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SUKUK AND PUBLIC DEBT MANAGEMENT: GENERAL ASSESSMENT AND THE WAY FORWARD

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Abstract

In recent years, countries have started to develop and issue innovative debt instruments, with the development of financial technologies contributing to this trend. One such innovative debt instrument is sukuk. Sovereign (public) sukuk issuance began in 2001 and has since continued to grow steadily. Sovereign sukuk are issued by countries with a majority Muslim population, as well as by countries with significant Muslim populations, where the majority of the population is non-Muslim. As a result of these developments, sovereign sukuk issuance exceeded \$100 billion. At present, countries issue sukuk for the general purposes of debt management, such as attracting a new class of investors (diversifying and expanding the investor base), promoting high levels of financial inclusion, and reducing public borrowing costs. In this context, the study examines the role of sukuk in supporting countries' public debt management objectives and explores ways to enhance its effectiveness. According to the findings of the study, it has been determined that sukuk is effective in achieving the basic goals of debt management, such as meeting the financing needs, developing financial markets, and maintaining market access, diversifying debt instruments and investor base, maintaining a balanced maturity structure and increasing household savings. However, there are several challenges that hinder the effectiveness of sukuk in achieving public debt management goals, including high issuance costs and a lack of standardization in the sukuk market. It is considered that overcoming these challenges will enable sukuk to play a more effective role in public debt management.

Keywords: Islamic Finance, Sukuk, Public Debt Management, Sovereign Debt.



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SUKUK VE KAMU BORÇ YÖNETİMİ: GENEL DEĞERLENDİRME VE GELECEĞİ

Öz

Ülkeler gelişen finans teknolojilerinin de katkısıyla son yıllarda yenilikçi borçlanma araçları geliştirip ihraç etmeye başlamışlardır. Söz konusu yenilikçi borçlanma araçlarından birisi de sukuktur. Devlet (kamu) sukuku ihracı ilk olarak 2001 yılında başlamış olup sonrasında artarak devam etmektedir. Devlet sukuku, Müslüman ağırlıklı nüfusa sahip ülkeler yanında halkın çoğunluğu Müslüman olmayan ülkelerde de ihraç edilmektedir. Bu gelişmelerin sonucunda devlet sukuku ihraçları 100 milyar doları aşmıştır. Günümüzde devletler; yeni bir yatırımcı sınıfını çekme (yatırımcı tabanını çeşitlendirme ve genişletme), yüksek düzeyde finansal katılımı teşvik etme ve kamu borçlanma maliyetlerini düşürme gibi borç yönetiminin genel amaçları doğrultusunda sukuk ihraç etmektedirler. Bu bağlamda çalışmada, sukukun ülkelerin kamu borç yönetimi hedeflerine ulaşmalarına yardımcı olmadaki rolü tartışılmakta ve borç yönetimine katkısını iyileştirmek için neler yapılabileceği değerlendirilmektedir. Çalışmanın bulgularına göre sukukun; finansman ihtiyacının karşılanması, finansal piyasaların geliştirilmesi ve piyasaya erişimin sürdürülmesi, borçlanma araçlarının ve yatırımcı tabanının çeşitlendirilmesi, dengeli vade yapısının sürdürülmesi ve hane halkı tasarruflarının artırılması gibi borç yönetiminin temel hedeflerine ulaşmada etkili olduğu tespit edilmiştir. Ancak, sukukun kamu borç yönetimi hedeflerine ulaşmadaki katkısını sınırlayan bazı zorluklar söz konusudur. Bu zorlukların başlıcaları yüksek ihraç maliyetleri ve sukuk piyasasında standardizasyonun bulunmamasıdır. Bu zorlukların aşılması halinde, sukukun kamu borç yönetiminde çok daha etkili ve yaygın bir rol oynayabileceği değerlendirilmektedir.

[Geniş Öz, çalışmanın sonunda yer almaktadır.]

Anahtar Kelimeler: İslami Finans, Sukuk, Kamu Borç Yönetimi, Devlet Borçları.



Introduction

The range of financial instruments issued by governments has experienced significant evolution due to shifting investor preferences, dynamic macroeconomic conditions, and transforming financial market spaces. In recent years, governments have introduced novel and alternative financial instruments or refined the structures of existing ones. For instance, they have issued green bonds to attract environmentally-conscious investors and inflation-linked bonds to protect investors against the detrimental effects of rising prices. Unquestionably, one of these innovative financial instruments is the sukuk, or Islamic bond.

Sukuk has been issued by numerous Islamic and non-Islamic countries. As debt managers introduce new and alternative financial instruments, they aim to achieve various public debt management objectives. In the case of sukuk issuance, many countries target several goals, such as diversifying their investor base, deepening their local financial market, financing high-cost infrastructure expenditures, and establishing themselves as leading Islamic financial centers (Balibek, 2017:9-10; HM Treasury, 2023:13; Kusuma & Silva, 2014:1; Lutfiani, 2018:4).

The primary focus of this study is to assess the role of sukuk in helping countries achieve their public debt management objectives. While countries issuing sukuk aim to attain specific debt management goals, certain barriers to sukuk issuance prevent them from issuing more sukuk. In this context, the sukuk issuance process involves considerable legislative and administrative costs, along with complex procedures. As a result, although sukuk positively impacts public debt management, it also carries associated costs and challenges.

As a Sharia compatible instrument sukuk has relatively limited prevalence because of some barriers impeding the growth of the sukuk market. These challenges include high structuring and issuance costs as well as a lack of standardization in Sharia interpretations. On the other hand, as innovative and novel bond types have joined the traditional bond family, the need for innovation in sovereign sukuk has been increasing. In this regard, to enhance the role of sovereign sukuk in supporting public debt management objectives, it is crucial to overcome these sukuk-related obstacles. Furthermore, developing innovative and cutting-edge structures will bolster sukuk's contribution to public debt management.

This study is structured into four comprehensive sections. The first section encompasses an in-depth exploration of data and fundamental aspects concerning sukuk and sovereign sukuk. The second section highlights the primary objectives of public debt management. In the third section, the benefits of sukuk for public debt management are discussed. Lastly, the fourth section delves into the necessary measures and strategies to optimize future sovereign sukuk issuances for enhanced public debt management outcomes.

A. Definition and Development of Sovereign Sukuk

1. Definition of Sovereign Sukuk

Sukuk is the plural form of the Arabic word “sakk”, which means legal documents, deed, check or certificate (Jamaldeen, 2012:207; Karimzadeh,

2012:97). As an Islamic financial instrument, sukuk differs from conventional bonds in several ways. First, sukuk is a Sharia-compliant instrument and cannot bear interest. Secondly, some proportion of sukuk asset must be given to sukuk holders (i.e. investors) (Salah, 2014:2). Therefore, sukuk requires an asset in a separate entity (namely special purpose vehicle=SPV) and the investors (i.e. lenders) to own the asset proportionally (Safari et al., 2014:14). Hence, a sukuk transaction generally contains three parties. In these parties, the first one is originator, which can be a government or corporation needing fund. The second one is trustee or issuer, which is called SPV acting as middleman between originator and sukuk holders. Third one is investors, who invest in sukuk certificates (Jamaldeen, 2012:214).

Although there are several definitions of sukuk in the literature, this study uses the following three definitions provided by international standard-setting bodies that are commonly referenced in the literature. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines sukuk as: “Certificates of equal value representing undivided shares in ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity” (AAOIFI, 2015:468). The Islamic Financial Services Board (IFSB) defines sukuk as follows: “Sukūk (plural of sakk), frequently referred to as “Islamic bonds”, are certificates with each sakk representing a proportional undivided ownership right in tangible assets, or a pool of predominantly tangible assets, or a business venture (such as a muḍārabah). These assets may be in a specific project or investment activity in accordance with Sharī’ah rules and principles” (IFSB, 2009:3). International Islamic Financial Market (IIFM) defines sukuk as “a commercial paper that provides an investor with ownership in an underlying asset” (IIFM, 2011:3). According to Ariff et al. (2012:20), these three definitions identify three common themes, namely “existence of SPV”, asset ownership” and “real assets as well as usufructs”.

Sukuk can be classified into three main categories based on the issuer’s status: corporate sukuk, sovereign sukuk, and quasi-sovereign sukuk. Ariff et al. (2012:29) defines sovereign sukuk as follows: “Sovereign sukuk are similar to conventional fixed income bonds that are default-free, referred to as sovereign sukuk. These are debt instruments that represent cash flows (fixed or floating) which are guaranteed as payable during a specific time period”. According to the IIFM, sovereign sukuk refers to “sukuk issued by a national government” (IIFM, 2023). This definition

emphasizes that sovereign sukuk is issued by national governments, not by corporate or quasi-sovereign (public sector entity) issuers. Similar to IIFM's definition, many countries have defined sovereign sukuk as sukuk issued by their national governments as part of their sukuk regulatory frameworks. For example, in Indonesia, sovereign sukuk is defined as "sukuk issued by the government directly or through a special purpose company" (The Republic of Indonesia Law Number 19, 2018). Similarly, Pakistan defines sovereign sukuk as "sukuk issued and guaranteed by the federal government" (Government of Pakistan Sukuk Privately Placed Regulations, 2017). Egypt defines sovereign sukuk as "nominal and tradeable government securities of equal value, issued for a specific time period, each of which represents undivided share in the usufruct rights of assets" (National Bank of Egypt, 2021:34).

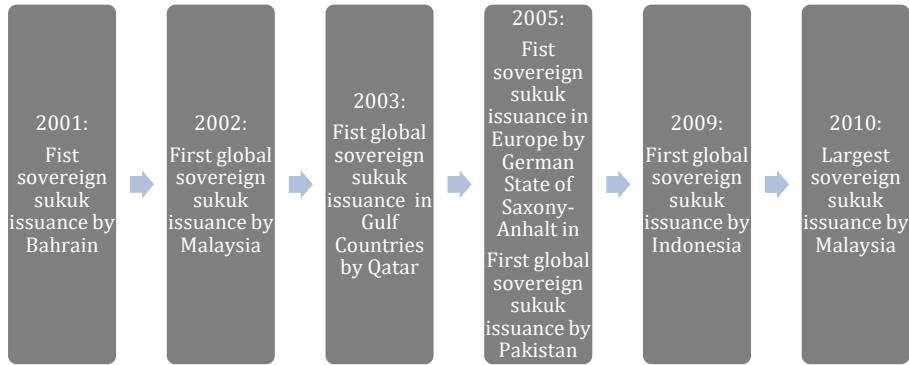
Sovereign sukuk has various structures that sovereign issuers can use in their issuances. For example, according to the (IIFM, 2021, 2022, 2023), sovereign issuers generally use *ijarah*, *wakalah*, *murabahah*, *salam* and hybrid structures in their sukuk issuances. On the other hand, governments can issue sukuk in either hard currency, also known as international sukuk, or in local currency, referred to as domestic sukuk, depending on their financing needs.

2. Development of Sovereign Sukuk

Sovereign sukuk has a very short history despite its role as driving force of the sukuk market today. Efforts to develop a modern sukuk began in the 1970s, and the first sukuk was issued by a foreign-owned, non-Islamic company called Shell DMS in Malaysia in 1990 (HSBC, 2011). After the successful debut of the modern sukuk by Shell DMS, governments around the world also started to explore the sovereign sukuk and recognized the need to establish legal and regulatory frameworks to support the issuance of these securities. The efforts made by various countries in establishing legal and regulatory frameworks for sukuk and Islamic finance have resulted in several landmark issuances over the years.

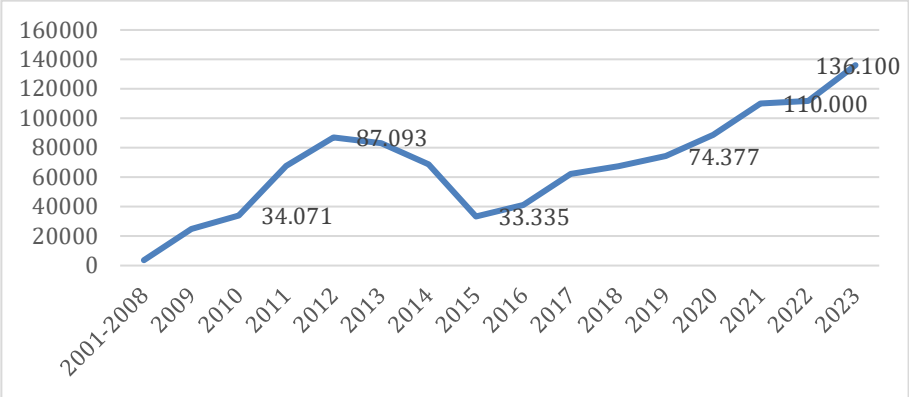
As seen in Figure 1, Bahrain and Malaysia made history by issuing the world's first two global sovereign sukuk in 2001 and 2002, respectively (IIFM, 2011:27-30). This was followed by issuance by Qatar, which is the first sovereign sukuk issuance in the Middle East. This period also witnessed first sovereign sukuk issuance by The German Federal State of Saxony-Anhalt, which is the first ever sukuk issuance in Europe (Al-Ali, 2019:42-43). Pakistan issued its first global sovereign sukuk in 2005, and Indonesia issued its first global sovereign sukuk in 2009 (HSBC, 2011). In 2010, Malaysia

Figure 1. Examples of First Sovereign Sukuk Issuances



issued the largest sovereign sukuk, and in 2011, Malaysia also issued the largest USD sovereign sukuk (IIFM, 2011:27-30). These landmark issuances contributed to the growth and development of the global sukuk market, despite the challenges posed by the global credit crunch. As the popularity of sovereign sukuk grew, countries such as Turkey, Senegal, Sudan, Ivory Coast, Nigeria, Oman, UAE, Bangladesh, Kuwait, and Saudi Arabia entered the global sovereign sukuk market with their first issuances. These sovereign issuances provided a strong foundation to the sukuk market. On the other hand, in 2014, non-Islamic countries such as the United Kingdom, Hong Kong, Luxembourg, and South Africa issued their first sovereign sukuk certificates (IIFM, 2013:15, 2016:20,47). In parallel with the increase in the number of sovereign sukuk issuers, sovereign sukuk structures and types have been diversified and many sukuk types such as gold-backed sukuk and green sukuk have been issued by various governments in recent years. For example, according to LSEG (2023), green and other ESG sukuk issuances reached \$10.1 billion in the first nine months of 2023.

Figure 2: Global Sovereign Sukuk Issuances (USD Millions, 2001-2023)



Source: IIFM (2021:46, 2023:48; 2024:44).

According to Figure 2, sovereign sukuk issuances were low during the 2000-2008 period due to both a low number of sovereign issuers and a low volume of sovereign issues during this time. On the other hand, in late 2007, AAOIFI's statement criticizing the compliance of sukuk structures with Sharia law had a negative impact on sukuk issuances (Askari et al., 2010:188). In addition, the global financial crisis that started in 2007 also affected the sukuk market negatively (Al-Amine, 2012:82). Despite these two developments that negatively affected the sukuk market, sovereign sukuk issuances continued their steady increase. Because, during the global financial crisis, investors became more risk-averse and turned to safe havens such as sovereign sukuk due to the uncertainty and volatility in the financial markets (IIFM, 2013:19). After the global financial crisis, sovereign sukuk issuances continued to increase for several reasons, including ongoing infrastructure expenditures (Abdullah, 2014; M. I. Ali, 2014), the fiscal burden imposed by the crisis. In other words, many governments, in response to the effects of the crisis, have implemented expansionary programs that have led to an increased need for financing (Moody's, 2009:14). However, after several years of consistent growth in sovereign sukuk issuances, a decline was observed in 2015. This reversal was caused by the Malaysia's decision to stop issuing short-term sukuk issuances (IIFM, 2017:13). Following a decline in 2015, sovereign sukuk issuances experienced a renewed period of steady growth, reaching \$136.1 million in 2023 (IIFM, 2024). This positive trend can be attributed to new sukuk structures such as green and sustainability sukuk, new sovereign issuers such as Egypt and Nigeria and the increasing number and volumes of sukuk issuances by major countries in Asia, the GCC and Africa.

B. Definition and Objectives of Public Debt Management

1. Definition of Public Debt Management

Definition of public debt management has changed and developed from the past to the present (Cabral, 2016; Wheeler, 2004:2). Public debt management, which in the past consisted of simple functions such as borrowing and debt servicing and was relatively less independent, became a more independent field following the reforms of the 1990s, along with an increase in specialization. This change is also reflected in the definition of public debt management. Today, public debt management has been defined by institutions such as the IMF and the World Bank, as well as by various researchers. Among the definitions provided, the one made by the IMF and the World Bank is widely accepted in the literature. Hence, the definition

made by IMF and World Bank is included in the study.

In 2001, IMF and World Bank defined public debt management as “the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities”. Then, the definition was revised by these institutions and in this way, IMF & World Bank (2014:15). defined public debt management as “The process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk”.

In the definitions, it is emphasized that creating a debt management strategy is necessary and that public debts are managed based on this strategy in order to achieve certain goals. On the other hand, in 2014, the modified definition omitted some statements regarding the development of the secondary market, which illustrates that the general framework of public debt management may change over time.

2. Objectives of Public Debt Management

Objectives of public debt management have evolved over time and exhibit variations across different countries (Hoogduin et al., 2011:1108). For instance, factors such as a countries' development level and their capacity to access capital markets can significantly influence the significance attributed to public debt management objectives. On the other hand, debt management objectives can evolve even in the same country due to the changing economic and financial conditions over time (OECD, 1996:659). And currently, numerous countries have adopted the public debt management targets established by the IMF & World Bank (2014). According to IMF & World Bank (2014), the main objective of public debt management “is to ensure that the government's financing needs, and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk”. In addition to these main objectives, diverse objectives are also highlighted in the literature (see Ela, 2022; Köstekçi & Yıldız, 2019). These objectives will be discussed in general terms below.

a. Achieving Minimum Borrowing Costs with Appropriate Risk Level

Achieving minimum borrowing costs is the main objective of public

debt management units (IMF & World Bank, 2014:4-7). The rationale behind this objective is that less taxation is needed due to lower borrowing costs (Paalzow, 1992:28). To achieve minimum borrowing costs, it is necessary to diversify debt instruments and investor bases. This is crucial for maintaining demand for government debt instruments (Egeli & Tandircioğlu, 2009:14; Srivastava, 2016:24). Moreover, developed, deep, and liquid secondary markets facilitate attaining this objective more easily (Khan, 2016:11-12).

However, programs adopted to achieve minimum cost may increase the risk level of government debt. In other words, there is a trade-off between cost and risk; as one increases, the other decreases. For instance, adopting short-term and foreign currency borrowing strategies to achieve low costs may increase interest and refinancing risks (Jonasson & Papaioannou, 2018:10-12). Therefore, it is crucial to select an appropriate and prudent risk level while minimizing borrowing costs.

b. Meeting Financing Needs

Another main objective of public debt management is to provide stable financing to the governments (Hubig, 2013:5). In a study conducted by the OECD, it was stated that one of the main priorities of debt managers is to meet financing needs. This objective becomes especially important in periods when it is difficult to access traditional funding sources and the need for borrowing increases (OECD, 1996:196). To maintain stability in borrowing, innovative debt instruments and a diversified investor base are essential, considering the changing investor preferences and sentiments over time. Consequently, during situations when traditional borrowing markets face negative investor sentiment due to the specific circumstances, it becomes possible to leverage other investor groups, such as Islamic investors (Ela, 2022:64-65).

c. Improving Financial Markets and Sustaining Market Access

In recent times, many countries have revised their public debt strategies, shifting toward market-based borrowing (bond etc.) rather than relying on traditional loans (Fastenrath et al., 2017:275-276). As a result, enhancing financial markets and ensuring continuous market access have become significant areas of debt management. This significance has grown even further due to the numerous crises encountered. Indeed, a country's capability to fulfill its borrowing requirements now hinges on its consistent access to financial markets (OECD, 1996:660). To ensure continuous market access, investor demand for government debt instruments must remain high, which means the market's absorptive capacity should be adequate. Achieving

high investor demand is possible through well-established and efficient secondary markets that enhance liquidity (Ulusoy, 2016:263). Moreover, diversification of debt instruments is crucial for sustaining investor interest (OECD, 1996:660-665). At this point, governments lead the way for efficient pricing of private sector bonds through benchmark issues and play a pivotal role in fostering the growth of an effective secondary market (Das et al., 2010:10,20).

d. Diversifying Debt Instruments and Investor Base

Although it is not a primary objective, diversifying public debt instruments plays a significant role in achieving various borrowing objectives. For example, to access financial markets and attract new investors, countries require diversifying their debt instruments. The diversification of debt instruments can be highly beneficial, particularly in situations of increased borrowing needs and in achieving objectives such as cost minimization and maintaining a balanced maturity structure. Moreover, diversifying debt instruments is crucial for financing the borrowing requirements under changing conditions (OECD, 1996:164). On the other hand, diversifying public debt instruments can remove the refinancing risk (OECD, 2021:62).

e. Maintaining Balanced Maturity Structure

As a secondary objective, maintaining a balanced maturity structure is to prevent the bunching of maturing debts and their related redemptions on a specific day or in a particular period of the year. Because the high amount of maturing debt and its rapid increase creates significant issues in terms of debt management. A longer repayment period for debts, a balanced maturity structure, and a balanced maturing debt amount reduce the refunding needs in a specific month or year. Hence, a balanced maturity structure reduces the refinancing risk (OECD, 1996:661).

f. Raising Household Savings

The objective of raising household savings is a key aspect of public debt management in developing countries; however, it has become less relevant for developed nations. To boost domestic savings, countries with low saving rates, particularly developing ones, should issue a diverse range of financial instruments that cater to the preferences of households (OECD, 1996).

C. Sukuk and Public Debt Management

Sukuk supports governments in achieving numerous public debt

management objectives, and some of them serve as their primary objectives. In this section, we will firstly examine the objectives that various countries aim to achieve through sukuk issuance. Secondly, we will explore the role of sukuk in supporting public debt management in a general context.

1. Objectives of Sukuk Issuance by Countries

Countries have various public debt management objectives when issuing sukuk. However, the primary objectives may differ due to the varying economic and fiscal features of the countries. For instance, a vulnerable country might aim to diversify its investor base, whereas a country with a robust secondary market and strong macroeconomic indicators could focus on establishing itself as a leading Islamic finance hub. On the other hand, the objectives of countries may not differ entirely, as some objectives are indeed similar. For example, diversifying the investor base is a crucial objective for nearly all countries. The main objectives of the countries in question are outlined in Table 1.

Table 1. Objectives of Sukuk Issuance by Various Countries

Country	Objective(s)
Tunisia	<ul style="list-style-type: none"> ▪ To attract a new class of investors.
United Kingdom (UK)	<ul style="list-style-type: none"> ▪ To strengthen London's position as the leading center for Islamic finance outside the Islamic world, ▪ To facilitate greater financial inclusion in the country, ▪ To promote greater trade and investment into the country.
Pakistan	<ul style="list-style-type: none"> ▪ To attract new investors, ▪ To increase liquidity of the sukuk, ▪ To lower costs for the government.
Jordan	<ul style="list-style-type: none"> ▪ To diversify the sources of financing, ▪ To broaden the investor base for government debt securities.
United Arab Emirates (UAE)	<ul style="list-style-type: none"> ▪ To access the expanding global sukuk market, ▪ To diversify the sources of financing and broaden the investor base for government debt securities, ▪ To reinforce the UAE's position as a prominent investment hub and attractive investment destination within the Islamic economy.

Bangladesh	<ul style="list-style-type: none"> ▪ To lower the cost of government borrowing by expanding its debt portfolio, ▪ To provide both new and secure investment options for Islamic banks, financial institutions, and individual investors, ▪ To execute more projects by issuing Sukuk regularly in the future.
Nigeria	<ul style="list-style-type: none"> ▪ To finance the construction or rehabilitation of crucial economic infrastructure projects, such as roads, ▪ To diversify the sources of government funding, ▪ To promote a higher level of financial inclusion, ▪ To serve as a reference for pricing sukuk issued by other bodies, especially private sector issuers.
Indonesia	<ul style="list-style-type: none"> ▪ To offer an alternative source of funding for the government, ▪ To promote Islamic finance through Shariah-compliant investment instruments.
Turkey	<ul style="list-style-type: none"> ▪ To boost domestic savings, ▪ To widen the investor base, ▪ To diversify borrowing instruments.

Source: Bangladesh Ministry of Finance (2021:1); Deloitte & ISRA (2018:22); Federal Government of Nigeria (n.d); HM Treasury (2023:13); IFN (2015:116); Jordan Ministry of Finance (2017:8); Pakistan Debt Management Office (2023:13); Turkey Undersecretariat of Treasury (2014:23()); UAE Federal Debt Management Office (n.d.)

According to table 1, the majority of countries focus on diversifying their sources of government funding and broadening or diversifying their investor base. However, due to the varying economic and fiscal features of countries, some other objectives may differ. In this regard, The United Arab Emirates (UAE) and the United Kingdom (UK) stand out from other countries by pursuing a more comprehensive objective, as they aim to establish themselves as leading Islamic finance hubs globally. Meanwhile, Bangladesh and Nigeria concentrate on enhancing their infrastructures by financing infrastructure projects through sukuk issuances. Some countries, like the UK and Nigeria, prioritize financial inclusion and some other countries, such as Bangladesh and Pakistan primarily target minimizing borrowing costs as a key objective. In alignment with the recent borrowing policies of emerging countries, Turkey seeks to boost its local savings rate by issuing sukuk. The

general inference from table 2 is that while governments predominantly strive to achieve similar objectives, such as diversifying their investor base, the specific objectives they pursue may vary according to the unique requirements of each country.

2. The Role of Sukuk in Achieving Public Debt Management Objectives

As a distinctive financial instrument, sukuk supports countries in achieving public debt management objectives. Nonetheless, it does not seem possible for a country to achieve all the public debt management objectives equally through sukuk issuance. In this respect, while sukuk highly supports governments in achieving some goals, such as diversifying the investor base, its contribution toward achieving other objectives may be relatively limited. In this section, we will examine the public debt management objectives that sukuk helps countries to achieve.

a. Achieving Minimum Borrowing Costs with Appropriate Risk Level

The minimum borrowing cost objective is considered the top priority in public debt management. However, sukuk has not been successful in achieving cost minimization for several reasons. One significant factor contributing to high costs is the high structuring and issuance costs of sukuk (COMCEC, 2017:7). Notably, as a financial instrument complies with Islamic principles, the sukuk issuance process entails higher legal and administrative costs. Legal costs involve expenses related to Sharia boards and expert opinions, while administrative costs stem from the numerous cash and asset transactions involved in the process (OECD, 2018:56-57). Unlike conventional bonds, sukuk issuance encompasses the underlying asset, transfer of usufruct or ownership of the underlying asset to investors, and cash flows originating from the asset. These transactions indeed lead to additional administrative costs, and require more time and effort compared to conventional bonds (Jobst et al., 2008:13). In accordance with the existing literature, public debt management offices often perceive sukuk to have substantial issuance costs. As per the 2017 survey conducted by the OECD (2018), numerous debt management offices of OECD countries do not consider issuing sukuk in the future due to the high issuance costs resulting from the unique requirements of sukuk.

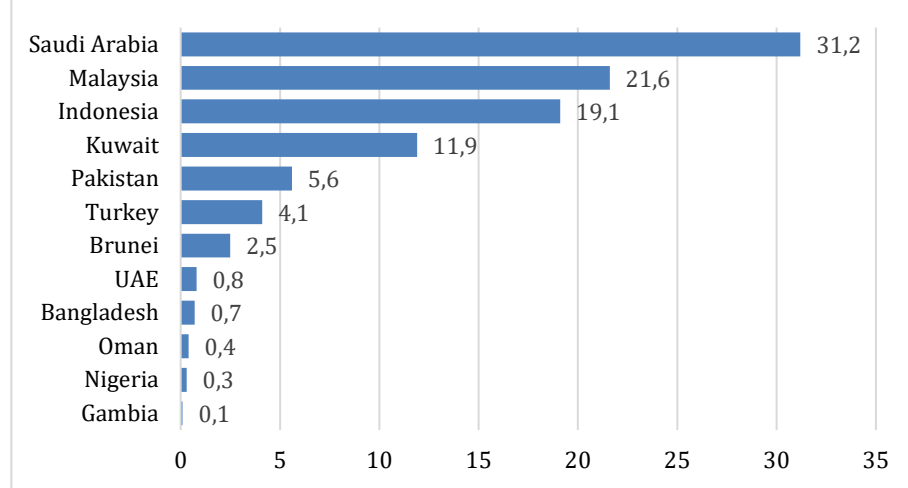
Another significant factor contributing to the high cost is the “hold to maturity” strategy adopted by sukuk investors. This strategy results in a limited secondary market and, consequently, higher sukuk returns (ADB,

2014:42; Jobst et al., 2008:9). Indeed, studies comparing the returns of sovereign sukuk and sovereign bonds show that sovereign sukuk has higher returns because of the limited secondary market and high liquidity risk (Ariff et al., 2018; Asmuni & Tan, 2021). In specific countries, such as Malaysia, the disparity in returns between sovereign sukuk and sovereign bonds can sometimes be rather insignificant. According to ADB (2014:42), this narrow difference in returns can be attributed to the larger and more liquid sukuk market.

b. Meeting Financing Needs

While countries strive for the minimum borrowing costs, they also aim to borrow an appropriate amount and at the right time, ensuring they meet the financial needs of the governments. Meeting the government's financing needs becomes crucial, particularly during crises when risk aversion and deteriorating sovereign risk perception come into play (OECD, 1996:196). At this point, sukuk can play a significant role in meeting the financial needs of the government. In this context, the global financial crisis that began in 2007 can be analyzed. Firstly, sukuk issuances were less affected by the global financial crisis than traditional bond issuances (Al-Amine, 2014:33) (see also Figure 2 and Figure 4). In fact, due to the influence of the global financial crisis and the negative impact of AAOFI's announcement regarding ijara sukuk, the sukuk market contracted by 50% in 2008, while the structured finance market shrank by 80% (Jobst, 2009). Secondly, the fact that banks in the USA and Europe reduced lending during the crisis period led many countries to issue sukuk. Consequently, sovereign sukuk issuances increased substantially after the crisis (Pasha, 2011; Reuters, 2012). All these instances demonstrate that countries can meet their financing needs through sukuk issuance in times of challenging borrowing conditions. In practice, many countries issue sukuk. Figure 3 shows % shares of countries in total sukuk issuances.

As shown in Figure 3, many countries issue sovereign sukuk in 2022. The top country as issuer is Saudi Arabia, which takes 31.2% share in total sovereign issues. Meanwhile, Malaysia and Indonesia are the second- and third-largest issuers, respectively, accounting for 21.6% and 19.1% of total sovereign sukuk issuances. Additionally, other countries such as Nigeria and Gambia also have issuances, although these make up a relatively small portion of the total sovereign sukuk issuance. The issuance of sovereign sukuk suggests that many countries need to meet their financing needs and hereby issue sukuk to fulfill these requirements.

Figure 3. Percentage (%) shares of countries in total government sukuk issuance (2022)

Source: Statista (2024).

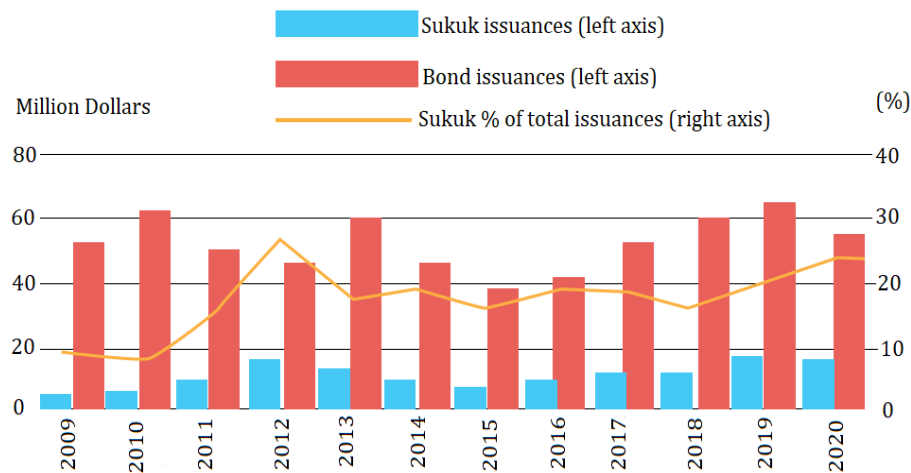
c. Improving Financial Markets and Sustaining Market Access

Sukuk can help countries in developing and diversifying their local capital markets (Jobst et al., 2008:15). In this context, one of the primary objectives of sukuk-issuing nations is to foster and deepen the sukuk market (Wedderburn-Day, 2010:326), a goal of particular importance for countries with strong financial positions and high credit ratings (Boujlil et al., 2020). While numerous countries have been issuing sukuk to develop and diversify their local capital markets (Jobst et al., 2008:6), several challenges hinder the growth of the sukuk market. Firstly, there has been a substantial gap between sukuk supply and demand for an extended period. According to Refinitiv (2022), the sukuk supply-demand gap is projected to reach USD 101.4 billion by 2027. Concurrently, due to the high demand for sukuk, sukuk investors adopt a “hold to maturity” strategy. As a result, the secondary market for sukuk remains limited and thin. To attain more comprehensive and diversified capital markets, there should be more frequent and substantial sovereign sukuk issuances (COMCEC, 2017:7).

Sustaining market access requires high investor demand (Ulusoy, 2016:263) and the diversification of debt instruments (OECD, 1996: 660-665). In this context, sukuk differs fundamentally from conventional bonds due to its unique structural and financial features (Balli et al., 2021; Hossain et al., 2021). Furthermore, sukuk has distinct investor segments who adhere to Islamic principles and exhibit a high demand for sukuk. These distinctive characteristics enable countries to enter international markets and sustain market access (COMCEC, 2017:43). For instance, following the global

financial crisis, the credit crunch in European countries led numerous European nations to the sukuk and Islamic finance markets in general to access capital (Chermi & Jerbi, 2015).

Figure 4: Sukuk and conventional bond issuances in key Islamic finance jurisdictions (2009-2020)



Source: Al-Natoor (2021).

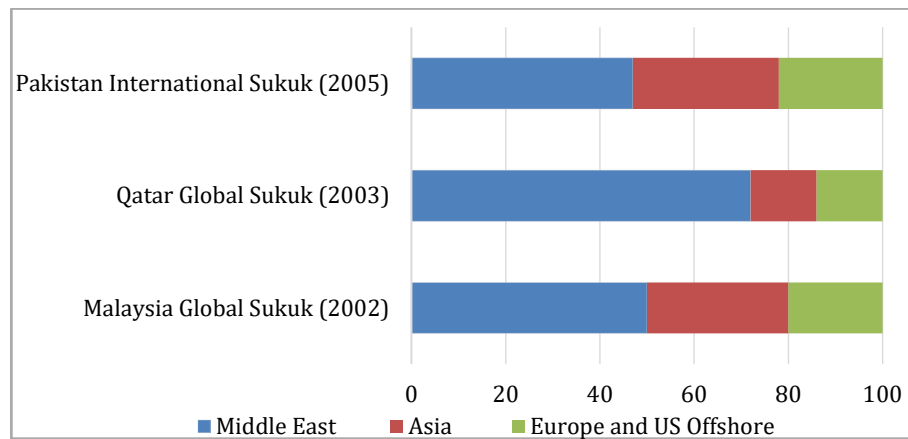
As shown in Figure 4, countries that have adopted Islamic finance issue sukuk in addition to conventional bonds. Sukuk accounts for 20 to 30% of total issuances in these jurisdictions (Al-Natoor, 2021). Figure 4 shows that sukuk issuances of countries increased after the 2007 global financial crisis and the 2009 European debt crisis (see also Figure 2). In 2019 and 2020, the share of sukuk issuances in the global bond market exceeded 20%. This suggests that countries benefit from sukuk issuance, particularly during difficult financial times.

d. Diversifying Debt Instruments and Investor Base

Diversified funding sources and investor bases are two crucial components for effective debt management (Hubig, 2013:7). These components play a vital role in maintaining liquidity within the secondary market. Moreover, Sophastienphong et al. (2008:14) highlight that diversified funding sources and investor bases enable issuers to access markets more effectively amid varying market conditions. In this context, sukuk emerges as a valuable instrument, as numerous countries issue sukuk with the objective of diversifying their funding sources and investor bases. This demonstrates the suitability of sukuk in diversifying both funding sources and investor bases.

The unique investor base of sukuk, with distinct investment objectives, sets it apart from traditional bonds. In this context, while Islamic banks hold a significant share in the sukuk investor profile, traditional banks and insurance companies also invest in sukuk with the aim of portfolio diversification (Reuters, 2014:30). On the other hand, individual investors show interest in investing in sukuk, and in fact, Sharia compliance is a significant factor influencing their purchase intention (Awn & Azam, 2020; Islam et al., 2023).

Figure 5: Geographic Distribution of Sovereign Sukuk Investors



Source: IIFM (2011:27-30).

The geographic distribution of sukuk also differ from that of traditional bonds. While traditional bond investors are predominantly from Europe and the US, sukuk investors are mainly from the Middle East and Asia region. As per Figure 5, investors from the Middle East and Asia constitute 78% in Pakistan International Sukuk, 86% in Qatar Global Sukuk, and 80% in Malaysia Global Sukuk. Consequently, the divergence in investor bases between sukuk and traditional bonds makes sukuk a valuable instrument in achieving the objective of diversifying funding resources and investor bases.

e. Maintaining Balanced Maturity Structure

Balanced maturity structure decreases high amount of maturing debt and hence the refinancing risk. Though debt management offices do not aim to achieve a balanced maturity structure through issuing sukuk, sukuk can help in achieving a balanced maturity structure or, at the very least, does not hinder this objective. Because sukuk can be issued with varying maturities. In this regard, according to IIFM (2023:85-89), sukuk maturities vary from 2 years to 10 years.

f. Raising Household Savings

Preferences of households on savings may affect domestic savings. To raise household savings, governments must issue a diverse range of financial instruments catering to the preferences of households (OECD, 1996:670). Some individual investors avoid interest and opt for Islamic financial products. As a Sharia-compliant instrument, sukuk is suitable for investors who prioritize Sharia-compliant investments. Numerous studies show that individual sukuk investors with Sharia consciousness invest in sukuk due to its Sharia-compliant structure (Awn & Azam, 2020; Chowdhury & Salema, 2023; Islam et al., 2023). In this context, sukuk can play a crucial role in attracting investors with Sharia consciousness.

D. The Way Forward

States have generally pioneered sukuk issuances in their countries, and sovereign sukuk issuances have served as a catalyst for the sukuk market (Balibek, 2017:8). Since 2010, sovereign sukuk issuances have been a large part of the sukuk market (IIFM, 2016:3, 2017:13). However, due to the leading role of sovereign sukuk and the supply-demand gap in the sukuk market, there is a need for more and higher amounts of sovereign sukuk issuances (ADB, 2014:43). On the other hand, increasing sovereign sukuk issuances can stimulate the market in the future and better serve public debt management purposes. In this context, it is argued that more sovereign issuances can cause the more diversified local financial markets and investor base will be diversified with increasing sovereign sukuk (COMCEC, 2017:7).

However, there are some obstacles to the increase in sukuk issuances. According to the 2017 survey conducted by the OECD (2018), 80 percent of the management offices in OECD countries did not consider issuing sukuk and 10 percent of them considered issue sukuk but decided not to issue sukuk. They stressed the complexity of sukuk transactions, additional costs including legal changes and lack of local investor demand as the main obstacles. On the other hand, sovereign sukuk issuers in OECD, namely Turkey, Luxemburg and UK indicated that high legal cost and additional administrative costs were the difficulties experienced with sukuk issuance. In addition, it is emphasized in the literature that the lack of standardization in Sharia interpretations hinders the development of the sukuk market (ADB, 2014; Chermi & Jerbi, 2015).

To increase in sovereign sukuk issuances and to develop the sukuk market, some problems facing sukuk issuers need to be solved. In order to solve these problems, it is necessary to follow the case of Malaysia and

establish a Sharia board in every country or to establish a globally effective and authorized Sharia board. On the other hand, international efforts are needed to achieve standardization in the sukuk issuance process and documentation. Thus, the differences in Sharia interpretations and sukuk transactions can be eliminated and costs can be reduced. Secondly, training can be provided to the sukuk stakeholders for awareness of sukuk. Finally, the legal and regulatory framework regarding sukuk should be improved, transparency should be increased, and a strong financial market infrastructure should be established for the development of the secondary market (ADB, 2014; S. S. Ali, 2009; IMF, 2015).

Solving the problems related to sukuk will develop the sukuk market and this development can be supported by innovation in sukuk structures (Laila et al., 2018). In the past, many countries have developed innovative sukuk types. For example, Indonesia has issued retail-oriented saving sukuk and Turkey has issued inflation-linked sukuk in order to diversify its investor base (Balibek, 2017:11). In addition, many governments have issued green sukuk, social sukuk, sustainability sukuk (sustainability and sustainability-linked sukuk) (Refinitiv, 2022). Countries need to increase the issuance of such sukuk types in order to diversify investor base. In addition, countries must develop and issue various sukuk types that have significant issuing potential, such as blue sukuk. With these innovative sukuk types, countries can develop the sukuk market and sukuk can support public debt management more strongly.

Conclusion

Financing needs of governments were generally met by loans until the 1980s. Afterwards, financing needs were met by marketable debt instruments such as bills and bonds. In recent years, driven by shifting investor preferences, dynamic macroeconomic conditions, and transforming financial market spaces, public debt managers have diversified the bonds issued and their properties, or have introduced novel and alternative financial instruments such as sukuk. Sukuk, which was first issued by the private sector in 1990, was increasingly issued by governments in the 2000s. Countries aim to achieve certain public debt management goals through sukuk issuance or prioritizing other goals such as becoming an effective financial center. This study examines the debt management objectives facilitated by sukuk and the measures necessary to enhance their assistance.

According to the results of the study, sovereign sukuk facilitates achieving the following public debt management objectives: a) meeting

financing needs, b) improving financial markets and sustaining market access, c) diversifying debt instruments and investor base, d) maintaining balanced maturity structure, e) raising household savings. However, sovereign sukuk cannot sufficiently facilitate the objective of achieving minimum borrowing cost because of high legal and administrative costs and the lack of standardization in Sharia interpretations.

In order for sukuk to facilitate achieving the public debt management objectives, problems such as high costs and lack of standardization sukuk market need to be solved. To solve these problems, this study offers some suggestions: a) providing training to sukuk stakeholders, b) establishing a global Sharia Board, c) improving the legal and regulatory framework regarding sukuk, d) improving transparency, e) establishing a strong financial market infrastructure for the development of the secondary market.

Resolving these problems may encourage more countries to issue sukuk and enable those already issuing sukuk to increase their volumes and explore innovative structures. With increasing sukuk issuances and novel sukuk types, sukuk may support the public debt management process more strongly.

This study offers some recommendations for policy makers. First of all, individual efforts of countries may not be sufficient to establish a global Sharia board, and in this sense, sukuk issuing countries must reach a consensus and act together. Similarly, in order to solve problems such as the high cost of sukuk, international organizations must lead and guide the facilitation of legal and administrative processes.

This study addresses features and problems of sukuk and their impact on public debt management. In this respect, further studies can offer more comprehensive suggestions by addressing the problems with a holistic approach. Additionally, future studies can conduct research on the perspective of public debt management offices on sukuk.



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SUKUK VE KAMU BORÇ YÖNETİMİ: GENEL DEĞERLENDİRME VE GELECEĞİ

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Extended Abstract

Ülkeler değişen finansal koşullar ve iklim koşulları gibi faktörlerin neticesinde son yıllarda yenilikçi borçlanma araçları geliştirmekte ve ihraç etmektedir. Söz konusu yenilikçi araçlardan birisi ise hiç şüphesiz sukuktur. Sukuk, 1970'li yıllarda İslami bir finansal araç geliştirme yönünde gösterilen çabaların ardından ilk olarak özel sektör kuruluşu olan Shell DMS tarafından Malezya'da 1990 yılında ihraç edilmiştir. Devletler tarafından ilk ihraçlar ise 2001 yılında Bahreyn'den ve 2002 yılında Malezya'dan gelmiştir. İlk devlet sukuku (sovereign sukuk) ihraçlarının ardından 2000'li yıllarda Birleşik Krallık ve Lüksemburg gibi Müslüman olmayan ülkeler yanında Türkiye, Kuveyt ve Suudi Arabistan gibi birçok Müslüman ülke tarafından devlet sukuku ihracı gerçekleştirilmiştir. Ülkeden ülkeye farklılaşmakla birlikte söz konusu ülkelerin sukuk ihraç etmekle ulaşmaya çalıştıkları amaçlara bakıldığında genellikle; a) yeni bir yatırımcı sınıfının çekilmesi (yatırımcı tabanının çeşitlendirilmesi), b) daha yüksek düzeyde finansal katılımın teşvik edilmesi ve c) kamu borçlanma maliyetlerinin düşürülmesi amaçlarının öne çıktığı görülmektedir. Bu noktadan hareketle oluşturulan bu çalışmada, sukukun ülkelerin kamu borç yönetimine sağladığı faydalar ve kamu borç yönetimi hedeflerine ulaşılmasını desteklemedeki rolü incelemekte, bu rolün gerçekleştirilmesinin önündeki engellere değinilmekte ve sukukun borç yönetimine katkısını iyileştirmek için gerekli olan çeşitli önlemler değerlendirilmektedir. Betimsel bir yöntemle ele alınan bu çalışmada, sukuk ve kamu borç yönetimine ilişkin literatür taranmış, ülke örnekleri incelenmiş ve tablo ve grafiklerle çalışma bulguları desteklenmiştir.

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Kamu borç yönetimine göre, ülkeler finansman sağlamak amacıyla bir enstrüman ihraç ettiğinde söz konusu enstrümanın çeşitli hedefleri gerçekleştirme düzeyini incelemektedir. Bu bakımdan kamu borç yönetiminin hedefleri genel olarak a) minimum maliyet ve uygun bir risk düzeyi ile borçlanılması, b) finansman ihtiyacının karşılanması, c) finansal piyasaların geliştirilmesi ve piyasalara erişimin sürdürülmesi, d) borçlanma araçlarının ve yatırımcı tabanının çeşitlendirilmesi, e) dengeli vade yapısının sürdürülmesi ve f) hane halkı tasarruflarının arttırılmasıdır.

Sukuk, kamu borç yönetiminin birçok amacını yerine getirmekte ve bu anlamda ülkelerin kamu borç yönetimi işlevlerini desteklemektedir. Bu açıdan, bu çalışmanın sonucuna göre sukuk, birtakım kamu borç yönetimi hedeflerine ulaşmayı kolaylaştırmaktadır. Söz konusu hedeflerden ilki a) finansman ihtiyacının karşılanmasıdır. Buna göre ülkelerin finansman ihtiyaçlarının karşılanabilmesi için özellikle global finansal kriz ve Avrupa borç krizinde başvurdukları finansal araçlardan birisi sukuktur. Nitekim devlet sukuku ihraçları AAOIFI'nın eleştirisine rağmen söz konusu krizlerin ardından artmıştır. İkinci bir hedef b) finansal piyasaların geliştirilmesi ve piyasaya erişimin sürdürülmesidir. Sukuk ülkelerin yerel sermaye piyasalarını geliştirmek ve çeşitlendirmek için başvurdukları bir araçtır. Diğer yandan sukukun İslami yatırımcı tabanına sahip olması, geleneksel piyasalarda oluşan kredi sıkışıklığı ve kriz gibi dönemlerde piyasaya erişimin (İslami finans piyasası) sürdürülmesini sağlamaktadır. Üçüncü hedef c) borçlanma araçlarının ve yatırımcı tabanının çeşitlendirilmesidir. Sukukun en temel özelliği, farklı bir yatırımcı segmentine sahip olmasıdır. Bu açıdan sukuka bir yandan geleneksel tahvilden farklı bölgelerden ve diğer yandan da yine geleneksel tahvilden farklı yatırımcı segmentinden talep gelmektedir. Dördüncü hedef d) dengeli vade yapısının sürdürülmesidir. Sukuk farklı vadelerde ihraç edilebilmekte olup dengeli vade yapısına ulaşılmasını destekleyebilmektedir. Burada vurgulanması gereken nokta sukukun dengeli vade yapısına ulaşılmasını sağlamada geleneksel yöntemlerden ayrıca bir üstünlüğünün olmamasıdır. Son olarak beşinci hedef e) hane halkı tasarruflarının arttırılmasıdır. Sukuk, İslami yatırımcı tabanının geleneksel faizli araçlara yatırım yapmamasından dolayı hane halkı tasarruflarını arttırabilmekte ve piyasaya kazandırabilmektedir.

Sukukun kamu borç yönetimine sağladığı faydalar yanında söz konusu faydaların arttırılmasının önünde birtakım zorluklar ve engeller söz konusudur. Bunlardan ilki ve en önemlisi a) sukukun yüksek ihraç maliyetlerine sahip olmasıdır. Nitekim sukuk ihracına hazırlık aşamasından yüksek yasal ve Şer'i giderlerin olması sukuk ihracını geleneksel tahvillere

göre daha maliyetli hale getirmektedir. Sukuk ile geleneksel tahvillerin getirileri konusunda ise literatürde sukukun kısmen daha yüksek getiri sağladığı vurgulansa da farklı ülkelerde (özellikle derin finansal piyasalara sahip Malezya gibi ülkelerde) sukuk ile geleneksel tahvil getirileri arasında önemli bir fark bulunmadığı vurgulanmaktadır. Bu açıdan sukukun yüksek ihrac maliyetleri, kamu borç yönetiminin mümkün olan en düşük maliyet ve uygun risk düzeyi ile finansman sağlama hedefinin gerçekleştirilmesine hizmet etmediğini göstermektedir. İkinci önemli engel ise sukuk piyasasında var olan standardizasyon eksikliğidir. Kısmen sukuka ilişkin belgelerde henüz standardizasyon yakalanamamış olup asıl standardizasyon ise Şer'i yorumlarda yer alan farklılıklardan kaynaklanmaktadır. Bu anlamda çeşitli ülkelerde yer alan farklı Şer'i kurullar birbirinden farklı yorumlamalarda bulunarak parçalı ve standardizasyondan uzak bir sukuk piyasasına neden olmaktadır

Çalışmaya göre, söz konusu engeller ve zorlukların aşılması, sukukun kamu borç yönetiminde daha etkili bir rol oynamasına yol açabilecektir. Bu açıdan çalışmada temel olarak uluslararası ve başat bir Şer'i kurulun kurulması, sukuk paydaşlarına gerekli eğitimin verilmesi, sukukun yasal ve yönetsel sürecinin geliştirilmesi, şeffaflaştırılması ve standardize edilmesi, güçlü finansal altyapının kurulması önerilmektedir. Bu halde, daha önceki sukuk ihrac süreçlerinde devletlerin sukuk ihracı ile öncü ve geliştirici bir rol oynadığı unutulmamalıdır. Bu anlamda devletlerin daha fazla sukuk ihracı ile süreci desteklemesinin ve çeşitli inovatif (yeşil ve mavi sukuk ile altına dayalı sukuk vb.) sukuk ihracı ile sukuk piyasasını çeşitlendirmesinin önemli bir gereklilik olduğu söylenebilmektedir.

Anahtar Kelimeler: İslami Finans, Sukuk, Kamu Borç Yönetimi, Devlet Borçları.



Hakem: Dış, Bağımsız.

Teşekkür:

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Beyanname:

1. Özgünlük Beyanı:

Bu çalışma özgündür.

2. Yazar Katkıları:

Fikir: AU-ME; **Kavramsallaştırma:** AU-ME; **Literatür Taraması:** AU-ME; **Veri Toplama:** AU-ME; **Veri İşleme:** AU-ME; **Analiz:** AU-ME; **Yazma – orijinal taslak:** AU-ME; **Yazma – inceleme ve düzenleme:** AU-ME.

3. Etik Kurul İzni:

Etik Kurul İzni gerekmemektedir.

4. Finansman/Destek:

Bu çalışma herhangi bir finansman ya da destek almamıştır.

5. Çıkar Çatışması Beyanı:

Yazarlar, herhangi bir çıkar çatışması olmadığını beyan etmektedirler.

