

The Role of Sukuk (Islamic Bonds) in Economic Development

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Abstract: Recent innovations in Islamic finance have changed the dynamics of the Islamic finance industry especially in the area of securitization, known as Sukuk or Islamic bonds. In the last ten years *Sukuk* have become increasingly popular both as means of raising government finance through sovereign issues, and as a way for companies to obtain funding through offering corporate *sukuk*. Beginning modestly in the year 2000 with total three sukuk worth USD 336 million to reach to a total volume of USD 197.203 billion, in all currencies, by the end of December 2010. The primary market of Sukuk grew between 2001 and 2010 at annual compounded rate (CAGR) of 57.0% which is 14.3% of the global Islamic finance assets. It has developed as one of the most significant mechanisms for raising finance in the international capital markets through Shariah-compliant structures. Today, local and multinational corporations, sovereign bodies and financial institutions are issuing sukuk as an alternative to syndicated financing, making sukuk an essential subset of the international financial system. Well-developed Sukuk markets would enhance access to financial services, deepen capital markets and create Sharia-compliant alternative for small and/or risk-averse investors.

This paper will trace the development of the fast growing Sukuk market and review the factors which have contributed to its development; in addition to exploring its role in the economic development of the Sukuk-issuing countries.

Keywords: Sukuk, Islamic Bonds, Securitization, Islamic Finance, Economic Development

JEL Classifications: E44, G31, G32

Introduction to Islamic Shariah

Shariah means the path to follow Allah's law. So, the Shariah is simply the Islamic law/jurisprudence. It controls, rules and regulates both public and private behaviour, such as prayers, fasting, Zakah, Hajj and many other religious matters. It can be also used as a guide to settle international disputes, conflicts and wars. Islamic Shariah derives its rules and principles from several resources, among which Quraan is the first (primary) one, and Sunnah is the second one.

Islamic Finance

In the Islamic finance, Shariah *compliant* services are the financial products that meet the requirements of Islamic law. Demand among Muslims for financial products and services that conform to the Shariah has led Islamic financial institutions to create Islamic financial alternatives based on Shariah and satisfy Muslims financial needs. The main characteristics of Islamic Finance can be summarized as follows:

- Making money from money is prohibited. Therefore, Islamic financial institutions cannot lend money to, or receive money from, someone and expect to benefit, which means that all types of interest (usury), known as "Riba" in Islam, are prohibited.
- The linking of finance to productivity, which means that wealth can only be generated through legal trade and/or investment in assets
- The desirability of profit sharing. Gains are shared between the party providing the capital and the party providing the expertise
- The prohibition of unethical investments, such as: Alcohol, Gambling, Tobacco, Pork products, and Sensual entertainment
- The emphasis on equitable contracts

Sukuk (Islamic Bonds)

Investment Sukuk (as defined by AAOIFI) are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services. Sukuk should be tied to an eligible Sharia contract and would represent undivided ownership rights to the underlying assets and/or services

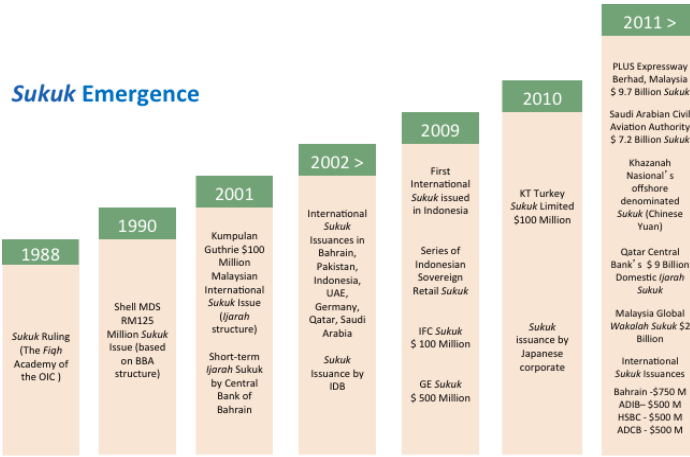
The Council of the Islamic Fiqh Academy of the Organization of Islamic Conference (OIC) in its Fourth Session held in Jeddah, Kingdom of Saudi Arabia from 6 – 11 February, 1988 legitimized the concept of Sukuk, which paved the way for an alternative source of financing to meet the needs of Islamic issuers and investors who are not allowed under the Shariah principles to invest in conventional bonds. Since that date, Sukuk market has dramatically grown up to become one of the fastest emerging alternative instruments and a significant capital markets tool which are increasingly used by governments, government-held entities and corporations, not only in the Middle East and South East Asia, but in a number of other countries across the globe.

In the year **1990**, the first Sukuk was issued in Malaysia by Shell MDS a foreign owned, non-Islamic corporation, with a value of RM 125 million (equivalent to \$30 million), based on the principle of *Bai' Bithaman Ajil*. In the year **2000**, Sudanese Pound (SDG) 77 million domestic sovereign short-term Government *Musharaka* Certificates (GMC's) were issued by the Sudanese Government. In the year **2001**, the Sukuk market went international with the issuance of the first United States Dollar (USD) denominated international sovereign Sukuk *Al Ijarah* of \$100 million (5 year tenor), and a series of domestic sovereign short-term (less than 1 year tenor) Sukuk *Al Salam* issued by the Central Bank of Bahrain on behalf of the Government of Bahrain. In the same year, the first 5 year international corporate Sukuk *Al Ijarah* of \$150 million were issued by a Malaysian corporate Kumpulan Guthrie Berhad or Guthrie Group Limited. After that, many sovereign and corporate Sukuk issues (domestic and international) have been offered in various jurisdictions such as the United Arab Emirates (UAE), Saudi Arabia, Indonesia, Qatar, Pakistan, Brunei Darussalam, Singapore, Kuwait etc. Since then, the Sukuk market emerged as one of the main sections of the IFSI and a lot of innovation took place in its structures such as *Ijarah*, *Musharaka*, *Mudaraba*, *Hybrid*, *Exchangeable* and *Convertible*.

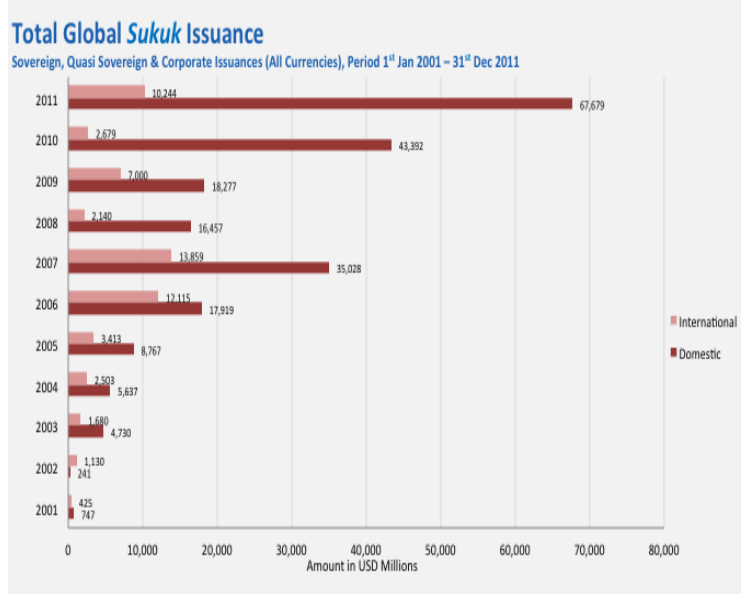
As far as the domestic Sukuk market is concerned, Malaysia has the lion's share in terms of both volume and value. Malaysia remains as the largest domestic issuer with 72% by value of domestic Sukuk issuance. The remaining 28% splits between a number of issuers, such as Sudan, Saudi Arabia, UAE, Bahrain, Brunei, Pakistan. Short-term Sukuk (maturity of 1 year or less) are essential for liquidity management purposes. Sudan is the leader in domestic short-term Sukuk issuances followed by Bahrain, Brunei and Malaysia. Bahrain has been the most active market within the GCC region and is a regular issuer of short-term Sukuk *Al Salam* and Sukuk *Al Ijarah*.

Overview & Trends in the Global Sukuk Market

a. The following chart refers to the historical trends in the global Sukuk market:



b. The following diagram represents the total global Sukuk issuance:

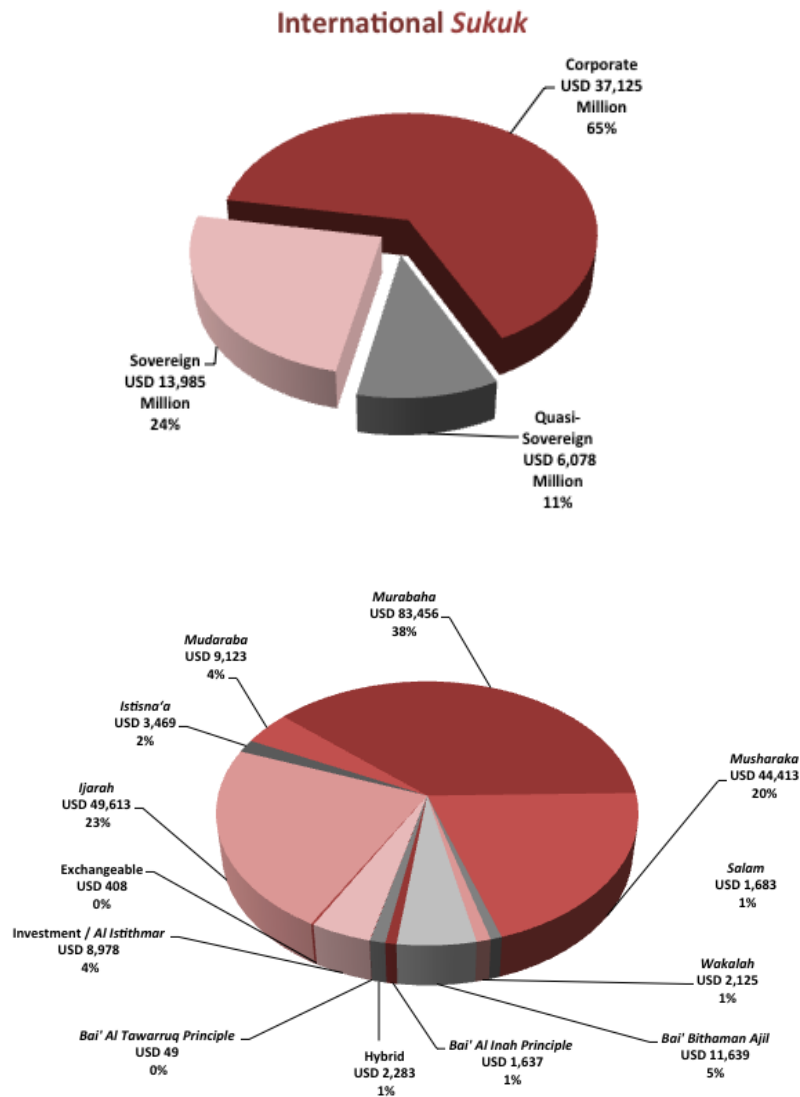


c. The following table shows a Country-wise breakdown of total global Sukuk issuance by volume:

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Country	Number of Issues	Volume (US \$ Million)	% of Total Value
Malaysia	2285	169,878	61.54%
UAE	43	32,946	11.93%
Saudi Arabia	25	17,099	6.19%
Sudan	23	13,344	4.83%
Qatar	7	11,568	4.19%
Bahrain	234	10,654	3.86%
Indonesia	75	6,780	2.46%
Pakistan	39	4,568	1.65%
Cayman Islands	6	2,679	0.97%
Kuwait	11	2,026	0.73%
Jersey	2	1,250	0.45%
Brunei Darussalam	21	1,176	0.43%
USA	3	767	0.28%
Turkey	2	450	0.16%
UK	2	271	0.10%
Singapore	5	192	0.07%
Germany	1	123	0.04%
Jordan	1	119	0.04%
Japan	1	100	0.04%
Gambia	49	30	0.01%
Iran	1	28	0.01%
Yemen	2	15	0.01%
Grand Total	2838	276,064	100%

d. The following chart displays a breakdown of total global Sukuk issuance by issuer status:



e. The following diagram displays a structural breakdown of domestic Sukuk issuance (% by volume)

Domestic *Sukuk*

