Article

The Political Economy of Sukuk Development in East Asia: A Comparative Study from South Korea and Taiwan

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Abstract
Sukuk is an alternative financial instrument for investing in the form of bonds. Compared with conventional bonds, Sukuk offers investors an asset distribution model and a fair return of profit and risk-sharing. Sukuk also prohibits the imposition of interest rates. The development of Sukuk in the East Asia region has shown a positive trend because of its profitable principle for medium- to long-term investment in supporting economic development and stability. South Korea and Taiwan are countries that are relatively new in developing Sukuk compared with China, Hong Kong, and Japan. This research aims to understand the development of Sukuk in these two countries from a political economy perspective. This research employs a qualitative method and compares how South Korea

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and Taiwan implement their policies in developing Sukuk using an approach from three aspects: political leadership, world economic order, and cultural factors. The data to be used is sourced from secondary data from government documents, central banks, and financial authorities.

Keywords
Sukuk, financial instrument, capital market, South Korea, Taiwan

INTRODUCTION

Sukuk refers to securities issued as alternative investment instruments based on a transaction, agreement, or underlying provision. Such instruments are sourced from Islamic transactions, which are based on how ownership of tangible assets is distributed and managed by prohibiting the imposition of interest. Islamic financial instruments are an interesting phenomenon to examine. Since the 2008 financial crisis, many countries have adopted Islamic financial instruments, including East Asia, which has a small Muslim population. This condition is due to the system's stronger stability than that of the conventional financial system, especially during an economic crisis. Therefore, each country competes to become an Islamic financial hub (Islamic financial center) in their respective regional areas.

The governments of East Asian countries tend to be more neutral on religious issues. Nearly all countries in the region have regulations and laws on financial instruments that have not been updated to apply Sharia law, which has prompted them to amend and make adjustments to their financial instrument regulations to support the issuance of Sukuk. One example is Hong Kong. After several years of intensive study and changes to its regulations, in September 2014, the Hong Kong government debuted its issuance of Sukuk and, in May 2015, reentered the international financial market by issuing Sukuk worth $1 billion in a year. In its aggressive issuance of Sukuk, the Hong Kong government had the ambition that the success of such issuance will encourage investors worldwide to enter the Hong Kong financial market (Wong & Bhatti 2019).

The Sukuk development in Hong Kong has led other countries such as China, Japan, South Korea, and Taiwan to adjust their financial instrument regulations. China modified its provisions in mid-2000 to attract investment funds from Middle Eastern countries and support the Belt and Road Initiative in Islamic countries. Japan updated its financial regulations to support Sharia transactions in 2008 (Wong & Bhatti 2019). Meanwhile, South Korea initiated efforts to amend its finance law in 2010 to accommodate the issuance of Sukuk (KoreanLII 2016), and Taiwan supported the issuance of Sukuk in 2019 (Gonçalves 2019). Table 1 illustrates the statistics on Sukuk issuance compared with conventional bond issuances in 2017:

Table 1. Sukuk Issuance vs. Bonds in East Asian Countries (2017)

Economy	Total (USD Billions)	% of All Sukuk
China	710.77	16.42
Japan	405.88	28.76
South Korea	170.51	68.45
Hongkong	113.19	103.11
All Sukuk	116.72	100.00

Source: (Wong & Bhatti 2019)

The positive development of Sukuk in East Asia prompted this research. Many studies have discussed the importance of Sukuk in creating national economic stability, such as Viswanath and Azmi (2009), Rauf (2013), Zulkhibri (2015), and Paltrinieri *et al.* (2020). Meanwhile, research on Sukuk development focusing on East Asia includes Mohammed (2015), Ogino (2018), and Wong and Bhatti (2019). Specifically, this study aims to compare the development of Sukuk in two East Asian countries: South Korea and Taiwan. Research has shown that South Korea has experienced quite an exciting dynamic associated with government support in making amendments to regulations on the issuance of Sukuk (Khan, Elsiefy & Kyoung 2014). Meanwhile, Taiwan is the latest country in East Asia to support such issuance. In addition, South Korea and Taiwan also showed high economic growth after the war—a rare event (Hattori & Sato 1997). Therefore, these identical economic phenomena is fascinating to analyze.

This study will compare South Korea and Taiwan based on several factors. First is their sociocultural similarity; both have a majority non-Muslim population. However, Sukuk, an investment facility reflecting Islamic values, can still develop in both countries, which also claim to have a high level of democracy, so they are more inclined toward supporting freedom. The second factor is their similarity in responding to changes in world financial conditions, which have begun to be flooded with various alternative investment facilities, including Sukuk. The third factor is leadership, where both countries' leaders have relatively the same interests in their efforts to develop Sukuk. Another influential factor is that, like Hong Kong, South Korea has long adopted Sukuk, but its development tends to stagnate. Taiwan, meanwhile, only developed Sukuk in 2019 as a means of investment.

The abovementioned phenomenon became the focus of this research, which raises the following questions: Why does Sukuk development in South Korea tend to be static, and why is Taiwan so left behind in implementing Sukuk? What is the extent to which their governments support Sukuk development? What are the challenges and opportunities for Sukuk development in South Korea and Taiwan? This study applies a comparative qualitative method by combining literature studies from government documents related to the issuance of Sukuk, information provided by the Central Bank and Financial Authorities, and previous research findings. The novelty of this research lies in its analysis of the application of Sukuk policy using three aspects of a political economy approach: political leadership, world economic order, and cultural factors. This research is further divided into several parts. Section 1 explains the research background; section 2 describes the definition, model, and advantages of Sukuk in detail; section 3 discusses the dynamics of Sukuk development in South Korea; section 4 focuses on such dynamics in Taiwan; and section 5 concludes the study.

SUKUK: HISTORY OF DEVELOPMENT, MODELS, AND ADVANTAGES

History of Global Sukuk Development

Sukuk, the plural form of Sakk, is an Arabic word that can be easily traced to classical commercial Islamic literature and that was generally used for international trade in Muslim areas in the Middle Ages. Traders used the term in those days to refer to a document that shows financial obligations arising from trading ventures and other commercial activities. However, several Western scholars in the Middle Ages concluded that the word *sakk* is from the Latin "cheque" or "check" used in contemporary banking (Huda 2008).

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) officially defines Sukuk as "certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or in the ownership of the assets of particular projects or special investment activity" (Latham & Watkins 2014). Sukuk pertains to the provision of financing that has ownership of real assets with a return system originating from these assets. This is different from conventional bonds where investors have debt instruments that produce returns dominated by interest payments. Under Sharia law, imposing additional interest or excess is not allowed (Lai, Rethel & Steiner 2017).

The issuance of the first global Sukuk in the international financial markets was encouraged by the Islamic Jurisprudence Council, which issued a fatwa to support Sukuk development. This prompted the Bahrain Monetary Authority, that is, the Bahrain Monetary Agency, to issue a 91-day Sukuk with a value of $25 million in 2001. Malaysia followed in the same year, issuing global corporals of Sukuk in international Islamic financial markets (Haerisma 2005).

Sukuk distribution in various countries follows a relatively fast process because it is considered more stable and based on the real sector, thus providing a sense of security because of its higher resistance to crises. After the 2008 economic crisis, governments and private sectors in various countries began issuing Sukuk in various currencies, allowing them to reach broader investors. Different countries have also started using Sukuk to finance their government projects. Global Sukuk issuance from January 2001 to December 2016 was valued at $181,725 billion, with Sukuk distribution implemented in 22 countries in Asia, the Middle East, Africa, and Europe. The largest Sukuk are still dominated by Middle Eastern countries, which constitute $109,203 billion or 60% of the total outstanding Sukuk (International Islamic Financial Market 2017).

Operational Model of Sukuk

Sukuk has terms of return with definite and predetermined periods. These can range from 3 months to 10 years. Sukuk operational schemes are usually based on a sale-and-purchase agreement but can also be based on a lease with a return value that has been agreed upon since the beginning of the agreement, without additional interest imposition (Aquil 2005).

An often used Sukuk model for short-term financing is the "sales by order" Sukuk (Salam). This accommodates sales transactions where the buyer determines the payment term, and the delivery of the asset is determined by the sale. The transaction period is usually only three months. Figure 1 shows the operational model of a "sales by order" Sukuk transaction.