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Sukuk in the World and Turkey *

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Abstract. As a result of globalization, the integration initiatives of the international financial markets cause various problems. Moreover, these problems are not only limited to the country in which they occur, but can also spread to other countries by snowball-effect or transmission. When we review the world financial history, countries have often experienced financial crises in recent years. At the same time, they have developed various methods to eliminate or reduce the negative effects of crises. Sukuk issues made in a country change the effects of the financial crisis that country is exposed to. This is mainly because of the fact that the Sukuk instruments are insensitive to interest. In this paper, the case study method has been adopted. In accordance with this method, it is intended to make an assessment of the sukuk applications in the world and in Turkey.
Keywords. Sukuk, Capital movements, Global financial crisis.
JEL. G10, G15, G20, G21.

1. Introduction

As a result of the developments in information and communication technologies and the trends of globalization, the increase in hot money inflows and outflows known as interest-sensitive capital movements cause negative effects on the economies and the emergence of crises. As it is known, capital movements are an important variable of the balance of payments. When this variable is not likely to occur in the form of foreign direct investments, but in the form of foreign capital investments, e.g. short-term capital inflows for speculative purposes, then the likelihood of global economic crises and high negative impact thereof on that country are increasing.

Developing market economies like Turkey must be able to attract permanent and long term direct investment oriented capital inflows in order to meet their external financing needs in order to realize their sustainable growth and development. However, in order to ensure the sustainability of the foreign exchange inflows they need and to protect them from the crisis risk caused by the hot money flows, it is of utmost

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importance that the exchange rate system is carried out in compliance with a stable financial structure.

When we look at the developments in recent years, it is understood that many countries that need foreign capital for the sustainability of economic development prefer Islamic financial market instruments, which is considered to be more secure than capital inflows and outflows. Sukuk is the instrument that comes out as an innovation and implemented for all sectors. The widespread use of Sukuk, which undermines the possibility of a financial crisis, undoubtedly makes the development of the Islamic financial market throughout the world significant.

The positive development of the sukuk market in recent years has been reversed with the negative impact of the covid-19 outbreak that emerged in early 2020 on financial markets. However, if the global pandemic is brought under control, it is expected that sukuk procedures will gain importance again in the re-establishment of the deteriorated financial balances of the countries.

As known, in the last 35 years many countries have had to struggle with the financial crises which are frequently seen in the intervals. One of the most important reasons for these crises is the indirect capital mobility. This study aims to analyze the development of sukuk applications, which are considered as a financial instrument to prevent financial crises, both in the world and in our country.

In this study, firstly, the relationship between the interest and the financial crises, which activate the capital globally, are discussed and then the sukuk market is explained. Finally, an assessment is made regarding the implementation of Sukuk in the world and Turkey.

2. Interest, capital mobility and financial crisis

Along with globalization, the integration of world markets in social and economic terms has accelerated international capital movements. The most important variable that directs capital from one country to another is interest rate. Accordingly, when there is an increase in interest rate, there is a flow of capital from outside to inside; when a decrease in interest rates, there is an outflow from inside to outside. This mobility is important in terms of balancing the balance of payments, which is one of the main macroeconomic targets. However, if there is a crisis environment in the economy due to the deterioration of financial sector and company balance sheets, increasing interest rates and increasing uncertainty, it is highly probable that real economic activity will decrease and income distribution will be adversely affected (Mishkin, 2001: 3).

On the other hand, it should be stated that there would be a deficiency if we just connect the capital flows between the countries to the interest variable only. In his study, Koç (2018) points out that the main factors leading to capital outflows besides international interest differences should be listed as follows: devaluation expectation, inflation, risk and profitability differences, mechanisms of capital evasion, transfers through international payments, cash transfers, abuse of transfers due to international trade, speculation, speculation in international money and capital markets.

The most important reason for perceiving the freedom of capital movements as a problem after the financial liberalization process started in the 1980s is the high inflation rate which has been in many countries for many years (Cansen, 2002). This brings with it the devaluation. A devalued money is very difficult to choose for saving. Without saving, the cost of the resources required for investments starts to increase, investments decrease, growth slips, bankruptcies are faced and capital is fled. Thus, the economy deteriorates to the brink of crisis. Especially in the 1990s, the crises in most developing countries are an extension of this reversal in capital flows. Increasing interest rates within the country trigger the entry of hot money into the country, which is primarily the predictor of the currency crises and subsequent banking crises (Delice, 2003: 60). The process followed by the capital account crises is clearly shown in Figure 1.

As it is understood from this point, the liberalization of capital markets has led to more selective, more mobile, shorter term, more anxious and more speculative features about which country to pursue more profits (İnandım, 2005: 13). Speculative capital inflows and outflows are seen as a source of instability for all economies and a fragile factor for all economies regardless of their conditions and structure. The capital entering the country for speculative purposes initially leads to the growth of the economy by meeting the liquidity needs of the country's economy, but later the increase in imports and the attempt to finance it with costly and short-term resources become the trigger of the crisis (Koç, 2018: 206 and Yeldan, 2016: 104-105).

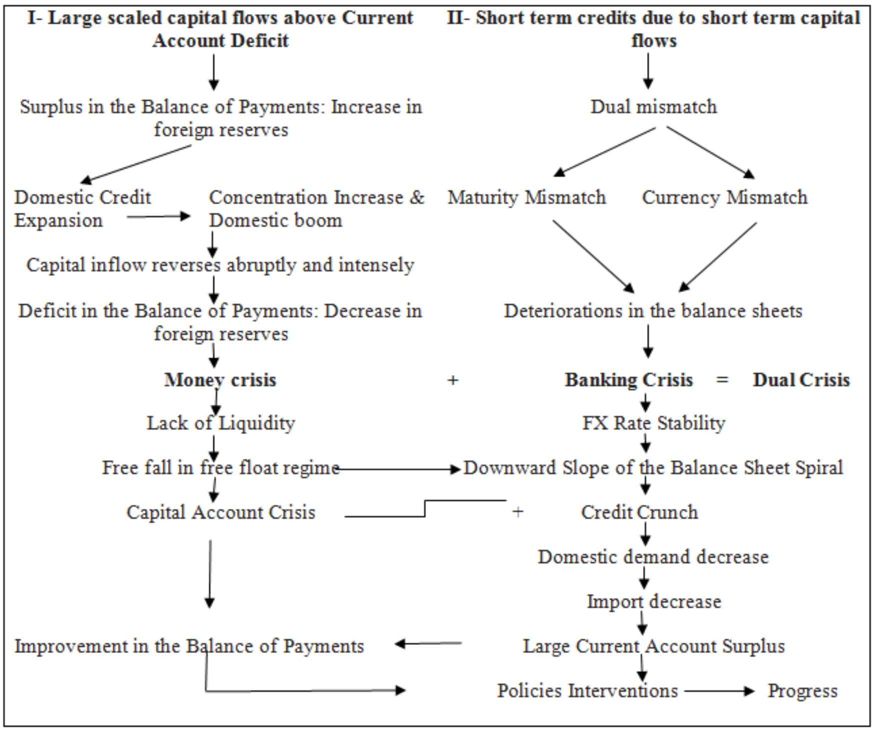

Figure 1. *Causality Ties between Capital Account Crisis and Credit Crunch*
Source: Delice, 2003: 60.

In addition, attracted with short-term and high interest yields, unpaid loans that was allocated without looking at the repayment ability influence all financial institutions under the effect of a financial crisis in the country and cause a crisis to break out. In such cases, financial instruments that are considered as halal (designed in line with Islamic principles, sharia-compliant), which are considered to be less profitable and are not much welcomed have become an alternative investment instrument. Today, these instruments are considered as antidote of financial crises. Because these tools do not take interest into consideration, they are based on profit-loss partnership and the funds used in this way can be transferred directly to the real economy and can increase employment (Büyükakın & Bilal, 2016: 45). It is not possible to follow this process in conventional banking applications (Büyükakın & Önyılmaz, 2012: 13).

The most distinguishing feature of Islamic finance and economic system is that interest is prohibited. However, interest is widespread and penetrated in to the capitalist system. After the 2008 Global Crisis, it was proposed that banks and financial institutions examine the principles of Islamic finance to reestablish confidence in their customers (Osservatore, 2009).

On the origin of the crises, there is an excessive financialization that leads to an increasing disruption of the link between money markets and real sectors (Faroog, 2009: 2). Extreme financialisation is generally used to express a structure in which financial capitalism of financial leveraged products used by large financial institutions and financial markets overshadow the real sector and dominates equity based stock markets (Palley, 2007: 2; Sawyer, 2013: 2-3).

After the 2008 global financial crisis, there has been a change in economics and there has been an increase in the opinion that a paradigm change is needed in the current global financial system. The changing new paradigm is the locomotive of the new economic era in the quantum zeitgeist (Fırat & Kurtoğlu, 2014: 98-99).There are studies that the Islamic banking and financial system can be applied to avoid and mitigate such crises. The most important pillar of these studies is the fact that all transactions in Islamic finance system are asset-based, without interest.

Among the indicators of extreme financialization, which caused the crises, an increase in the indebtedness indicators, an excessive rise in the debt/GDP ratio, and significant jumps in the volume of financial product transactions can be shown. Considering that the financial markets are traded at a rate of US$ 1 trillion per day including foreign exchange, the extent of financialization is better understood.

The effects of excessive financialization can be stated as; the economies of the countries undertake significant cost, the threat to the stability of the financial system and the national currency causing the economies to fall into difficulty in payment, the disruption of income distribution, the effects on financial assets holdergroups' economic and political power (Deeg & O'Sullivan, 2009: 32).

There are studies that suggest that the Islamic banking and financial system can provide solutions to the aforementioned problems. The ability of the Islamic finance system to work in an asset-based structure is one of the main strengths here. On the other hand, asset-based work will demonstrate the effects of fluctuations in mortgage-backed markets (Alasrag, 2009: 56).

Recent 2008 global crisis has demonstrated the fundamental weaknesses and contradictions of the economic system based on interest (Fadel, 2008: 655-704). Interest-based borrowing is the oldest and most attractive activity in the world. The main feature of the natural instability of the current global financial system based on interest is its instability, defined as periods of balloon and collapse (Feroz, 2009: 22).

Keynes understood the inherent unstable structure of the interest-based system and described the irrational market behavior summarized as "animal spirits". Likewise, on the G-20 Summit in November 2008, after the 2008 global crisis, it was emphasized that the existing global financial system structure is inherently unstable and self-destructive.

3. Interest free financial bonds: Sukuk

Sukuk, also referred to as an "Islamic bond", is a capital market instrument that enables the owner of the right to obtain income from this asset by considering the right of ownership over an asset (Alpaslan, 2014: 16). All kinds of assets can be subject to sukuk. However, it mainly serves the purpose of financing infrastructure projects carried out by the public and private sectors (Ayub, 2007: 412). Sukuk has a certain maturity and provides regular return to investors during the maturity period. In addition, sukuk gives the opportunity to take back the capital of the sukuk holders (Ulusoy & Ela, 2016: 344). If a default is realized, the asset cannot be sold or foreclosed. However, the asset subject to sukuk must have a quality that cannot be consumed until its maturity (Ulus, 2013: 300). Sukuk is a financial instrument suitable for Sharia since it contains dividends instead of interest.

Sukuk is a very diverse financial instrument. There are about 14 different types known. Among these, Mudârabe (profit sharing), Müşâreke (profit/loss sharing), Icara (lease/rental), Murâbaha (cost and profit share sales), Salam (prepaid sales), Exception (purchase order) and Hybrid (mixed) sukuks are most common types used.

3.1. Sukuk practices in the World

Sukuk-like products in the world were first issued in Malaysia in the 1980s and 1990s (IIFM, 2011: 3; Hussin *et al.*, 2012: 92). About 125 million Malaysian Ringgit ($ 30 million) was issued by a non-Muslim UK Shell company in a Muslim country (IIFM, 2011: 3). In the 1990-2000 period, while only sukuk issuances were made for the private sector, in 2002, Malaysia based sukuk and the sukuk market began to grow rapidly in the world (Ulusoy & Ela, 2016: 348). In 2004 the State of Saxony, in 2006 USA and; later Japan, Singapore, Germany and other European Union countries contributed to the development of the sukuk market by sukuk issues.

As it is understood from the following tables (Table 1 - Table 2), sukuk issuance is carried out in 35 countries in the world in the period of 2001-2019. Of these countries, Malaysia is the country that issues the most sukuk. Malaysia is followed by Turkey, Indonesia, Bahrain, Gambia, and Brunei Darussalam. Number of issuance of sukuk as an interest-free financing bond is almost non-existent in Iran which is governed completely by the provisions of the sharia. Global sukuk issuance in China, Mali, Morocco, South Africa, Togo, France, Kazakhstan, Maldives, Sri Lanka, Yemen and Senegal is almost none, either.

2019 was a year of record in global sukuk issues. The shares of Saudi Arabia, United Arab Emirates, Qatar, Sudan and Pakistan in total sukuk issues increased. In addition, the entry of Egypt into the market and sukuk issuance of Taiwan in early 2020 have attracted great interest (IIFM, 2020: 11). In the early years of sukuk issuances, the market was largely owned by Malaysia, Indonesia and the Gulf Cooperation Council (GCC). However, Pakistan, Turkey and some African countries as they become more active, this trend is slowly changing.

Table 1. *Regional Distribution of the Global Sukuk Issues (2001:01-2019:12)*

ASIA & FAR EAST	Number of Issues	Amount USD Millions	% of Total Value
Bangladesh	6	59	0.005%
BruneiDarussalam	173	10,949	0.878%
China	1	97	0.01%
Hong Kong	5	3,196	0.26%
Indonesia	490	98,908	7.93%
Japan	3	190	0.02%
Malaysia	7,090	733,748	58.83%
Maldives	2	10	0.001%
Pakistan	98	17,630	1.41%
Singapore	16	1,498	0.12%
Sri Lanka	2	5	0.0004%
Total	7,886	866,290	69.46%
GCC & MIDDLE EAST	Number of Issues	Amount USD Millions	% of Total Value
Bahrain	437	33,735	2.70%
Jordan	4	483	0.04%
Kuwait	20	4,458	0.36%
Oman	13	6,188	0.50%
Qatar	53	33,667	2.70%
SaudiArabia	217	146,291	11.73%
United ArabEmirates	140	88,688	7.11%
Yemen	2	253	0.02%
Total	886	313,764	25.16%

Source: IIFM Sukuk database. Accessed on Dec. 10, 2020.

69,46% of the total global sukuk issuances in the world is realized in Asia and Far East countries, 25,16% in Middle Eastern countries, 1.84% in African countries and 3.54% in Europe and other countries. As it is understood from this point, sukuk issuances are mostly concentrated in Asia, Far East and Middle East countries. The fact that only Muslim countries are not included in the mentioned countries can be considered as an indication that the use of sukuk will become more widespread.

Table 2. *Regional Distribution of the Global Sukuk Issues (2001:01-2019:12)*

AFRICA	Number of Issues	Amount USD Millions	% of Total Value
Gambia	429	407	0.03%
IvoryCoast	2	460	0.04%
Nigeria	5	864	0.07%
Mali	1	285	0.02%
Morocco	1	105	0.01%
South Africa	1	500	0.04%
Senegal	2	445	0.04%
Sudan	36	19,646	1.58%
Togo	1	245	0.02%
Total	478	22,956	1.84%
Europe & OTHERS	Number of Issues	Amount USD Millions	% of Total Value
France	1	1	0.0001%
Germany	3	206	0.02%
Luxembourg	3	280	0.02%
Kazakhstan	1	77	0.01%
Turkey	585	40,544	3.25%
United Kingdom	10	1,719	0.14%
USA	5	1,367	0.11%
Total	608	44,194	3.54%
Grand Total	9,858	1,247,204	100%

Source: IIFM Sukuk database. Accessed on Dec. 10, 2020.

As can be seen from Figure 2, global sukuk issues are in a continuous upward trend as of years, except the 2008 global crisis period. In 2012, it reached its highest level. The figures, which showed a decrease from this year onwards, started to rise again in 2016. It can be said that the sovereign sukuk, which has been mainly issued since 2002, has been driven by this increase.

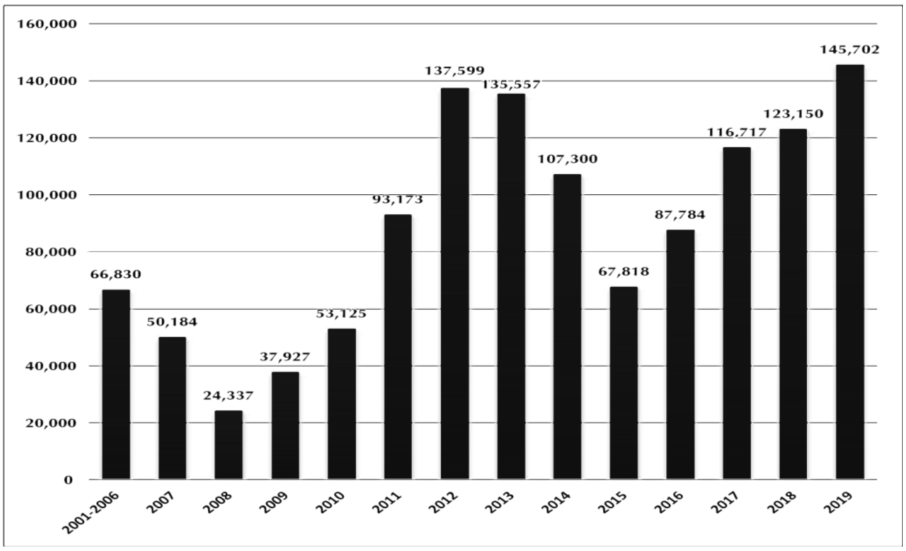

Figure 2. *Global Sukuk Issues (2001:01-2019:12) Million $*

Notes: Total Global Sukuk Issuance 1.247 Trillion $

Source: IIFM Sukuk Database. Accessed on Dec.10, 2020.

Global sukuk issues have been adversely affected from the 2008 Mortgage Crisis, as is evident from the figure. As a result of the credit crunch, investors' decision to withdraw from all fixed income markets caused global sukuk issues to decrease. Although this shows that sukuk is fragile and sensitive to crises, it is observed that sukuk is more durable compared to conventional bonds and protected from crises in the light of certain principles (Ahmad & Radzi, 2011: 33). The decline in 2015 was due to the decline in oil prices and the slowdown in the growth of developing countries (Ulusoy & Ela, 2016: 350). After 2015, there has been a continuous increase in global sukuk issues worldwide. This rise continued until 2019 and reached a record level in 2019. However, the Covid 19 epidemic, which emerged from the beginning of 2020 and spread all over the world, undoubtedly affected the financial markets negatively. The sukuk issues of the countries have also received their share.

When we look at the general course of global sukuk issuances for the period 2001-2019 in terms of financial institutions (Figure 3), similar results are obtained from the previous analysis in Figure 2. Namely; the increased issues between 2003 and 2006 period was followed by a decrease in 2008 due to the crisis, a recovery period started after the crisis and the upward trend continued until 2012. However, there has been a decline in the negative direction between 2012 and 2014 and an increase has been observed after 2014. Global sukuk issues of financial institutions, which have decreased again in 2015, continue their upward trend as of 2016. This rising trend continued in 2017, 2018 and 2019. By the beginning of 2020, the global sukuk issuances of financial institutions totaled 75.96 million dollars. From here we can say; in the near future, global sukuk issues across the globe are not limited to only 35 countries. However, the worsening in the economies of the country due to the epidemic has led to the pressure on institutional sukuks in the short term. Because corporate sukuk issuances are greatly affected by adverse economic conditions and must be reconstructed.

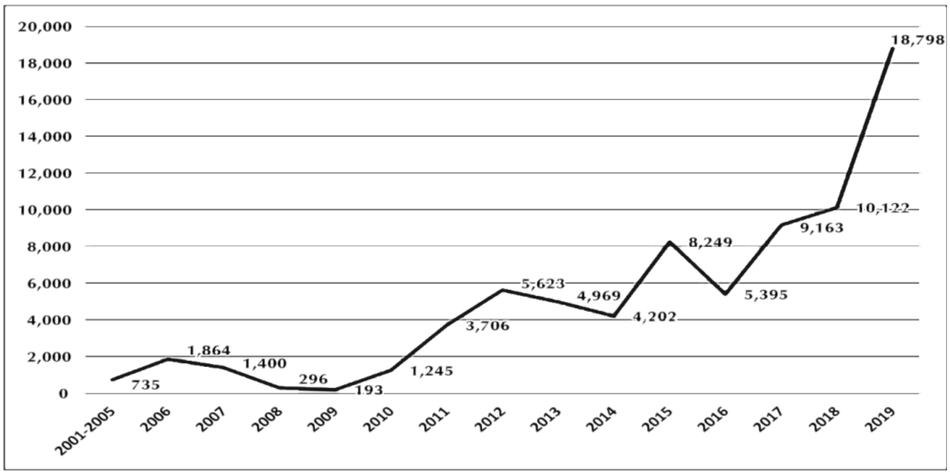

Figure 3. *Total Global Sukuk Issues of Financial Institutions (2001: 1-2019: 12) Million $*

Note: Total Global Sukuk Issuance of Financial Institutions is USD75,96 Million.

Source: IIFM, 2020: 45.

3.2. Sukuk practices in Turkey

Turkey, as the world's 17th largest economy, offers many different types of investment options to investors because it has a dynamic and strongly growing markets. Since the first Sukuk issued in 2010 in Turkey, there have been improvement in financial infrastructure and institutional capacity, many significant reforms were realized in capital markets to increase the diversity of financial products and services provided (IIFM, 2018: 178). Within the scope of the Istanbul Financial Center Action Plan, significant milestones have been completed in the last few years to develop the regulatory framework for corporate sukuks in Turkey.

Referring to practices in Turkey, although there have been many kinds of Sukuk (as is the case in majority of countries around the world), only ijara (rental, leasing) sukuk issuance has been realized. The most important reasons for this are simplicity, general acceptance and tax regime which covers only ijarasukuk among five kinds of the sukuks' issue regulation is available (Ulusoy & Ela, 2016: 341). On the other hand, ijarasukuk carries a significant level of Sharia risk since it is exposed to various criticisms in the Islamic world (Ulusoy & Ela, 2016: 355).

Although financial debt markets in Turkey are generally managed by the public sector, in recent years corporate issues by private companies began to attract attention (Table 3). After the elimination of the deficiencies in the legal and tax regulations, the increase in the sovereign sukuk offerings have positively trigger the development of the sukuk market.

Table 3. *Total Sukuk Issuance Realized in Turkey*

	USD*** (000 USD)	MYR (000 MYR)	TL (000 TL)	Total in TL (000 TL)
Corporate*	4.276.000	1.960.000	36.015.000	33.352.800
Public**	6.000.000		29.296.000	46.800.000
TOTAL	10.276.000	1.960.000	65.311.000	80.152.800

Notes: * It covers the 2010-2018 period; **It covers the 2012-2018 period; *** 1$ = 7.800 TL.
Source: [Retrieved from]. Accesed on: Dec, 07.2020.

First regulations for the issuance of sukuk in Turkey has been covered in the Capital Market Law (CMB) in 2012. Accordingly, services carried out by the central securities depository (MKK) and the central clearing house (Takasbank) under the supervision of the Capital Market Board (CMB) also utilized for Sukuk transactions. They facilitate a reliable infrastructure to create a reliable Sukuk database for secondary market activities (IIFM, 2018: 181). In recent years, important steps have been taken to increase the international recognition of the Turkish sukuk market and the Islamic Development Bank listed its sukuks traded in London, Dubai and Malaysia in 2016 to Borsa Istanbul. At the same time, in 2016, the Turkish Treasury issued a 5-year sukuk in order to increase liquidity, followed by Sukuk linked to a 5-year consumer price index (CPI), offered in domestic market. In addition, a legal regulation was made in 2016 to allow investors to access sukuk issues more easily, and tax and fee exemptions were extended to cover all lease certificates. However, in 2016, it has taken the decision to 50% discount on the registration fee set by the Capital Markets Board, including all kinds of capital market instruments (IIFM, 2020: 172). Thus, private sector sukuk issues increased in 2017, thanks to both tax exemptions and the reduction in CMB registration fees. These developments are shown in Table 3.

In 2017, Ijarahsukuk issuances based on gold were made to bring the gold under the pillow into the economy (IIFM, 2018: 181). This situation caused an increase in the interest of domestic and qualified investors rather than foreign investors in the sukuk market (IIFM, 2020: 174). As can be seen from Table 4, while the ratio of lease certificates (LC) to debts securities (DS) tended to decline between 2014 and 2016, it increased rapidly in the last 3 years and reached a record level (LC/DS = 15.9%) in 2019.

Table 4. *Corporate Sukuk Issuances (2014-2019)*

(USD Million)	2014	2015	2016	2017	2018	2019
LeaseCertificates (LC)	2 074	1 250	973	2 210	4 717	7 758
DebtSecurities (DS)	50 482	37 706	33 019	43 311	34 551	51 494
LC / DS (%)	4.11 %	3.31 %	2.95 %	5.10 %	13.29 %	15.06 %

Source: [Retrieved from]. Accessed on Dec. 01, 2020.

In Turkey; regulations on stocks, sukuk, interest-free products and real estate certificates is made by the Capital Market Board. However, when any financial instrument is offered to the public in accordance with CMB regulations, it must be traded on Borsa Istanbul. With the latest regulations, the effective, reliable and flexible execution of sukuk transactions has led to an increase in the total transaction volume. Sukuk issuances in Turkey are listed as ownership (Ijarah), trading (Murabahah) and management contracts (Wakalah). The underlying assets of these sukuk issuances are mostly real estates, commodities listed on the London Commodity Exchange or Bursa Suq-al-Sila, bank receivables and loans (IIFM, 2020: 174).

4. Conclusion

Since the beginning of the 1990s, started with corporate sukuk issuances followed by sovereign sukuks after 2002, significant developments have been observed in the sukuk markets. Sukuk, based on profit/loss sharing principle, has a more resilient structure against the instabilities that may occur in financial markets compared to conventional market instruments. There is no risk, uncertainty and speculative movements in Sukuk programs. It ensures that the economies of countries are financed by more sound sources and the capital markets develop and gain depth. Thus, various sources of borrowing with high quality, cheaper and easily obtained features, especially in the public sector have been available by sukuk programs. At the same time, since sukuk is a long-term borrowing source, it can be used to make significant contributions to country development, production and employment.

Through Sukuk practices, surplus capital outflows are prevented and many investors are encouraged to bring back capital to the country. In this way, the capital spreads into a broader investor base. In addition, as sukuk is completely asset-based, it is an important source for meeting the financing needs of small and medium-sized companies. However, the elimination of taxation-related problems is of great importance for the expansion of sukuk markets. On the other hand, the existence of various doubts about sukuk, which is an Islamic financing instrument, may cause investors to avoid it.

After the 2008 global financial crisis, there was an increase in the number of views that a paradigm change was needed in the current global financial system. Studies advocate that Islamic banking and financial system can be applied to avoid such crises and reduce the effects. The most important pillar of these studies is the realization of all transactions in the Islamic financial system with an interest-free asset-based structure. Furthermore, sukuks can be used as an effective tool in reducing the impact of excessive financialization which is the basis of the financial crises and which leads to an increasing disruption of the connection between money markets and real sectors.

Sukuk is one of the important financial instruments preferred not only by Muslim countries but also by other countries in the world. Especially if it is taken into consideration that the first sukuk issuance was made by the British Shell company, it will be better understood how important it is. It is expected that the UK will issue a large amount of sukuk after the Brexit process.

Turkey ranks fifth among the pioneers of the international sukuk market (Figure 4). However, this is not enough and it has to improve itself more. However, this is not enough and it has to improve itself in order to take advantage and utilize opportinities in this market. That is, if the market infrastructures in the country are strengthened by eliminating the legislative deficiencies, the efficiency of the sukuk markets will increase and a large amount of capital transfer will be provided, especially from the Gulf countries.

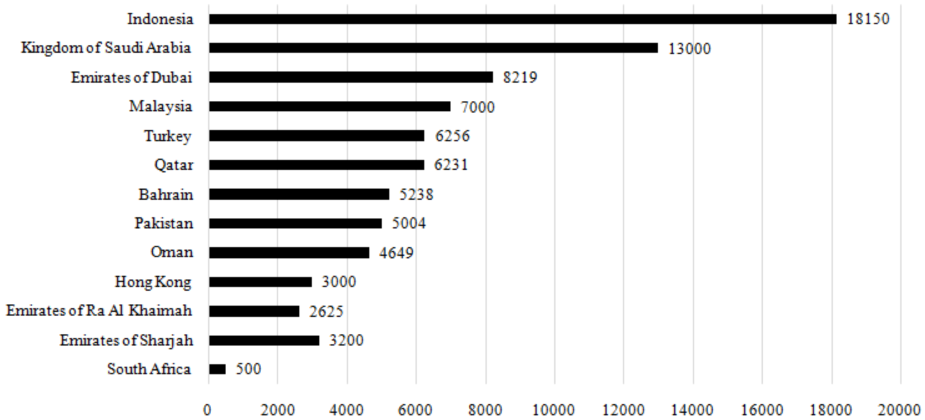

Figure 4. *Sovereign Sukuk in the World (Million USD)*

Source: IIFM, 2020: 164.

Through sukuk issuances, it is possible to provide capital inflows to the country, to overcome various financing problems that countries may encounter, to increase investments, to make income distribution more fair and therefore to realize growth. However, trading sukuk issues in secondary markets ensures that the instrument in question is a liquid source. In addition, sukuk facilitates the sustainability of economic and social development as it minimizes risk and uncertainty. In this context, it is thought that sukuk practices will be effective in eliminating the negative effects of the covid-19 pandemic in the country's economies.

Notes

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