

Islamic Banking in Turkey Facts, Figures and Prospects

(Sayfa 74-81)

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Abstract

Muslim world, who suffered from colonization policies of capitalist western world, tried to build development policies complied with Islamic sharia. That was the main derive behind interest free Islamic banking model. Therefore Islamic banking is based on Quran, Sunnah and moral bases of Islamic ethics. Islamic banking has historical roots in Egypt and Saudi Arabia. Turkey has first Islamic banks after 1980's with Turkish politician and Prime Minister Turgut Özal. He changed official banking rules and regulations for this purpose. However, the main paradigm change in Islamic banking in Turkey was after 2002 with ruling AKP government. They founded main legal framework for participation banks and encourage conservative business community. This paper explains current facts about participation banks of Turkey. In the end, the potential of Turkish economy and prospects for Islamic banking system in country discussed.

Keywords: Turkish economy, Islamic banks, participation banks in Turkey

1. Introduction

Post world war period of 1950's with new independent Muslim countries and failure of capitalist model in economic development in periphery world, lead Islamic scholars a new Islamic economics paradigm. It is obvious that the philosophical foundations of Islamic economics is entirely different than capitalism and socialism in ethical background. In particular, postcolonial Muslim countries partook in the first struggle to figure out how to build an economic system that would comply with the Quran and Sunnah, the ontological sources of Islam. In this approach, there is an understanding of an alternative system which addresses not only the aspects overtly mandated or prohibited by Islam – e.g. zakah and riba – but also the basic principles and values that embrace society at large (Özdemir & Aslan, 2018).

The philosophical and conceptual foundations or the axioms of the Islamic economic system are as follows (Asutay, 2007): First, the axiom of Tawhid (God's unity and sovereignty): Tawhid, as the essential part of this economic system, provides for freedom of action whereby each individual is viewed as an integral part of the whole. Secondly, the axiom of Al-'adl wa'l-ihsan (Equilibrium and Beneficence or Socio-Economic Justice). In this intra-and inter-generational equality, human beings and societies are expected to establish a balance between the needs of present and future generations, develop policies to fulfil the needs of individuals, enable them to earn a respectable source of living, develop policies for an equitable distribution of wealth and provide for growth and stability-oriented policies. Third, the axiom of Ikhtiyar (Free-will): In the Islamic economic systemic understanding, humans are believed to be endowed with free-will. This, thus, constitutes functional norms of economic activity in Islamic economic system. Fourth, the axiom of Fard (Responsibility): This axiom states that although 'responsibility' is voluntary, individuals and society must recognize their mutual obligations for public good, which stems from the principle of Tawhid and, hence, of humanity's vicegerency on earth. Hence, in economic terms, there is a social aspect and responsibility of every asset owned or managed by private or public entities. Fifth, the axiom of Rububiyyah: This implies the necessity of sustainable economic growth and development in terms of having harmony between various components of economic and social life. It is expected that within this balanced and sustainable environment as defined by Qur'anic principles that human efforts take place. Sixth, the

axiom of Tazkiyah, in the Islamic economics axiom, is “concerned with growth towards perfection through purification of attitudes and relationships” This principle refers to growing in harmony in every aspect of life.⁴ “The result of tazkiyah is [therefore] falah, prosperity in this world and the hereafter” . Seventh, the axiom of Khilafah and human accountability before God: Thus, being a vicegerent on earth defines roles, outlines responsibilities and provides the reasons of existence for the individual. Thus, the implications of the principle of khilafah include the notion of universal solidarity, sustainable consumption of resources, which are trust from God, pursuing a humble lifestyle and having human freedoms to conduct daily life. Lastly, the Maqasid al-Shari’ah or the objectives of Shari’ah provides the legal-rationale framework within which Islamic economic activities should be conducted. This final principle aims to interpret the text and restore the principles of Islamic economics in relation to the objective.

2. Development and Operation of Islamic Banking

The struggle to find a suitable compromise between the demands of modernity and the demands of Islam is under way throughout the Islamic world, forced Muslim business environments alternative ways of banking (AIMS, 2019).

Islamic banking, also known as non-interest banking, is a banking system that is based on the principles of Islamic or Sharia law and guided by Islamic economics. Two fundamental principles of Islamic banking are the sharing of profit and loss, and the prohibition of the collection and payment of interest by lenders and investors. Islamic law prohibits collecting interest or "riba" (Tarver, 2019). Modern Islamic banking is a new development compared to Western banking. The first Islamic bank, was introduced in 1963 in Egypt by young scholar aiming to prevent financial loses of poor farmers. In 1974, the Organization of Islamic Countries (OIC) had established the first Islamic bank called the Islamic Development Bank or IDB. The basic business model of this bank was to provide financial assistance and support on profit sharing.

By the end of 1970, several Islamic banking systems have been established through out the Muslim world, including the first private commercial bank in Dubai(1975), the Bahrain Islamic bank(1979) and the Faisal Islamic bank of Sudan (1977) (Islamic Banker, 2016).

The main and important models of Islamic banking system can defined shortly as follows. **Murabaha** is the sale on the profit which is mutually agreed by both parties. Murabaha is actually a request which is set by the client to the Islamic bank to leverage certain services or goods for him and in return, the bank provides a definite profit to the client over the cost of the services or goods. **Ijarah** is the contract or the legal right against a lawful or a specified return for the effort or work which is proposed to be expended and for the benefits that are proposed to be taken. **Musawamah** is the regular or general sales of goods in which the price of the goods or commodity is bargained between the buyer and the seller.

The ground of Islamic finance based on preservation of wealth, ownership and property rights which leads to economic and social justice. Then prohibition of interest (riba) and reduction risk asymmetry (gharar) enables both parties to share risks occurred in business transactions.

⁴ Mehmet Asutay used most of the academic writings of Khurshid Ahmad (b. 23 March 1932) PhD, DSc, NI, is a Pakistani economist, philosopher, politician, and an Islamic activist who helped to develop Islamic economic jurisprudence as an academic discipline. His main academic writings are: Ahmad, K. 1979. Economic Development in an Islamic Framework. Leicester: Islamic Foundation. Ahmad, K. 1980. "Economic Development in an Islamic Framework," in K. Ahmad and Z. Ishaq Ansari (eds.), Islamic Perspectives: Studies in Honour of Mawlana Sayyid Abul A'la Mawdudi. Leicester and Jeddah: Islamic Foundation and Saudi Publishing House. Ahmad, K. 1994. Islamic Approach to Development: Some Policy Implications. Islamabad: Institute of Policy Studies. Ahmad, K. 2003. "The Challenge of Global Capitalism," in J. H. Dunning (ed.), Making Globalization Good: The Moral Challenges of Global Capitalism. Oxford: Oxford University Press

Theoretical foundations of Islamic Financial System

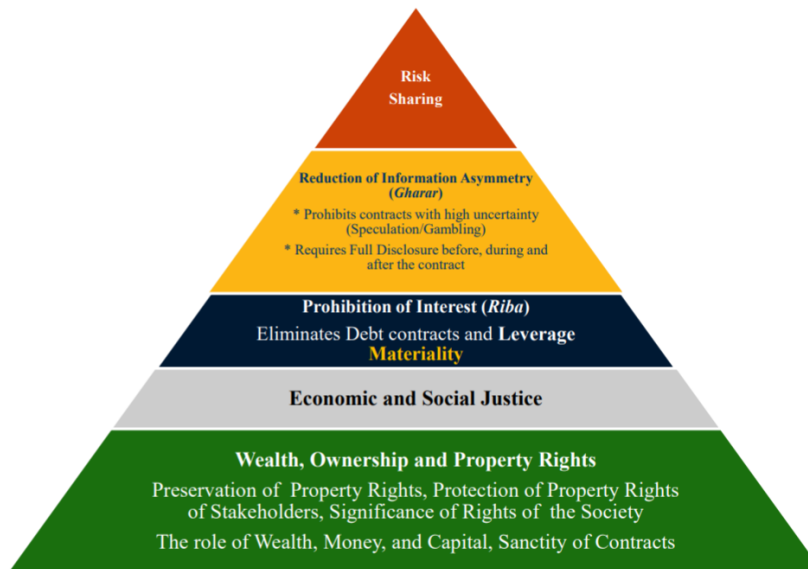


Figure 1. Theoretical Foundations of Islamic Financial System (Iqbal, 2017)

The Holy Qur'an, ijihad and sunnas follow all actions in all stages of Islamic banking due to the nature. Therefore, both the depositor and bank share the loss or profit rather than accepting risks by the deposits. That enable both parties to share output fairly as indicated in Islamic norms. One of the best positive sides of this banking is that it is not concentrating on the repayment of loans or interests, rather, it depends on worthiness and how much profitable will be the project. Since there is a low uncertainty, the risk of bankruptcy is not as high as it is expected in conventional banking. The pillars of economic and social justice can be achieved by elimination of risks in banking operations. Thus not only lender but also creditors share the risk of failure in business. The core balance sheet contents assets and liabilities in standart banking operations are quite similar in Islamic banking .

Islamic Financial Intermediation (Banking)

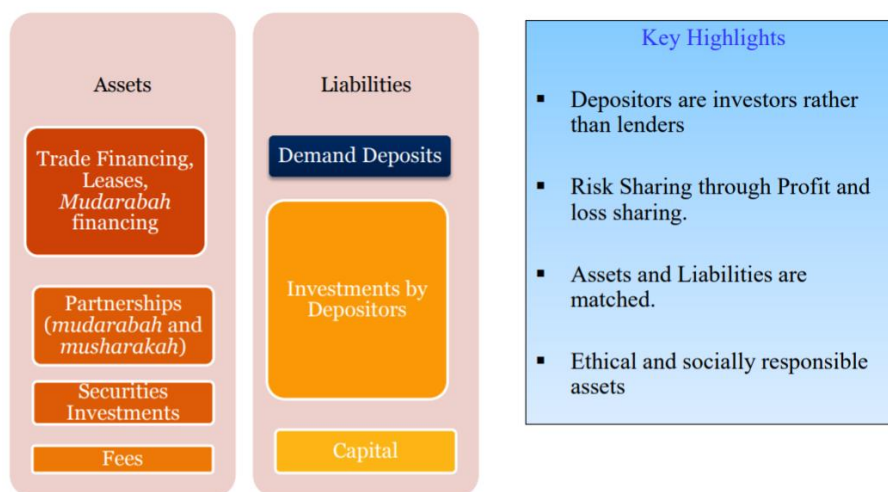


Figure 2. Islamic Banking Intermediation (Iqbal, 2017)

There is increasing trend in global Islamic banking both in Muslim and non-Muslim world. There are even some western banks founded Islamic banks to attract financial capital from those Islamic segments of society. Besides Islamic religious preferences discrimination and alienation of Muslims in western world increased financial flow to those banks. Meantime some countries such as Iran isolated and marginalized from international financial systems such as SWIFT, that in turn increased their Islamic banking operations. According to assets size Iran and Saudi Arabia are the highest in global context.

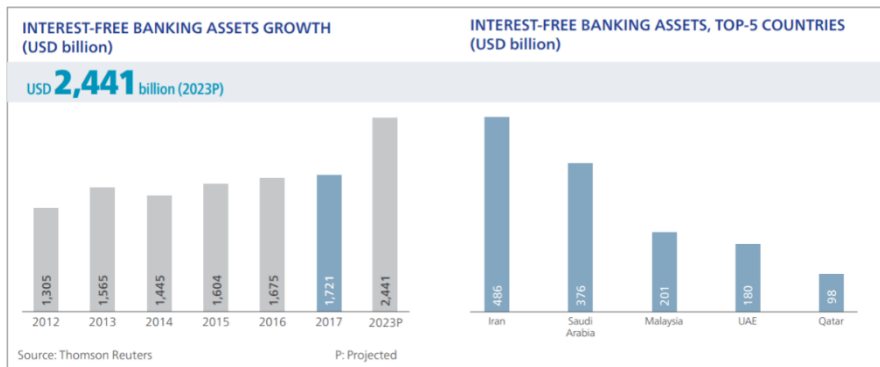


Figure 3. Islamic Banking Growth (TKBB, 2019)

Even if there are many advantages of Islamic banking, there are some challenges in implementing them. Since this banking started organize globally nearly few decades ago, there is weak competitive environment, which creates low efficiency. Improving in technology leads to efficient operations and to adopted. Bu it is obvious that non-conventional banking is operated based on Shari'a rules, new products can be adopted if Shari'a scholars approve them (Göncüoğlu, Karaahmetoğlu, & Uysal, 2014).

3. The History of Islamic Banking in Turkey

The origin of Islamic banking in Turkey goes back to 1985, when the legislation about interest-free banking was passed by the government of Prime Minister Turgut Özal. Up until then “under the pillow” idle funds were not brought in the economy because of hesitations of public about interest. Even though the origins of interest-free banking is too old, international Islamic banking in experience of Turkey today's sense was brought into the agenda in 1973, with the initiative and support of Saudi Arabia Faisal bin Abdulaziz Al Saud, Islamic Development Bank where Turkey is one of the 43 founding members.

First conservative political party National Salvation Party (MSP) had political agenda of Islamic banking in 1970's in coalition governments with Republican People's Party (CHP). The first institution based on profit-loss participation principle was DESİYAB (State Industry and Workers Mutual Bank-(Tr)- Devlet Sanayi ve İşçi Yatırım Bankası) under the aim of transfer the savings of workers in Europe to investments. After Turgut Özal era in 1980's non-interest banking came to the agenda again when the Mainland Party (ANAP) came into the power. Therefore, Özal prepared the ground for the establishment of Islamic Finance Houses by enacting a decree numbered 83/7506 on 16.12.1983. In short, Islamic finance institutions were allowed to be established under the name of “Special Finance Houses” in 1983. The main was to canalize under-the-mattress savings of conservative Muslims to Turkish financial system. Despite the fact that Islamic finance institutions were not quite popular in Turkish banking sector. In 19 December 1999 their establishment and organizations were tied to banking law with 4491 numbered law in Banks Act No. 4389. In 2005, Special Finance Houses were completely integrated into the Banks Act and equalized with other depository and investment institutions by denotation as Participation Banks.

Following AKP era, the regulatory framework for participation banking enhanced with special provisions. Participation Banks Association of Turkey founded in order give priority to those institutions with the article 81 of Banking Law No.5411 in 2006. Main duties of association are as follows (TKBB, 2020):

- a. To ensure the development of the banking profession,
- b. To ensure that members function in a dignified and well-disciplined manner as required by the banking profession and in line with the needs of the economy, by setting professional principles,
- c. To set the ethical professional principles and standards that the personnel of member banks will have to abide by, upon receiving the approval of the Agency,
- d. To monitor the enforcement of the decisions taken pursuant to the applicable legislation as well as the measures required to be taken by the Agency,
- e. To take and implement any measure required for preventing unfair competition among members,
- f. To set the principles and conditions for announcements and advertisements in terms of type, format, qualitative and quantitative elements to be complied by the members, upon receiving the approval of the Agency,
- g. To ensure cooperation among banks for joint projects, in collaboration with the Agency,
- e. To file lawsuits on the basis of board of directors' decision on matters that relate to the common interests of their members,
- i. To set the principles and procedures applicable to contract format and contents envisaged by the provisions regarding customer rights,
- j. To set up a board of arbitrators within the framework of the principles and procedures to be prepared thereby and approved by the Board, in order to evaluate and settle the disputes between the members and their individual clients, with the reservation of their rights to legal application pursuant to the Law No. 4077 regarding the Protection of Consumer Rights and other laws.

BorsIstanbul, the main financial exchange in Turkey also has quotations on participation banks equities. Bizim Securities Inc. and calculations by Istanbul Stock Exchange launched participation Index (its index code is KATLM) on 6 January 2011 with the sponsorship of all four Participation Banks, index consultancy.

4. The Share of Participation Banks in Turkish Financial System

The share of Islamic banking was about around 2% in Turkish banking sector until the 2002. Following the implementation of new targets and programs for participation banks there is a slight movement in this sector. Even if Turkey's population is over 90 percent Muslim, the share of participation banks, in the Turkish banking sector, stands at 5 percent today (Özdemir & Aslan, 2018).

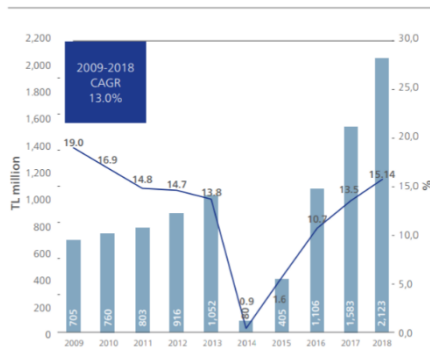
YEARS	Participation Banks (million liras)	Annual Growth (%)	Banking Sector (million liras)	Participation Banks Sector Share (%)
2000	2.266		106.549	2,1
2001	2.365	4,4	218.873	1,1
2002	3.962	67,5	212.681	1,9
PERFORMANCE OF PARTICIPATION BANKING SECTOR DURING THE AK PARTY GOVERNMENTS				
2003	5.113	29,1	249.688	2,0
2004	7.299	42,8	306.439	2,4
2005	9.945	36,3	406.909	2,4
2006	13.752	38,3	499.731	2,8
2007	19.445	41,4	581.606	3,3
2008	25.770	32,5	732.536	3,5
2009	33.628	30,5	834.014	4,0
2010	43.339	28,9	1.006.667	4,3
2011	56.148	29,6	1.217.695	4,6
2012	70.279	25,2	1.370.690	5,1
2013	96.075	36,7	1.732.401	5,5
2014	104.319	8,6	1.994.329	5,2
2015	120.183	15,2	2.357.432	5,1
2016	132.874	10,6	2.730.943	4,9

Source: PRAT and BRSA December 2016 Interactive Bulletin

Table 1. Participation Banks in Banking Sector in Turkey

Empirical research findings reveals the insufficient growth of participation banking sector in Turkey (Egresi & Belge, 2017). As of 2018, five participation banks were operating in Turkey - Albaraka Türk, Kuveyt Türk, Türkiye Finans, Ziraat Participation and Vakıf Participation. Emlak Participation Bank also joined these banks in 2019. They work with partnership methods such as the labor-capital partnership (mudarabah), profit-loss partnership (musharakah) and investment agency (wakalah).

DEVELOPMENT OF NET PROFIT OF PARTICIPATION BANKS



DEVELOPMENT OF BRANCHES AND STAFF OF PARTICIPATION BANKS

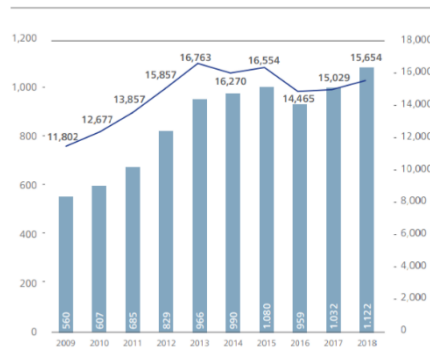


Figure 4. Development of Participation Banks (TKBB, 2019)

The effect of the long period of secularism effects bank selection patterns of citizens, which in turn create low level of deposits in those banks. Even though participation banks have grown faster than conventional banks over the last decade, conventional banks are more widespread, more visible and more convenient to use.

Same research findings reveals that religion plays a limited role in bank selection in Turkey. On the other side findings of a questionnaire to the members of five associations of conservative businessmen (MÜSİAD, TUSKON, ASKON and TÜMSİAD) shows that they aim to have more tendency to prefer participation banking (Savaşan, Saraç, & Gürdal, 2013).

The ratio analyses in comparison of participation banks with whole banking sector reveal some facts that ROAA's of those banks is a bit lower than whole sector. The comparison is as follows according to Participation Banks Association of Turkey yearly report.

Description	Participation Banks			Banking Sector		
	2018	2017	2016	2018	2017	2016
Non-Performing Loans (Gross)/Total Cash Loans (%)	4.14	3.22	3.90	3.9	3.0	3.2
Provisions for Non-Performing Loans/Non-Performing Loans (Gross) (%)	63.30	70.75	62.10	68.3	79.4	77.4
Large Deposits (TL 1 million and Above)/Total Deposits (%)	45.49	41.38	37.70	54.5	53.2	53.3
Profit/Loss Before Tax/Average Total Assets (ROAA) (%)	1.48	1.36	1.10	1.8	2.0	1.9
Net Profit/Loss/Average Shareholders' Equity (ROAE) (%)	15.14	13.50	0.90	14.7	16.0	14.3
Net Profit Share Income/Loss/Average Total Assets (%)	3.57	3.52	3.30	3.9	3.8	3.6
Fees, Commissions and Banking Services Income/Average Total Assets (%)	1.02	1.03	1.10	1.3	1.2	1.2
Fees, Commission and Banking Services Income/Total Income (%)	8.96	10.73	12.42	10.1	11.8	12.1
Operational Expenses/Average Total Assets (%)	2.05	2.17	2.20	1.7	1.8	1.9
Income Other Than Profit Share/Expenses Other Than Profit Share (%)	99.33	97.13	96.00	98.3	97.2	98.9
Fees and Commissions Income/Operational Expenses (%)	49.62	47.61	49.90	78.2	67.3	63.6
Average Total Assets/Average Number of Employees (TL thousand)	12.280	9.845	8.531	17.937	14.306	11.760
Deposits/Average Number of Employees (TL thousand)	8.890	7.131	5.767	9.769	8.148	6.833
Profit/Loss Before Tax/Average Number of Employees (TL thousand)	181.21	113.59	96.77	315	292	222
Deposits/Number of Branches (TL thousand)	127,417	105,928	88,116	175,849	146,392	121,452
Loans/Number of Branches (TL thousand)	113,829	106,219	90,292	215,471	185,307	150,088
Number of Employees/Number of Branches (Person)	14	15	15	18	18	18
Total Cash Loans/Deposits (%)	89.3	100.3	102.4	122.6	126.6	123.6
Total Securities Portfolio/Deposits (%)	11.1	12.3	12.8	23.5	23.5	24.2
Demand Deposits/Total Deposits (%)	32.8	30.5	28.4	21.3	21.2	20.3
Shareholders' Equity/Total Risk-Weighted Items (Capital Adequacy Standard Ratio) (%)	15.8	17.0	16.2	17.3	16.9	15.6
Liabilities/Shareholders' Equity (%)	1,121.11	1,058.7	1,043.1	809.07	791.0	793.8

Table 2. Participation Banks vs Banking Sector Comparison between Selected Ratios (TKBB, 2019)

Since participation banks has relatively small share in Turkish banking sector and there are handful of participation banks in the sector, comparison of regular banks with and participation banks would not give relevant results. At this stage, they play a complementary role in Turkish financial system.

5. Prospects for Participation Banks in Turkey

Islamic banking is also becoming popular in western countries. There are some banks following Islamic rules in most of the European countries. The main aim was to attract Muslim minority funds to financial system. In that case Turkey has overwhelming advantages in that context.

It is a given that the geographical location provides Turkey with important advantages. Turkey is within just a 4-hour flight distance to 1.5 billion people and to an economy of over 20 trillion, from the Fjords to the Red Sea, and from the Urals to Gibraltar. Many global giants have chosen Turkey as their production and management base due to this position of Turkey. Turkey has become a regional power and an important center of attraction. The logistics industry, which will be supported with the increased investment in the railway networks, will maintain its growth for many years, when Turkey's geographical advantages are also considered. Turkey's location, which is an important trade and energy bridge connecting East and West, will gain further importance in world economy in the future, when China's project of reviving the historic Silk Road is also considered (Turkey Discover Potential, 2019).

Turkey is a splendid country full of God's blessings that located both in Asia and in Europe as a bridge between different continents. Due to the geographical conditions, the prospects of Turkey to become Islamic banking and finance hub is very high, with different financial, economic and other regional issues in emerging Islamic finance centers. Turkish Banking and Financial industry have a big influence in regional financial markets in central Asia and Balkan countries. Meantime the increasing number of Muslim minorities in European Union may flourish Turkish Islamic banking and finance image to grow in Europe. Many UAE and KSA based Islamic financial institution already have good footprints in Turkey with having good investment in diversified sectors especially in real estate. All such figures and geographical facts led us to be convinced over to a fact that Turkey would be the hub of Islamic banking and Finance in near future (Mughal, 2019).

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