

Sovereign Islamic Sukuk and the Economic Development: A Case Study of Jordan

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Abstract

The importance of Islamic sukuk, especially sovereign Islamic sukuk (which are issued by the government) for a country as Jordan that needs to develop projects and finance these projects is a very vital issue. Jordan does not have enough economic resources, but it can rely on national savings and use them effectively, rather than relying on foreign financial aids that represent a burden on the national economy and increase in external indebtedness, but all of that does not deny the issuance of these sukuk represents new financial obligations on the government if these sukuk are directed to meet the public common of Jordan's needs in a time that requires sukuk to be issued to the existence of real assets, not cash, and here we highlights that the most important question which is do we have the ability to find real and new assets so that we can benefit from the issuance of these sukuk?

Keywords: Islamic Sukuk, Economic Development, Sovereign Financing, and Jordan.

Introduction

Islamic sukuk are instruments to finance projects from an Islamic perspective, they open abroad way to innovate and create promised opportunities to improve Islamic banking and financing because of the relationship between Islamic finance and diverse investing instruments. Although, we cannot ignore legal and economic obstacles and challenges, but we must take advantages from the innovation and developing the world of Islamic banking and finance especially when we talk about Islamic sukuk.

Islamic sukuk are considered in producing vast scope of innovations and large potentials for the growth of Islamic finance (AL-AMINE, 2008). So, in this study we are going to give a clear descriptive picture about the importance of Islamic sukuk especially for a country like Jordan.

The name of sovereign Islamic Sukuk came from their purpose of issuing instrument to finance projects that can help to enhance the common good, for that the government should prepare and facilitate to let that experience to succeed. In addition, that can increase the diversification of financing the government budget and find a good source to finance it. On the other hand, by issuing Islamic sukuk, Islamic and commercial banks will find a way to invest the excess of liquidity they have to find a new way of investing (Al ABBADI and ALTALEB, 2016).

(Note: Sukuk is plural, and Suk is singular according to the Arabic language).

Research Problem

Many countries and companies around the world rely on the bonds to finance their projects; these bonds have elements and conditions are related to the amount of interest rates and how to pay those interest rates. On the other side, Islamic sukuk represents a common share in the ownership of the asset and the main principle of Sukuk is the profit and loss which represents the real sharing in the businesses results.

What we want to talk and discuss about is the ability of Islamic sukuk in financing the current projects and the planned ones. Which we mean is that Islamic Sukuk can increase the financial ability to build and enhance the infrastructure and development projects.

Research Importance

Jordan is a country needs development projects, good infrastructure, and financial resources. So, we prefer to rely on national savings and local banks instead of foreign loans and foreign institutions. Taking foreign loans is a burden on the Jordanian Gross Domestic Product (GDP) and on the public budget as well.

For that reason issuing Islamic sukuk must serve the current account and the capital account for Jordan to increase the economic and social development. The Jordanian government can finance its buildings by using leasing sukuk (Ijara), these sukuk (al-Ijara Sukuk) is the most widely accepted sukuk structure in the global capital markets and quickest to bring to the markets. Furthermore, most sovereign sukuk transactions were under the Ijara structure, for example Malaysia, Indonesia Qatar, Pakistan and so on (HSBC Amanah, 2012).

Research Objectives

The objectives of this study is giving a financial solution can reduce the Jordanian budget deficit and increasing

the quality of the infrastructure to be a reason to improve the economic development in Jordan without relying on the financial instruments that use the interest rate as a main way of financing but instead of that relying on sharing the profit and loss in any business.

As a result of that, Jordan will be motivated to reform its economic and financial problems in a line with reducing the public debt. In addition, Issuing Islamic sukuk will produce real assets that will enhance the economy.

Literature Review

In this part the reader will take a look at some previous studies about Islamic Sukuk as Ahmad and Radzi (2011) mentioned that the first issuing of Islamic sukuk was in 1970s and it had not shown any sign of slowing down until the recent global financial crisis. Their research attempted to investigate the sustainability of Sukuk issuance during the recent economic downturn by focusing on the Malaysian debt capital market. Malaysia's sukuk market has grown remarkably in recent years, surpassing the outstanding amount of conventional debt securities issued in the domestic market.

Their paper examined three variables concerning the sustainability of sukuk and conventional bond issuance for the period 1990-2009; GDP, foreign exchange, and market liquidity. The findings revealed that both Sukuk and conventional bond issuance in Malaysia consider foreign exchange to be the major cause of issuance. On the other hand, unlike sukuk, conventional bonds issuance does not consider the economic condition as a proxy by GDP and market liquidity as a driving force.

In a study about comparing the return on Islamic sukuk and conventional bonds in Indonesia (2013), Fathurahman and Fitriati found that the performance of Islamic sukuk is better than conventional bonds in Indonesia. Also, Yield to maturity (YTM) and portfolio optimization model (Markowitz Model and Single Index Model) for Islamic sukuk was higher and better than conventional bonds.

Furthermore, pricing mechanism and rating Islamic sukuk is a very important issue because Islamic sukuk are attractive investment instruments for Islamic financial institutions, shariah managed funds, and takaful Islamic insurance companies that cannot invest in conventional securities that involve payment of interest as Ahmed, Islam, and Alabdullah (2014) mentioned at their study about Islamic sukuk and the pricing mechanism.

Araar studied (2014) Islamic finance based on sukuk approach, the roadmap for economic development in Tunisia. He considered Islamic Sukuk as a tool can promote social and economic justice and stimulate economic development. Unfortunately, there are many challenges and obstacles to issues Islamic Sukuk such as the lack of Islamic advisors and counselors knew very well about issuing and managing Islamic sukuk. Tunisian government is facing a deficit and is trying to find solutions for that problem. So, the Tunisian government needs to find a source of funding to rebuild and improve its infrastructure and reform the economic problems.

Research Methodology

In this study we used the descriptive approach to highlight the importance of the sovereign Islamic sukuk as an investment instrument to enhance the economic development in Jordan, because this experience is still in the beginning. We are trying to give financial solutions by relying on the internal funding and savings instead of the external borrowing which contains the interest rate.

The Concept of Sovereign Islamic Sukuk

Islamic Sukuk are certificates are considered to be the sharia compliant version of conventional bond, except that sukuk are asset backed. Although referred to often as Islamic bonds, sukuk are in reality investment certificates evidencing an undivided pro rata ownership of an underlying tangible asset (Jaffer, 2013).

Islamic sukuk are financial instruments to fund investment project by considering the common ownership for assets or services and all investors are going to participate in the results of the project which means sharing the profit and loss outcomes.

Sukuk are issued according to the Islamic law and represent equal values and common shares in the ownership of the project for the owners to implement the project and to achieve the return (Islamic Financing Sukuk Law, 2012).

Sovereign Islamic Sukuk and their Economic Importance

Sovereign Islamic Sukuk funds the economic activities without considering those Sukuk as a debt on the issuers, but as a partnership between the issuers and investors. From that point we are going to take a look at some advantages of issuing Islamic sukuk.

1- Controlling Inflation

When any country issues sukuk, it will spend that fund on capital structures to improve its capabilities in investing money. So, that fund will be directed toward building infrastructures, bridges, factories, and so on.

By increasing the money supply with increasing goods and services, that protects the money from reducing the

purchasing power and prevents devalue of money. So, the country protected its labors and employees who are receiving low salaries and wages from increasing the rising of the prices. As a result of that the local government protected its people from economic and social problems that may face during the long run.

Moreover, Issuing Islamic Sukuk can give solutions to monitor the monetary policy in Jordan for instance according to the monetary requirements, controlling the money supply, and controlling inflation in parallel with the economic needs.

2- Improving Investments

Increasing the financial resources and funds can help the companies and countries to improve the investments in many sectors such as the agricultural and industrial sectors which are considered as long run sectors, instead of focusing on the consuming sector which is considered to be a short run sector.

Also, as advantage to the companies, issuing Sukuk can increase the financial fund for them and take advantage of that by using that money with the new economic opportunities which will be reflected as increasing and enhancing the company's capability to achieve higher levels of profits.

3- Reducing Public Debt

As a case of Jordan, the public debt is a real burden on the budget and that reducing the Gross Domestic Product growth by paying back the foreign debt. So, instead of issuing more bonds or taking more foreign loans, Jordan can rely on its national savings and banking reserves to reduce the budget deficit and reform the economic situation.

4- Controlling privatization

We can consider issuing Sukuk for standing projects as a temporary privatization for that projects because the government is going to sell that project by issuing Sukuk and after that the government will repurchase that project after a period of time according to an agreement with the first buyer. This example is a good example for mega projects such as airports or seaports.

5- Improving Foreign Trade

The developing countries such as Jordan and many countries are considered as countries rely on consuming goods and services more than producing them. As a result of that those countries are relying on importing goods rather than exporting them which makes a deficit in the balance of payments. Also, that is going to be a reason to raise the prices and increase the burden on the consumers in the developing countries.

The solution for this problem is making economic reforms by issuing Islamic Sukuk to fund the productive projects in Jordan, which will lead to increase the local productivity and reduce imported foreign products.

6- Using Excess Liquidity

Banks in Jordan have excessive amounts of money in forms as cash and balances at central bank, balances at other banks and financial institutions, and banking reserves. Many banks are waiting for opportunities to invest these amounts of money to increase their yearly net income. Fortunately, one of these opportunities is Issuing Islamic Sukuk. That will improve the banking capabilities especially when we talk about the economic and social capabilities in serving their communities.

In addition, that will increase diversification of banking investments to be short and long run investments. Also, that improves the banking performance especially Islamic banks because these banks have high levels of excess liquidity.

Sovereign Islamic Sukuk and their Social Importance

Social role is a very vital issue when any government wants to issue sovereign Islamic sukuk, social Islamic sukuk aim to find financial solutions for business and social projects such as renewable energy, agriculture, and transportation.

Issuing Islamic sukuk can be in the Islamic communities and non-Islamic communities as well. The purpose of issuing Islamic sukuk is to find financial solutions for the economic and social problems. So, marketing this kind of sukuk is very important because all countries around the globe need sustainable projects to improve the sustainable development and sustainable environment as well. By looking at this kind of Islamic sukuk from another angle as social responsibility sukuk, for that reason we urge the governments in Jordan to focus on that issue to solve many economic and social problems that face our community.

Special Purpose Vehicle (SPV) with an Islamic Identity

Special Purpose Vehicle (SPV) is a limited liability company which is used by the commercial banks for the securitization when the commercial banks need liquidity by selling the debts. On the other side, this way in Islamic banking and finance is not acceptable because dealing with interest rate, and selling debt are prohibited in Islamic principles.

To solve this point, special Purpose Vehicle is an independent company that possesses the assets from the government or the company and SPV deals with the investors directly. For that, SPV is an independent company financially and legally and is not as a branch from the company that needs the funding.

In Jordan there is a regulation number (44) for year (2014) that focuses on organizing the way of working SPV to be parallel with Islamic principles and regulations in Jordan to solve any obstacles or challenges that might be faced in issuing Islamic sukuk (Regulation of Special Purpose Vehicle, 2014).

Issuing Islamic sukuk needs experts and counselors in the law and Islamic principles to improve the positive points and to reform the negative ones. In addition, Islamic finance supports many economic and social affairs at any community. Moreover, Islamic sukuk decreases budget deficit, funds the infrastructure projects, and gives financial solution as well (Araar, 2014).

Summary

Jordan is a country needs funds and financial solutions to overcome the challenges and obstacles that Jordan faces them. Fortunately, many banks in Jordan have excess liquidity and these banks are waiting for any golden opportunity to invest that amounts of excess liquidity.

There is no disagreement about that, Islamic sukuk are very important financial instruments can open up many investments doors and take advantage from the national savings. Also, Islamic sukuk will help to make a sustainable development and economic and social prosperity. By looking at table (1) the reader can notice the advantages of Islamic sukuk.

Table (1) Advantages of Islamic Sukuk

Economic and Social Solutions	
1- Controlling Inflation	4- Controlling privatization
2- Improving Investments	5- Improving Foreign Trade
3- Reducing Public Debt	6- Using Excess Liquidity

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