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SHARIAH COMPLIANT REAL ESTATE INVESTMENT AND ECONOMIC GROWTH: CASE OF KINGDOM OF SAUDI ARABIA

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ABSTRACT

The concept of Shariah compliant derive from Islamic law or the Shari'ah law, the roots of which in turn are derived from Qu'ran, sunna, and ijma or consensus of the community of scholars and finally qiyas, or analogical assumptions and reasoning. This study aimed to examine the relationship between Shariah compliant real estate investment and economic growth in Kingdom of Saudi Arabia. Besides, the study also investigated the effect (s) of Shariah compliant real estate on the GDP. The study had used an ordinary least square (OLS) or linear least squares to analyze the data from 2002 to 2012 in Saudi Arabia. The findings found that real estate investment had a positive but non-significantly effects on economic growth. Meanwhile, the real estate investment had negative effects on gross domestic product. The main implications of this study were providing financial investment strategies for investors, where relying on the vision 2030.

INTRODUCTION

The real estate industry has been important factor in economic growth in almost all countries. In China, real estate investment is increased from 3311.98 hundred million yuan in 2000 to 44,319.50 hundred million yuan in 2011 [1]. The real estate market demand is influenced by demographic and social-economic characteristics of inhabitants, economic circumstances and desired residence characteristics [2]. Real estate investment is the investor capital into real estate to obtain an uncertain future gain [3]. The business support and religion are important factors that impact business firms' attitude towards Islamic finance [4].

Islamic financial institutions are one of fastest growing financial sectors locally and globally [5]. Islamic financial helps to fulfil the Muslim needs to obtain a financing that respects their religions (Halal financing) [6]. Islamic financial institutions achieved annual growth rates over 20% in last decade with approximately USD 1.25 trillion in 2010 [7].

Investment and finance play a significant role in a contemporary economic life, it became an essential function through contractual operations acquired from funding to become known by the expression for financing role play in order to achieve their intended objectives. Based on the people need, the real estate financing take an important place between all other financing types, and this is reflected on all contractual formulas which the real estate is financing from. The real estate financing is relatively new way to finance property; to make the process much convenience for the people, and give them proper financing, the policies and ligament tool has been developed. Even though the real estate finance has many constrains but, the Islamic banks attempt to face this constraint very well.

The principal framework of Islamic financial system is a set of laws and rules, referred as Shariah, governing economic, political, cultural and social, factors of Islamic societies. Shariah begins from the rules dictated and written in the Quran, and its practices and explanations are known as Sunnah. Further explanation of the rules is given by scholars in Islamic jurisprudence under the light of Quran and Sunnah.

In Shariah law perspective, any company operating or investing in alcohol, pork products, gambling, arms define etc. are not allowed under Shariah law as classified as non-permissible investments. However, there are no strict guidelines for operating an Islamic real-estate company; except avoiding investing in these activities. In addition, an Islamic real estate company must adhere to certain financial screening conditions. Real-estate development and investment must be financed using Islamic financing, if capable.

Prohibition of interest a term which means “an excess” and considered as any unjustifiable increment of capital whether in forms of sales or loans is the central tenet of the Islamic system. Moreover, any fixed, positive and predetermined rate which is tied to the amount of the principle such as guaranteed regardless of the presentation regarding investment is considered as interest (riba) which is not allowed. However, the general agreement among Islamic scholars is that interest deals with not only usury but it also charges interest that is practiced widely.

Real Estate Investment trust can be categorized as income stock rather than growth stock [8]. As growth stock substantial yield on capital whereas income stock yield higher dividend. This study examined the impact of global financial crisis on real estate investment in Malaysia. In Malaysia, Islamic real estate investment performed much better than conventional real estate investment in term of growth of net asset value. Whereas in term of efficiency & yield distribution conventional real estate outperformed than Islamic Real estate investment. This study concluded that conventional real estate investment was better income stock than Islamic real estate investment in Malaysia during a period of global financial crisis.

There are many factors that directly or indirectly contribute to gross domestic product (GDP) growth or decline. Many researches have been conducted on macro level & micro level in order to find correlation between GDP & various factors such as education impact on GDP growth and public and private investment [9,10]. As per expenditure approach of GDP, investment is also taken into consideration when GDP is calculated but either all type of investment is equally good for GDP growth or not, researches have also taken this factor up to micro level & argued on that.

There are many types of real estate investment it's not only limit to the housing it can be investment in commercial land, office building, business purpose etc. and each of them might have same impact on economic growth or may differ. The housing investment had more influence of Chinese economic growth than other real estate investments. The housing investment was good option for short term economic variation than other. Numerous studies had been conducted in China by different studies to find the relationship between real estate investment & economic growth. Liu et al. 2002 had studied important of housing investment [11].

The study used Granger causality analysis & examined interaction between housing investment on economic growth as well as relationship between non housing investments on economic growth. The findings showed that housing investment had stronger and positive impact on economic growth in short term than non-housing investment. Further in long term the study also found that housing investment has positive impact on economic growth whereas economic growth had impact on both type of investment (housing & non housing). Liming (2014) used the panel data 284 China regions from 1994 to 2010 and found that there was positive and stronger relationship between real estate investment and economic growth in short term while in long term there is inverse or negative relationship between real estate investment & economic growth. This study had concluded that in short term real estate investment in housing would be more beneficial than long term real estate investment [12].

Kong et al. (2016) used that data of investment in real estate in China and its impact on national level and provincial level economic growth and found that it had a positive significant impact on both levels [13].

Sing et al. (2014) used the empirical data of Islamic global assets, S&P global property shariah Index and Eureka hedge Global Islamic Fund Index and two conventional global assets S&P Global REIT Index and S&P Global Property Index [14]. The study had explored predictability of excess return on Sharia Compliant real estate, Sharia Stocks, Conventional real estate and real estate investment trust (REITs). The study used the data set of weekly observation of excess return from the period 2001 to 2010 and found that results accepted the hypothesis that Shariah compliance risk was considerably estimated in the excess returns of a portfolio of the four global asset types that included

Shariah-compliant real estate, Shariah-compliant stocks, conventional real estate and real estate investment trusts (REITs).

Furthermore, this prohibition supported arguments of equality, social justice, and property rights. However, Islam allows the earning of profits but impedes from charging the interest because profits deals ex post, considered as successful entrepreneurship and development of additional wealth whereas interest is like ex ante. It is a cost that charged irrespective outcome of business functions and may not establish wealth if there are losses regarding business. Besides this, the social justice quest for borrowers and lenders to share profits and as well as losses in an equitable manner and the procedure of wealth accumulation and distribution in the finance become fair and portray true productivity.

METHODOLOGY

In this study, the relationship between real estate investment, economic growth and GDP in linear regression such as

$$In\,GDP_t = \alpha_0 + \alpha_1 rei_{t-1} + \alpha_3 govexp_{t-1} + \varepsilon_t$$
$$In\,GT_t = \alpha_0 + \alpha_1 gdp_{t-1} + \alpha_2 rei_{t-1} + \alpha_3 red_{t-1} + \alpha_4 govexp_{t-1} + \varepsilon_t$$

GDP_t = gross domestic product the year t;
REI_{t-} = real estate investment during the period of 2002-2012
RED_{t-} = real estate development during year t
$GOVEX_{t-}$ = government expenditure during the year t
GT_{t-} = economic growth during the year t
In this study, two dependent variables and three independent variables were used. These variables and their symbols are listed in Table 1.

Table 1. Symbols of Time Series Variables

Variables	**Symbol**
Gross domestic product	GDP
Real estate investment	REI
Real estate development	RED
Government expenditure	GOVEXP
Economic growth	GT

The dependent variables were GDP and economic growth. The number of observations in any particular regression depended on the specific variables used. Since the study had focused on the relationship between real estate investment and economic growth and GDP. Hence, the study primarily concerned with the coefficient and significance for real estate investment and control variables that could be affecting its relationship with the dependent variable. The independent variables were used such as real estate investment, real estate development and government expenditure.

The main purpose of this study was to explore the relationship between real estate investment and economic growth, and gross domestic product in Saudi Arabia. However, estimation of impact of the variables of interest (real estate investment), the study needs to control other potentially important variables that influenced the economic growth and GDP such as real estate development and government expenditure. All the control variables had bidirectional relations with economic growth and GDP.

The annual data used was from year 2002 until 2012. The data were obtained from Annual Reports of Saudi Arabia Ministry of Finance and Bloomberg Database. This study used a quantitative study to investigate the relationship between the economic growth and the real estate investment and development in KSA. Ordinary least square (OLS) method was applied to test the model.

RESULT AND DISCUSSION

Empirical Results

In Table 2, table of skewness with value 0.24 and kurtosis result of the value 0.59, which are both less than one. The data was normally distributed with less than 0.05 level of significant. The result showed that data did not had heteroscedasticity or homoscedasticity.

Table 2. Normality and Heteroscedasticity for Model 1

Test	**Value**	**p-value**
Global statistic	2.75	0.60
Skewness	0.24	0.63
Kurtosis	0.59	0.43
Link function	0.18	0.67
Heteroscedasticity	1.74	0.19

In Table 3, the skewness was 0.01 and kurtosis result of the value 0.78, which are both less than one. The data was normally distributed with less than 0.05 level of significant. The result showed that data did not had heteroscedasticity or homoscedasticity.

Table 3. Normality and Heteroscedasticity for Model 2

Test	**Value**	**p-value**
Global statistic	1.196	0.88
Skewness	0.01	0.93
Kurtosis	0.78	0.38
Link function	0.20	0.65
Heteroscedasticity	0.21	0.65

For the Model 1 the multiple R-squared was 0.97 and the adjusted R-squared was 0.96. From the above table 6 the coefficient of the lag of real estate investment is -0.11 with t-statistical of -3.01. The corresponding p-value 0.01 which less than 0.05. Hence, the null hypothesis of no impact of real estate investment on the GDP is rejected. In other words, real estate investment has a significant negative relationship with GDP.

While the coefficient of the lag of real estate development is 0.32 with t-statistical of - 1.85. The corresponding p-value 0.10 which more than 0.05. Hence, the null hypothesis of no impact of real estate development on the GDP is accepted. In other words, real estate development has no significant positive relationship with GDP.

And the coefficient of the lag of government expenditure is 0.35 with t-statistical of 8.92. The corresponding p-value 4.51 which more than 0.05. Therefore, the null hypothesis of no impact of government expenditure on the GDP is accepted. In other words, government expenditure has no significant positive relationship with GDP.

Table 4. Main Result for Model 1

	Coefficient	t-statistic	p-value
Intercept	7.28	4.62	0.00***
REI	-0.11	-3.01	0.01**
RED	0.32	1.85	0.10
GOVEXP	0.35	8.92	4.51e-05**

*significant at 10%, ** significant at 5%, *** significant at 1%

From the above table 7 below, the coefficient of the lag of gross domestic product is 98.35 with t-statistical of 4.84. The corresponding p-value 0.00 which less than 0.05. Hence, the null hypothesis of no impact of gross domestic product on the GT is rejected. In other words, gross domestic product has a significant positive relationship with Economic Growth.

Second, the coefficient of the lag of real estate investment is 6.61 with t-statistical of 2.29. The corresponding p-value 0.06 which more than 0.05. Hence, the null hypothesis of no impact of real estate investment on the GT is accepted. In other words, real estate investment has no significant positive relationship with GT

Third, the coefficient of the lag of real estate development is -34.49 with t-statistical of -3.00. The corresponding p-value 0.02 which less than 0.05. Hence, the null hypothesis of no impact of real estate development on the GT is rejected. In other words, real estate development has a significant negative relationship with GT.

Finally, the coefficient of the lag of government expenditure is -29.69 with t-statistical of -3.97. The corresponding p-value 0.00 which less than 0.05. Hence, the null hypothesis of no impact of government expenditure on the GT is rejected. In other words, government expenditure has a significant negative relationship with GT.

Table 5. Main Result for Model 2

	Coefficient	**t-statistic**		**p-value**
Intercept	-705.5	-4.14		0.00***
REI	98.35	4.84		0.00**
RED	-34.49	-3.00		0.02**
GOVEXP	-29.69	-3.97		0.00**

DISCUSSION

Studies on real estate in Shariah compliance investments and development are rare and limited, in additions, most previous studies have been qualitative in nature due to data limitations.

Overall, this thesis contributed to understand the real estate investments on perspective of Shariah compliant and its effect on the economic growth and gross domestic product. In addition, it gave a brief about the real estate investment and development in the GCC, and the reasons behind the increase the number of investors in this sector; such as, The oil boom which was in the period of 2002 to the mid of 2008, and Improved investment environments by allowed the foreign ownership in most of the countries with 100% which led to attract more investors and improved the trading in the GCC countries, finally, the attacks of 11 September and its effect for transfer most of the people funds from over the world to these countries as it's the most safe for their Money. After that it give an overview of the real estate investment and development in kingdom of Saudi Arabia as per the new "vision 2030" will be developed more and the government will focus on this sector and other non-oil investment sectors, starting from applying tax on the unused land.

This study was carried out in order to find relationship between Sharia Compliant real estate investment & economic growth in kingdom of Saudi Arabia. We had used ten-year data for this study from 2002 to 2012. Data were collected from annual Government reports Bloomberg; from the first model we have concluded that there is a negative relationship exists between GDP and the real estate investment, surprisingly, we found the relationship between the GDP and all other variables which are real estate development and government expenditure are not strong enough. From the second model we have concluded that there is a positive relationship exists between GDP and the economic growth, while it tends to be negative between real estate development and economic growth and government expenditure. However, the relationship between the real estate investment and economic growth is not strong enough.

CONCLUSION

In conclusion, the result found that real estate investment had a positive but non-significantly effects on economic growth. Meanwhile, the real estate investment had negative effects on gross domestic product.

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