SOVEREIGN ISLAMIC SUKUK AS A PUBLIC DEBT MANAGEMENT INSTRUMENT: A CASE STUDY OF BAHRAIN

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Abstract- Islamic Sukuk are one of the alternatives that play an important role in financing economic development by attracting liquidity from economic units with surplus funds to those with funding deficits. In addition to the diversity of its forms, which makes them meet the wishes of a class of investors. For the increasing needs of financing for economic development, many countries, especially Islamic ones use Sovereign Islamic Sukuk in the management of public debt as a substitute or addition to conventional public debt instruments. Bahrain is one of the pioneering experiences in issuing Sovereign Islamic sukuk in the management of public debt and thus financing economic development.

Keywords- Islamic Sukuk, Sovereign Financing, Public Debt, Economic Development, and Bahrain.

I. INTRODUCTION

For the growing needs of financing the economy, many countries resort to borrowing as a source to meet those needs despite the negative effects associated with it through the growth rate of debt service. So the Islamic financial products were created in a way to contribute to the employment of national savings in development projects with a general return to society without borrowing. Islamic Sukuk is one of the most highlights Islamic financial engineering products as an important instrument in financing development by attracting savings and directing them to different levels of investment, they represent excellent investment opportunities. Bahrain is a leading model in the management of public debt through the issuance of Sovereign Sukuk and thus contributes to financing the State budget deficit especially in light of the low oil prices.

A. Research Problem
What extent can Sovereign Sukuk instruments contribute to the management of public debt?

B. Research Importance
Public debt management is very importance in solving the deficit problem in the state budget. Thus, there are many instruments through which public debt can be managed in a manner that meets the requirements of achieving sustainable economic development, hence, there is a need to use Sovereign Islamic Sukuk as an appropriate instrument by which the State can obtain funding without bearing the consequences of obligations arising from conventional debt instruments.

C. Research Objective
Highlight the importance of Islamic Sukuk in providing the necessary financial resources to achieve economic development, and Relative importance of Sovereign Sukuk in the management of public debt in Bahrain.

D. Research Methodology
The Researcher based on the analytical and deductive approach to collect information about Islamic Sukuk and their importance in managing public debt in order to reach results that could provide suggestions that would support the Islamic Sukuk métier.

II. THE CONCEPT OF ISLAMIC SUKUK AND THEIR ECONOMIC IMPORTANCE

A. Definition of Islamic Sukuk
Islamic Sukuk is define as equivalent documents representing common shares in beneficial ownership, benefits or services, or in the assets of a particular project or investment activity, and that is after collecting the value of the Sukuk and closing the Initial public offering (IPO) use it for its own sake[1]. Sukuk as an investment instrument based on the splitting of speculative capital by issuing Sukuk ownership of speculative capital on the basis of equal units of value, Also registered in the names of their owners[2]. The definition of Sovereign Islamic Sukuk as equal documents issued by the government or from on the basis of the wording of Islamic finance represents a right of ownership in negotiable government assets.

B. Characteristics of Islamic Sukuk
There are several characteristics of the Islamic Sukuk[3]:

1. Sukuk represents common interests in the ownership of assets that have a return and do not represent debt in their source. These may be assets are interest or interest benefits or services and may be money or debt in others.
2. Based on participation in profit and loss, this means that the holder of the instrument must assume the ownership of the instrument is...
assumed as investment expense or falling in value.
3. Issued the Sukuk of the categories of equal value, because they represent equal shares in the ownership of the common shares in the project for establishing or financing instruments issued.
4. Trading instruments; selling, buying, the prices prevailing at the time of circulation, which determined in accordance with the financial position of the project, which is announced by the bank or the investor in periodic intervals are close.
5. Issued in accordance with the format of Islamic finance, and then the instrument, and governed by the regulations of that formula.

TABLE I

<table>
<thead>
<tr>
<th>Items</th>
<th>Notes</th>
<th>Sukuk (Islamic Bonds)</th>
</tr>
</thead>
<tbody>
<tr>
<td>The legal Form</td>
<td>Ownership of a common Share of assets</td>
<td>Ownership of a common share of assets</td>
</tr>
<tr>
<td>Return</td>
<td>Participation in profits and Losses</td>
<td>interest rate</td>
</tr>
<tr>
<td>Trading</td>
<td>Trading instruments</td>
<td>Trading instruments</td>
</tr>
<tr>
<td>The degree of Risk</td>
<td>High</td>
<td>Low</td>
</tr>
</tbody>
</table>

The Differences between Islamic and conventional Financial Instruments and Securities[4]:

C. The economic importance of the Islamic Sukuk
The importance of Islamic Sukuk can be summarize in the following points[5]:
1. Extra budgetary funding source.
2. Harmonization between funding sources and uses.
3. An instrument to control the monetary policy.
4. Financing instruments, does not affect the credit limit of the company in the banks.
5. An instrument for financing development projects.
6. The revitalization of the trading market.

III. CONCEPT OF PUBLIC DEBT MANAGEMENT

A. Definition of Public Debt
The public debt is one of the important source of income to the government in times of financial crisis, emergencies like war, drought, etc.[6]. The management of the public debt are intend to all decisions affecting the structure of the public debt through the following functions[7]:
1. Issuing and marketing debt.
2. Organize the structure of debt maturity.
3. Consumption of public debt.

B. Public debt instruments in the Kingdom of Bahrain
The Central Bank of Bahrain, issuance of debt instruments on behalf of the Government of the Kingdom of Bahrain and is divided into public debt in terms of borrowing instruments to conventional financing instruments, as well as Islamic finance instruments could be clarified as follows[8]:

1) The conventional Public Debt instruments:
   a. Treasury bills {Bahraini Dinars (B.D)}: Short-term investment instrument is issued according to the following categories:
      1. For a period of three months (91 days) and is issued on a weekly basis by amount of 70 million B.D.
      2. For a period of six months (182 days) and is issued on a monthly basis by amount of 35 million B.D.
      3. For a period of Twelve months (365 days) and is issued on a quarterly basis by amount of 225 million B.D.
   b. The governmental development bonds: Long-term bonds to be issued to the US dollar or the B.D, where issued at a fixed rate of interest for periods of entitlement from 2 to 30 years.

2) The Islamic Public Debt instruments:
   a. Salam Sukuk: is a Short-term instrument for asset disclosure described in the deferred delivery, issued by the Government of the Kingdom of Bahrain for the purpose of finding new areas to invest the surplus of financial resources in the community to finance public spending and short-term needs for development projects. They are issue on a monthly basis for a period of three months entitlement (91days) 43million Bahraini dinars. They are issued as follows:
   (2) Good of Salam (Aluminum)
   Date of delivery of goods: Maturity date of the Sukuk
   Date of receipt of goods value: 7/11/2001
   (3) A sale contract with an independent party at a price that exceeds the purchase price

   Fig. 1 Structure of the Islamic Salam Sukuk in the Government of the Kingdom of Bahrain[9].

   b. Ijara Sukuk: is an investment instrument issue in accordance with Shari’a standards. They are issued in B.D or U.S Dollars

Proceedings of Academicsera 20th International Conference, Montreal, Canada, 29th-30th May 2018
with a fixed or variable yield and maturities of 2 to 10 years and issued as follows:

1. First sale contract:

   ![Diagram of a first sale contract]

   40 million B.D

   Bahrain Comprehensive Bank (the issuer)

   40 million B.D

   Investors (Holders of Sukuk)

   40 million B.D

   **Fig. 2:** Ijara Sukuk Structure of the Government of the Kingdom of Bahrain [10].

2. Lease contract on 20 July 2004:

   ![Diagram of a lease contract]

   40 million B.D

   Bahrain Comprehensive Bank (Leased asset)

   40 million B.D

   Investors (Holders of Sukuk)

3. Execution of the purchase promise 20 July 2014:

   ![Diagram of a purchase promise execution]

   40 million B.D

   Bahrain Comprehensive Bank (seller of asset)

   40 million B.D

   Amortization of Ijara Sukuk

**IV. THE RATE OF CONTRIBUTION OF SOVEREIGN ISLAMIC SUKUK IN THE STRUCTURE OF THE PUBLIC DEBT IN BAHRAIN**

The public debt structure in Bahrain was characterized by an increase in the proportion of public debt instruments in the form of conventional securities only, represented in treasury bills and bonds in addition to the development of Islamic financial instruments.

**TABLE II:** Indicate to the existing balance of Sovereign Islamic Sukuk has reached in the second quarter of 2017 around 1816.8 million B.D compared to 1292 million B.D at the end of 2013 at a growth rate of %40.6. Although the use of Islamic financing instruments to manage public debt in Bahrain has risen during the period (2013-2017), but the most of the public debt is financed through conventional financing instruments which grew from 3813 million B.D at the end of the year 2013 to around 7239.2 million B.D at the end of the second quarter of 2017, a growth rate estimated %89.8.

**TABLE II - Financing Instruments for Managing Public Debt in Bahrain [11]:**

<table>
<thead>
<tr>
<th>Items</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury bills</td>
<td>1130</td>
<td>1270</td>
<td>1710</td>
<td>1785</td>
<td>1910</td>
</tr>
<tr>
<td>The governmental development bonds</td>
<td>2683</td>
<td>3153</td>
<td>3867</td>
<td>5103.6</td>
<td>5329.2</td>
</tr>
<tr>
<td>Other internal loans</td>
<td>15.638</td>
<td>9.383</td>
<td>3.128</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Development Fund Loans</td>
<td>255.084</td>
<td>211.283</td>
<td>172.287</td>
<td>161.2</td>
<td>-</td>
</tr>
<tr>
<td>Salam Sukuk</td>
<td>108</td>
<td>108</td>
<td>129</td>
<td>129</td>
<td>129</td>
</tr>
<tr>
<td>Ijara Sukuk</td>
<td>1184</td>
<td>962</td>
<td>1348</td>
<td>1687.56</td>
<td>1687.8</td>
</tr>
<tr>
<td>Total public debt</td>
<td>5375.252</td>
<td>5752.666</td>
<td>7229.415</td>
<td>8866.36</td>
<td>9056.8</td>
</tr>
</tbody>
</table>

At present, public debt financing is still largely finance by conventional financing instruments in the second quarter. In 2017, treasury bills and local development bonds accounted for about 79.9% of total public debt show Fig. 2, while Islamic government bonds contributed 20.1% to funding, and the other loans has been significantly reduced until not in the second quarter of this year.

**Fig. 2:** The contribution of Sovereign Islamic Sukuk in total Public debt in Bahrain during the period of (2013-2017) [12].

The adoption of Bahrain to finance a portion of the public debt through Islamic instruments reflects the commitment and contribution of the government in the development of Islamic Finance, which made it occupy second place worldwide and the first in the Middle East and North Africa According to the Thomson Reuters of Islamic Financial Development Index (IFDI) in 2016 as shown in the following table:

**Table III Thomson Reuters Report of Islamic Financial Development Indicator (IFDI) in 2016 [13]:**

<table>
<thead>
<tr>
<th>Country</th>
<th>(IFDI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>123.382</td>
</tr>
<tr>
<td>Bahrain</td>
<td>86.920</td>
</tr>
<tr>
<td>UAE</td>
<td>66.348</td>
</tr>
<tr>
<td>Oman</td>
<td>52.732</td>
</tr>
<tr>
<td>KSA</td>
<td>46.668</td>
</tr>
<tr>
<td>Pakistan</td>
<td>46.159</td>
</tr>
<tr>
<td>Kuwait</td>
<td>44.695</td>
</tr>
<tr>
<td>Jordan</td>
<td>42.452</td>
</tr>
<tr>
<td>Qatar</td>
<td>38.898</td>
</tr>
<tr>
<td>Indonesia</td>
<td>28.386</td>
</tr>
</tbody>
</table>
The marked improvement in the Islamic financial development index in Bahrain due to the presence of a considerable number of Islamic financial institutions has contributed to the development of the Islamic financial industry in Bahrain[14]:

a. Islamic Banks: The number of Islamic banks 29 in 2016 with 7 windows on Islamic financial transactions in conventional banks. The assets of Islamic banks in the second quarter of 2017 amounted to U.S $26,290 million compared to U.S $25,486.2 million during the same period in 2016.

b. Cooperative insurance companies: Bahrain has seven cooperative insurance companies. Its assets in 2017 amounted to about 154,419 million B.D compared to 140,536 million B.D in 2016.

c. Islamic Investment Funds: The number of Islamic investment funds reached 91 funds out of total licensed investment funds registered from the Central Bank of Bahrain (CBB) at the end of September 2017. While the value of its assets reached U.S $1.21 billion at the end of June 2017.

d. Islamic financial services development institutions:
   1. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).
   2. The Council of Islamic banks and financial institutions (CIBAFI).
   3. The Liquidity Management Center.
   5. The Islamic International Agency for classification.

CONCLUSIONS

1. The decline in oil prices has significantly affected the state budget in Bahrain, so the increase in public debt for the purpose of coverage budget deficit is an inevitable result of lower oil revenues.

2. Islamic Sukuk that are issued in accordance with various Islamic financing formulas are good instruments for managing public debt by attracting savings and directing them to finance the budget deficit to ensure that the requirements of economic development.

3. Islamic Sukuk are characterize by their diversity, which increases their ability to attract investors who wish to form financial portfolios in terms of return and risk.

RECOMMENDATIONS

1. The Bahraini economy should diversify from sources of income instead of focusing efforts on diversifying sources of deficit funding in the state budget because alternatives are limited.

2. The need to adopt the appropriate disclosure rules for the management of the Sovereign Islamic Sukuk in order to enhance the confidence of investors and to ensure fair and transparent trading in markets.

3. The increase in the number of investors in the Islamic Sukuk market means the need for more trained human resources. Through the use of intensive training programs and activate research centers for the Islamic economy and adopt comprehensive awareness plans.

REFERENCES


[12] Prepared by the researcher based on the data of Table II
