*Figure 1.* Sukuk issued by Government of Luxembourg

## 8. Sukuk Issuances in Thailand through Trans Thai-Malaysia Thailand (TTMT) Sukuk Berhad

The purpose of Malaysia's structuring of the cross-border sukuk with Thailand is to raise funds for a joint-gas project in Southern Thailand. It is planned to bridge the gap between the prosperous and poorer parts of Thailand and to appease the unrest in the Muslim majority regions who have been clamoring for secession from main Thailand due to unequal economic development in the various regions of Thailand.

TTMT is a 50:50 joint venture between project sponsors Petroliam Nasional Bhd (Petronas) and PTT Public Company Ltd (PTT). The cross-border sukuk, TTM Sukuk Bhd is a wholly-owned subsidiary of Trans Thai-Malaysia Thailand and the issuer (SPV or funding vehicle) of TTMT to build two more gas pipelines to transport natural gas from the Malaysia-Thailand Joint Development Area (JDA) in the Gulf of Thailand to the industrial city of Rayong in Thailand. The gas pipeline construction, which was completed in June 2010, is the second phase of the TTM project comprising a 667km gas transmission pipeline system and a gas separation plant to meet the energy requirements in both countries. The sukuk size is RM600 million. The arrangers for this sukuk are CIMB Islamic and HSBC Amanah. Legal counsels for the issuers and lead managers consist of law firms from Malaysia, Thailand and UK for the Malaysian law, Thai Law and English law respectively. The cross border sukuk is structured and issued asa MR600 million secured Commodity Murabahah Sukuk, where the underlying assets of TTM Sukuk (the commodities) are based in Malaysia to overcome taxes such as withholding tax, VAT, stamp duty and others (Sheila, n.d).

The TTM Sukuk transaction reflects a number of important contributions.

- Firstly, this was the first Kingdom of Thailand government-linked company (GLC) issuance. This raised hopes that the Kingdom would issue directly in 2011, or that they will launch domestic Sukuk transactions, if not both.

- Secondly, it remains the demonstration of a commitment to regional peace and economic development as the issuance is made via Malaysia for a joint gas project serving southern Thailand.

- Thirdly, it is used as a case study here to show the ingenious structuring of a Shariah compliant sukuk designed to overcome transnational taxation issues.

Based on the present authors' analysis of this cross border sukuk, it can be deduced that when contracting nations have a robust and comprehensive taxation framework complemented by bilateral tax treaties to remove double taxation or any cross border tax impediments, the combined effects lead to an overall increase in cross-border flows of Islamic funds needed for infra structural developments of emerging markets.

## 9. Issues and Challenges to Cross-Border Sukuk

One must also be aware of the issues and challenges to cross-border Sukuk. From the perspective of the global sukuk investor, there are two main issues which are impeding demand for international sukuk. Firstly, there is the issue of enforceability from a common law and shari'ah perspective. The second issue relates to the underlying assets that make sukuk unique. The distinction between shari'ah-incorporated jurisdictions and purely secular jurisdictions is important in addressing the issue of when and under what circumstances shari'ah is an enforceable element of a contract under the laws of a specific nation. It is not known what the governing laws for this TTMT sukuk are but it can be presumed that the laws of Malaysia will be the governing law of the sukuk given that Malaysia's legal and regulatory framework is relatively more developed to protect sukuk investors. The Securities Commission of Malaysia has also issued comprehensive guidelines governing sukuk issuances to safeguard stakeholders' interest.

One of the most important factors that are necessary for sukuk when it comes to tax regulations is to ensure that there is parity between taxation on sukuk and conventional bonds. If the tax system favors one of them, this creates an unfair market where it is impossible for the disadvantaged financial instrument to thrive. Currently, most tax systems around the world are structured to handle conventional bonds but lack some of the specific attributes necessary to work with sukuk and other Islamic financial instruments. Ownership of assets in many regions requires additional tax duties and often involves other legal transactions that incur additional costs. Without special provisions for sukuk, this characteristic of Islamic financial instruments puts them at a severe disadvantage if the right legal frameworks do not exist. A typical example is an *Ijarah* sukuk structure. In these cases, the initial transfer of asset ownership can trigger capital gains, sales tax, holding tax and stamp duty. Each time a transfer of ownership occurs, which will happen at least twice, these taxes will be required unlike conventional bonds which will only be taxed according to their capital gains. Under the Thai's taxation framework, returns from sukuk investment are classified as "rental revenues" and are subject to property taxes. The tax code also treats transfers of land or property assets as "land transactions" and is taxable. The Thai tax code is seen here to be an impediment to the development of Islamic finance in Thailand. Latest update gathered on Thailand's tax initiatives is that reforms are underway to remove remaining tax implications on sukuk. The proposed regulations have also set out the key requirements for Thai sukuk issuance and their disclosure requirements as well as the guidelines to achieve tax neutrality between sukuk and conventional debt securities.

Another hurdle when creating the necessary legal framework for sukuk in a country's legislation is the differential treatment between profit and interest. Most of the time interest payments are tax deductible. On the other hand, profit is taxable. Some types of transactions are affected by additional duties. For example, *Murabahah* sukuk must pay sales tax or *Ijarah* sukuk often suffers from additional stamp duty payments. Currently, the United Kingdom, Malaysia, Qatar, and Turkey are the four countries that have some of the best conditions when it comes to taxation systems and frameworks for Islamic financial instruments. Thailand has yet to review its tax regime to make it supportive of Islamic financial and investment instruments.

About the rating of sukuk, Malaysian Rating Corporation Bhd (MARC) has affirmed its AAAIS rating of Trans Thai-Malaysia (Thailand) Ltd (TTMT) unit's RM600mil *Sukuk Murabahah* with a stable outlook (Star Online, 9th February, 2015). The affirmed rating incorporates a very high probability of support for the Trans Thailand-Malaysia (TTM) project from creditworthy project sponsors, in particular Petronas on which MARC maintains a senior unsecured rating of AAA/Stable based on available public information. It has been reported that the rating is not constrained by Thailand's foreign currency rating notwithstanding that the sole off-taker of the second phase PTT and the project company TTMT are domiciled in Thailand and the project revenues are denominated in US dollars or the Thai baht equivalent. This assessment is based on Petronas' strong incentive to provide ringgit liquidity in the event of foreign exchange restrictions imposed by the Thai government. The rating also considers the credit linkages in the form of cross-acceleration and cross-default provisions between the Sukuk and the syndicated bank loan taken to finance the first phase of the project for which Petronas is the co-off taker.

There is a need for greater transparency of sukuk structures. In addition to the traditional benefits of sukuk, such as diversifying an investor base and. accessing investors who do not invest in interest based bonds, a less discussed value add of sukuk is its structure, particularly the *Ijara* structure which to a greater deal over conventional bonds prevents the wastage of funds through corruption and theft. Increased transparency can be used to inspire investor confidence and trust thus leading to increased foreign direct investment (FDI). For countries which face the challenges of corruption as well as those seeking to avoid the injustices of interest-based bond borrowing, sukuk present an opportunity to tap a new investor base, one that is ethical and provides the borrower more rights and prevents abusive interest charges in case of default. At a recent Islamic finance conference in Nigeria, Usman Hassan, CEO of Jaiz Bank, a Nigerian based Islamic Bank set up in 2003, urged the Nigerian government to take a closer look at sovereign sukuk issuances to fund infrastructure projects due to the Islamic principles governing sukuk structures where productive assets must be put to work in order to generate returns.

The Kingdom of Thailand has already talked extensively with Malaysia in the development of the domestic Thai Islamic finance market and during this transaction the relationship has been expanded and a new tool has been added to the Thai repertory. Instead of *Bai alInah,* the transaction follows the *Tawarruq* method and utilizes Ableace Raakin's to secure the needed funds in an Islamic sales transaction.

## 10. Thailand's Cross-Border Collaboration with Malaysia on Empowering the Halal Industry

The Halal food industry has great potential for further growth and enhancing cooperation amongst trading nations as halal food is now in greater demand in the global market. Thailand is a leading food producer with internationally recognized standards. In 2011, Thai halal food exports increased by 30 percent. Major markets for Thai halal food include Indonesia, Malaysia, Nigeria and other ASEAN region, with more than 60 percent of the exports going to Indonesia, Malaysia and Brunei Darussalam.

Cooperation in the halal industry has always been a major topic of discussion with its Malaysian neighbors to strengthen economic partnership. On October 30th, 2012, during a two day trade and investment mission organized by the International Trade and Industry Ministry in collaboration with the Halal Industry Development Corporation (HIDC) and East Coast Economic Region Development Council, it was announced that Malaysia and Thailand would work closely to empower the halal industry (Mustapa Mohammad, Malaysia's International Trade and Industry Minister, 2012, News Agencies). More than 90 Malaysian companies participated in the mission to work with their counterparts.

The halal food industry has great potential for further growth and enhancing cooperation among trading nations as halal food is now in greater demand in the global market.

Previously, Thai food products were little known in the Middle East. However in 2012, after signing an MOU on trade and investment cooperation in agricultural products with Bahrain and Qatar, Thailand is optimistic about the continued growth of its halal industry. Cooperation with Bahrain and Qatar in the halal food industry is expected to promote Thai halal food exports to the Middle East. With the GCC countries' support for the halal food industry in the southern border provinces of Thailand, it is expected to contribute to the development of the Thai economy and more equitable distribution of wealth.

Domestically, the Government of Thailand continues to support food production under Thailand's "Kitchen of the World" strategy. The department of industry promotion has set plans to spend 29 million baht in raising the standards of Thai Halal entrepreneurs in terms of production and marketing. With the goal to increase Thai Halal export growth to more than 8% a year, the department will help the entrepreneurs pass more standards so that their products are accepted by Muslim consumers. To this end the following organizations have been established to support its halal industry:

a. The Central Islamic Council of Thailand

b. The Halal Standard Institute of Thailand

c. The Halal Science Centre Chulalongkorn University

d. Halal Forensic Laboratory at Yala Rajabhat University

The Ministry of Industry in its effort to push for the development of the Thai Halal industry is launching a pilot project for 150 entrepreneurs with the objective to help them enter the ASEAN market. Pattani (one of the southern border provinces of Thailand) is being developed into a halal industrial center. Located in Panare district of Pattani, the Government offers special privileges for investors wishing to invest in the Halal Food Industrial Estate. It has also helped in the establishment of the Islamic Bank of Thailand. The Halal Science Center in Chulalongkorn University in Bangkok also plays an important role in developing the standards of Thai halal food. As a result of the extensive collaboration with its ASEAN neighbors and the GCC countries, greater business opportunities have been opened up for the Thai halal food industry. Thai Halal exports were worth almost three billion USD after the first half of 2014.

Back in Malaysia, an initiative is already under way with HIDC to integrate halal financing (Islamic financing) with halal industry (food, pharmaceuticals, cosmetics etc.) to further grow both industries. Hopefully, it will attract 1.9 billion Muslim consumers worldwide.

### 11. Thailand's Cross Border Collaboration with Malaysia on Awqaf Development

Waqf is a tool for eradicating poverty and promoting socio-economic development. The institution of waqf has been around in Islamic civilization since the time of Prophet Mohammad (PBUH). However with the fall of the Ottoman Empire, waqf institutions around the world suffered a setback due to mismanagement and diminishing Islamic values to endow property in the name of Allah for public benefit and charitable purposes for the needy, the orphans, the indigents and the widows. Besides being a tool for philanthropy, it can be explored further about how it may be used for productive purposes. This means finding ways to generate revenue from waqf assets which can be channeled for consumptive purposes like building mosques, education, healthcare, agricultural production and other services which can alleviate poverty and contribute towards the socio-economic development of a country. The type of waqf assets that can be utilized to raise funds can be in the form of movables (cash waqf) and immovables (land, etc). Movable waqf has been legitimized by the four schools of Islamic jurisprudence. The definition of waqf albeit for movable or immovable property is summed up as:

"The confinement of property or an amount of money by a founder (s), (individuals, companies, institutions, corporations or organizations), and the dedication of its usufruct in perpetuity to the welfare of the society".

Where the waqf management is undertaken by a corporation[5], it becomes a corporate waqf and is defined in the following manner:

"The confinement of an amount of liquid money, shares, profit, dividends by founder(s) such as individuals, companies, corporations, organizations or institutions, and the dedication of its usufruct in perpetuity to the welfare of society".

Where waqf is corporatized, this means that the money, profit, shares, dividends and liabilities of the business belong to the corporation, not to the shareholders. In addition to its legal personality, once the corporate waqf is registered, it will have limited liability and will be governed by a Board of Directors appointed by the founder; the BOD will appoint the *mutawalli*/trustee (specifically an associate institution) in order to manage the affairs of the corporate waqf; and the beneficiaries should be specified by the founder in his or her *hujjah*/*waqfiah* (waqf deed) (Magda, 2014).Similar to the investment of cash waqf, the accumulated funds in the associated waqf institutions or waqf foundation can be invested in any lawful investment albeit in low or high risk investment.

The objective of the Shari'ah is to ensure that economic prosperity is achieved through fair means and that wealth is generated and circulated for public benefit based on distributive justice to achieve social justice and *falah* or happiness for society. This type of financing vehicle should be explored further about how countries can use waqf (illiquid and liquid assets) to raise funds through *sukuk waqf* for infrastructural developments; and waqf-based micro-financing to provide funding for SMEs and fostering entrepreneurship, and waqf shares to finance the growth of cottage industries dominated by women or by the founder granting them a goodly loan or *qardulhasan* from the profit of waqf; or even to assist industry members who are facing financial difficulty through such interest-free loans.

Waqf properties in Thailand have been increasing since the presence of mosques in Thailand. However, the waqf is not managed in a convenient manner. According to a study, the greatest form of waqf management in Thailand is the rental form. The key problem of waqf management is the lack of understanding about it and the key obstacle is waqf administrative law (Orawit, Boonchom, 2009). There is lack of awareness on the economic significance of waqf in Thailand. However Thailand appears to be reviving the waqf spirit as on January 18, 2013 a sermon was delivered on 'Reviving the Spirit of Waqf-e- Nau' by Hadhrat Mirza Masroor Ahmad organized by Ahmadiyya Muslim Community, Thailand.

[5] A corporation is a legal business structure that establishes the business as being a separate entity from the shareholders. Once a corporation is created, it becomes an incorporated entity having a separate legal entity.

## 12. Conclusion and Recommendations

It is asserted here that greater cooperation should be garnered with more members of ASEAN especially in Cambodia, Laos and Myanmar, These countries represent the less developed or emerging economies of ASEAN. In order to bridge the regional gap, greater assistance should come from developed or more prosperous ASEAN members. Assistance can come in the form of developing the Islamic financial markets in those countries through financing the infrastructural developments and introducing regulations before they can participate in the Sukuk, Halal and waqf markets.

These three markets have been the "engines of economic growth" for Thailand as discussed above. These Islamic financial markets can alleviate poverty, economically empower the ASEAN community and the Muslim ummah; ensure equitable distribution of wealth and enable Muslim Ummah to fulfill the spirit of "prospering thy neighbor's" within a legally acceptable framework and political platform. Under *maqasid al- Shari'ah*, the objectives of Shari'ah is focused on human welfare and protection of essential needs such as faith, life, intellect, family and wealth. The *maqasid* of wealth requires that wealth must be circulated in the hands of as many people as possible to fund infrastructural developments within the state for public benefit and across borders to help fund newly emerging economies. All trading nations depend on local and foreign investments for them to grow or expand. Investing in sukuk, the halal industry and corporate waqf will provide the unifying factor, promoting unity among ASEAN nations as *God has permitted trade and forbidden interest* (Quran:2:275).

Given the impediments to cross-border collaborations in Islamic finance, the following recommendations are made:

**12.1. Removal of Restrictions to Trade.** There should be a mutual relaxation of laws to allow Islamic finance to develop with all the benefits discussed above. This includes liberalization of taxation laws, tax treaties and jurisdiction laws which are supportive of sukuk issuances, halal industry and Islamic endowment. (Contract and shariah enforceability)

**12.2. Creating a Levelled Playing Field.** A levelled playing field should be created for Islamicfinancetobecompetitiveandlesscostlythrougharobustlegalandregulatoryand tax framework.

**12.3. Unified and Concerted Effort.** A unified and concerted approach is needed to alleviate poverty and economically empower emerging ASEAN member nations through Islamic finance.

**12.4. Setting up an International Waqf Bank through IDB.** The idea of setting up a Waqf bank or even an international waqf bank has been bandied around at international waqf conferences. It is hoped that the pooling of waqf resources and assets will be a step towards helping to enrich ASEAN members, specifically in Cambodia, Laos, Myanmar and the Philippines.

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