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# **"SUKUK (ISLAMIC BONDS): ECONOMIC BENEFITS AND POLITICAL RISK"**

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# THE MAIN POINT IN THIS PAPER IS;

**Most sukuk are asset-based, not asset-backed investment.**

**The rate of return is based on the asset transaction and not based on interest on money loaned.**

# DISTINGUISHING SUKUK FROM CONVENTIONAL BONDS

*ACCORDING TO FALEEL JAMALDEEN, ISLAMIC FINANCE FOR DUMMIES*

- Distinguishing Criteria:
  - Asset Ownership
  - Investment Criterion
  - Issue Unit
  - Issue Price
  - Investment rewards and risks
  - Effects of Costs

# ASSETS OWNERSHIP CRITERION

- “Sukuk give the investor partial ownership in the asset on which the sukuk are based.”

“Whereas bonds don’t give the investor a share of ownership in the asset, project, business, or joint venture they support. They’re a debt obligation from the issuer to the bond holder.”

# INVESTMENT CRITERION

- “The asset on which sukuk are based must be sharia-compliant.”
- “Generally, bonds can be used to finance any asset, project, business or joint venture that complies with local legislation.”

# ISSUE UNIT

- “Each sak represents a share of the underlying asset.”
- “Each bond represents a share in debt.”

# ISSUE PRICE

- “The face value of sukuk is based on the market value of the underlying asset.”
- “The face value of a bond price is based on the issuer’s credit worthiness (including its rating).”

# INVESTMENT REWARDS AND RISKS

- “Sukuk holders receive a share of profits from the underlying asset (and accept a share of any loss incurred”).
- “Bond holders receive regularly scheduled (and often fixed rate) interest payments for the life of the bond, and their principal is guaranteed to be returned at the bond’s maturity date.”



# EFFECTS AND COSTS

- “Sukuk holders are affected by costs related to the underlying asset. Higher costs may translate to lower investor profits and vice versa.”
- “Bonds holders generally aren’t affected by costs related to the asset, project, business, or joint venture they support. The performance of the underlying asset doesn’t affect investor rewards.”

# THEORETICAL FRAMEWORK

- Assuming that firms produce a single commodity  $Y$  by means of capital  $K$  and labour  $N$ . For simplicity assume that the technology is Cobb-Douglas with constant return to scale.

- $Y = K^\alpha N^{(1-\alpha)}$ ,

The number of workers equals the population.

Domestic output can be devoted to consumption  $C$ , investment  $I$ , and net exports  $X$ .

$$Y = C + I + X$$

- Assume that domestic residents save a certain fraction of their income;
  - $S = s \cdot (Y - \gamma D (I))$ ,
  - Assuming that the country in question is a debtor country sells sukuk internationally to finance its domestic projects and hence its debts depend on its ambition of domestic investment. Consider  $\gamma$  is the share rate of the foreigner in the domestic asset in exchange for debts they lend (in different words the return rate for the foreigner). In the same time it's considered the capital cost rate for the country in question. The  $\gamma D (I)$  is the reward outflow.
  - Because lenders share the borrowers same risk and same reward; then the domestic interest rate is assumed to equal  $\gamma$  as well.

- Consider the  $B$  is the current account deficit,

- $B = -X + \gamma D(I)$ ,

- Assume that foreign borrowings adds to foreign debt.

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- $\dot{D} = B$

- Investment adds to the stock of capital. Assuming zero depreciation rates to simplify the analysis.

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- $\dot{K} = I$

# THE REPRESENTATION OF THE MODEL IN PER CAPITA TERMS:

- $k = (\alpha / \gamma)^{1/(1-\alpha)}$ ,
- $y = (\alpha / \gamma)^{\alpha/(1-\alpha)}$ ,
- $y = c + i + x$ ,
- $S = s \cdot (y - \gamma \cdot d \cdot f(i))$ ,
- $b = -x + \gamma \cdot d \cdot f(i)$ ,
- $\dot{d} = b - nd$ ,
- $i = nk$

$$d(d)/dt = i - s(y - \gamma d f(i)) - n d$$

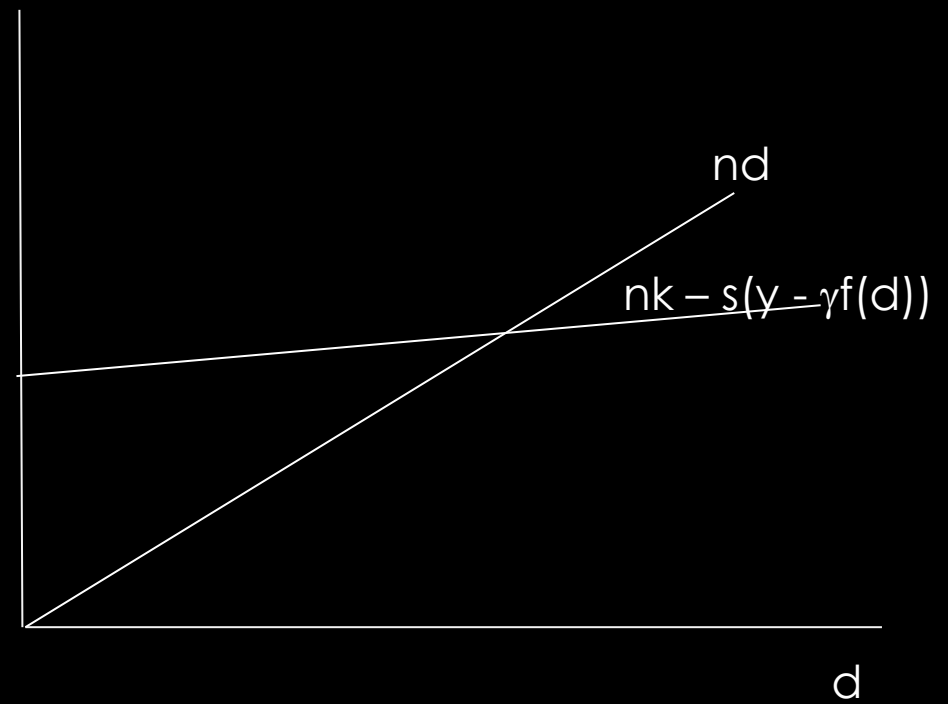
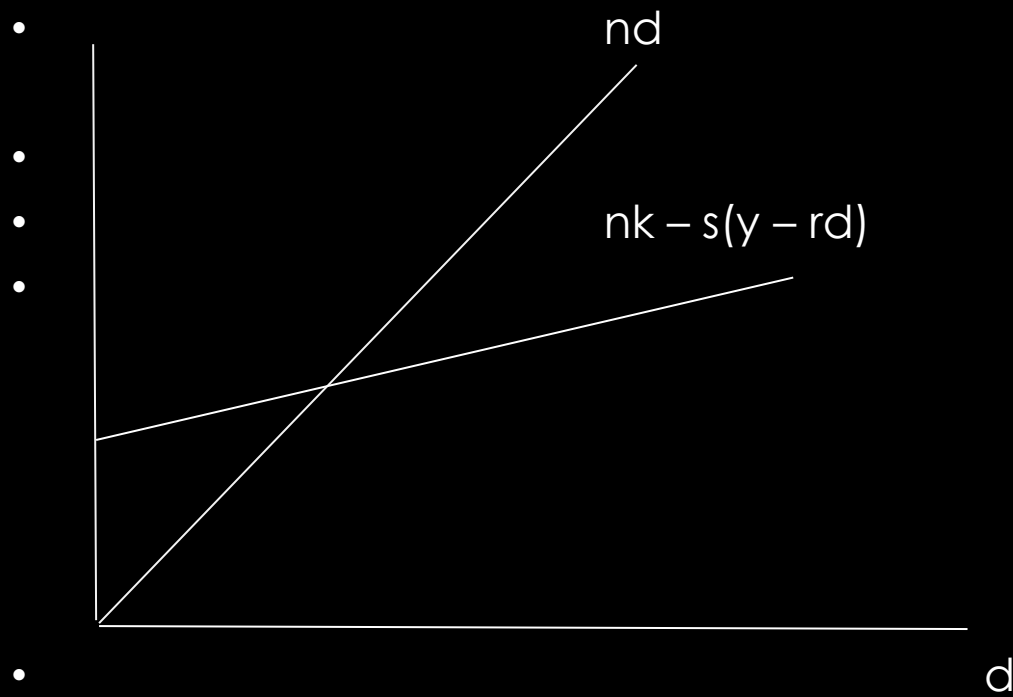
*This is the fundamental equation derived from the proposed model.*

*Per capita current account deficit equals the difference between per capita domestic saving and per capita domestic investment.*

# STEADY STATE EQUILIBIUM

- Let  $d(d)/dt = \text{zero}$ ; thus;
- $nd = nk - s(y - \gamma \cdot d f(i)), \quad i = nk$
- To check the stability of the steady state;
- Recall;  $d(d)/dt = i - s(y - \gamma d f(i)) - n d$ , Thus;
- $(d(d)/dt) / d(d) = s \gamma d f'(i) - n$ ; and since  $i$  is pinned down in the model; then;  $f'(i)$  is zero and hence;  $(d(d)/dt) / d(d) = -n < \text{zero}$ ; thus; the steady state is stable.

# DIFFERENCES IN RESULTS BETWEEN THE CONVENTIONAL ECONOMY & THE ISLAMIC ECONOMY



# CONCLUSION

- According to the proposed small open economy version of the Solow model; the Islamic economy grows longer but the political risk on the debtor country is great.
- Thank you!



