

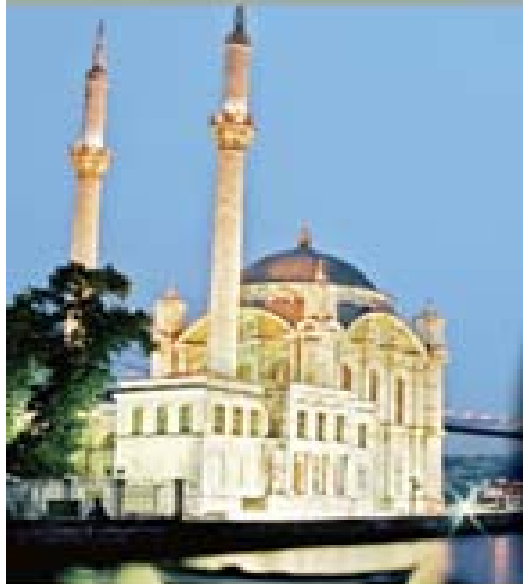
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**The Impact of Politics on the
Underdevelopment of Islamic Banking
in Turkey**

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I. Introduction

- The first Islamic bank, or as it was coined as Special Finance Houses, in Turkey was established in 1985 during the former PM Ozal.
- That financial institution was given the status of 'special finance house' to distinguish it from conventional banks operating in Turkey.
- This was done with the objective of also not disturbing the ideological sensibilities of the prevailing financial establishment with the use of 'Islamic' as a descriptive label, despite the fact that it functioned with Islamic compliant products.
- The initiation of Islamic banks in Turkey was largely influenced by the economic and financial reforms pursued by PM Ozal.



II. Evolution of Islamic Banking in Turkey: Changes and Continuity

- 1985, establishment of Special Finance Houses;
- 1999, after collapse of the Ihlas Special Finance House and also due to the new regulations introduced into the financial sector, Special Finance Houses were brought under the umbrella of the banking sector by extending the existing and the new regulations to the Special Finance Houses;
- An important landmark is the changes brought up in 2005: the name of Special Finance Houses was changed to Participatory Banks.



III. Trends and Developments in Islamic Banks in Turkey

- During the last twenty years, the growth and development of Islamic finance in Turkey has been slower in comparison to the Gulf and South East Asian countries.
- With a population exceeding seventy million and about 60% urbanisation rate, four 'Islamic compliant' (or participation banks, with the new regulative changes) financial institutions is a clear indicator of this sluggish growth.
- Thus, it is difficult to state that Islamic finance has reached its potential in Turkey, which is the largest economy in the Muslim world in terms of national income.



3.1. Share of Islamic banking and finance in dual banking systems:

Malaysia 10.4%,

Kuwait 22%,

Egypt 17%,

Bahrain 8.4%,

Turkey 2.6%

Indonesia 1.34%

Pakistan 2%

Note: Indonesia opened its financial system to Islamic banking in mid-1990s, while operations of Islamic finance began in 2003 in the case of Pakistan.

3.2. Role of Participatory Banks in Turkey's Banking System

	Place of Participation Banks in Bank Assets (%)	Place of Participation Banks in Funds Raised by Banks (%)
1995	2.1%	2.4%
2000	2.2%	2.7%
2001	1.1%	1.3%
2002	1.9%	0.8%
2003	2.0%	2.8%
2004	2.4%	3.0%
2005	2.5%	3.3%
2006	2.8%	3.6%
2007	3.46%	4.19%
2008 /06	3.65%	4.55%

The role of or the share of Participation Banks in the banking system remains to be significantly low and even negligible.



Role of Participatory Banks in Turkey's Banking System

Loans to Deposit Ratios

Years	Conventional Banks (%)	Participatory Banks (%)
1995	65	97
2000	50	93
2001	39	56
2002	40	66
2003	42	75
2004	47	82
2005	59	88
2006	68	93
2007	77	103
2008	80	104

Role of Participatory Banks in Turkey's Banking System



Trends in the Staff Number and Branches of Participatory Banks

	No. of Staff	Growth in No. of Staff (%)	No of Branches	Growth in No. of Branches (%)
1985			2	
1990			19	850.0
1995			60	215.8
1996	1,493	22.4	56	-6.7
1997	1,828	2.9	83	48.2
1998	1,881	-0.3	87	4.8
1999	1,876	16.3	86	-1.1
2000	2,182	-10.0	109	26.7
2001	1,964	28.8	115	5.5
2002	2,530	38.5	148	28.7
2003	3,504	36.7	188	27.0
2004	4,791	20.0	256	36.2
2005	5,749	23.7	290	13.3
2006	7,114	22.1	355	22.4
2007	9,215	30.0	422	19.0
2008/08	10,711	16	483	14.0

Source: Turkish Association of Participation Banks (TKBB)

3.3. Efficiency Analysis of Participatory Banks in Turkey



The participation banks have performed better than the conventional banks in terms of assets and funds raised and also provide higher credit to real economy than the conventional banks as indicated by loan-to-deposit-ratio.

- See: Alpay and Hassan (2006) investigated the comparative inefficiency of conventional and participatory banks in Turkey for 1990-2000 period, who found participatory banks more cost and revenue efficient; and hence in a way lesser inefficient.
- See: El-Gamal and Inanoglu (2005) investigated the relative efficiencies in the Turkish banking sector by including the participation banks for the period of 1990-2000. Their findings demonstrate that participatory banks scored well by ranking at the top in the domestic bank group, which included forty banks.

IV. Political Attitudes and Islamic Banks in Turkey

- Comparing Islamic banks with the conventional banks in Turkey, reveal similar performance and efficiency.
- Therefore, the slow growth should be explained by exogenous factors rather than the internal dynamics of these banks.
- Until recently, the inability of the Turkish governments to continue with the financial reforms should be counted among such external adverse factors.
- Developments in Islamic finance require a mindset that understands the importance of resource creation and efficient use of the resources rather than having political priorities in resource creation and allocation.
- Clearly, the external working environment in Turkey does not possess this financial mindset and its corresponding political attitudes undermine economic and financial choices.
- In order to understand the slow growth of Islamic banking and finance in Turkey, one must analyse the political attitudes of Turkish governments following the late



PM Ozal in 1980s, the bureaucracy and the conventional financial and banking sector. Thus, rather than the internal dynamics of the Participatory Banks, external working environment has to be questioned.


- The prevailing political attitude in Turkey since the establishment of 'Islamic' banking institutions, characterised these institutions as 'second class'. More clearly, prevalent perceptions of Islamic banking and finance throughout the external working environment viewed Islamic compliant banks as secondary due to their staunch secular political culture.
- The staunch secularists position in Turkey, therefore, constantly made ideological objections to any attempt to nurture Islamic banking and finance.
- As an extension of such a negative attitude, for instance a derogatory term '*yesil sermaye*' or green capital was coined over the years to describe funds emanating from Islamic banks and religiously conservative sections of the society.



- However, as a heterogeneous product of conventional financial sector, Islamic banking and finance is no longer associated with the value system imposed on it during its initial years. Evidently, the large surge towards Islamic finance in Europe, in particular the UK, substantiates this claim.
- It is, therefore, difficult to expect Islamic financial institutions in Turkey to use their dynamics in a successful manner within such a working environment. In other words, under such a working environment, Islamic finance institutions have always worked with ‘hesitance’ or ‘timidity’.
- The following statements from the documents provided in the Association for Participatory Banks website provide evidence for the mentioned hesitance:
 - “not an alternative, but an integral component of Turkish banking sector”;



- “a third type of banking, together with depository banks and development and investment banks”; and
- participatory bank is “not a political but socio-economic reality”.
- Such messages aim at politically not to disturb the establishment and to prevent adverse perceptions. Such a hesitant attitude can also be seen in lack of representation from Turkish Islamic financial institutions in the international networking conferences all over the world.
- However, with recent regulative changes, the status of the Islamic financial houses has been raised to ‘participatory banks’, which is expected to alleviate ‘second class’ feelings.

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- This has immediately showed positive results as some of these participatory banks adopted dynamic approaches, through enhanced self-confidence, towards development and growth.
 - With this new status, the role and functions of Islamic financial houses are clearer for ordinary individuals and the business sector.
 - These regulative changes have improved the status of these institutions in the sight of the public, as they began to see them as part of the banking system, which provide 'normal' banking services. Thus, this has increased the trust to these banks, as previous concepts did not make much sense to ordinary people in terms of the functions of these institutions.

V. Mis-constructed Views on Islamic Finance in Turkey

There have been a small number of papers investigating the political sources of Islamic banking developments in Turkey:

- Jang, Ji-Hyang (2003): “The Politics of Islamic Banks in Turkey: Taming Political Islamists by Islamic Capital”;
- Baskan, Filiz (2004): “The Political Economy of Islamic Finance in Turkey: The Role of Fethullah Gulen and Asya Finans”.
- Rubin, Michael (2005): “Green Money, Islamist Politics in Turkey”;
- Demiralp, Seda (2006): “The Rise of Islamic Capital and the Decline of Islamic Radicalism in Turkey”;



- These studies look into the development of Islamic banking through a political perspectives by claiming that Islamic banking developments in a results of Islamic political identity formation; and therefore they claim that developments in the sector have contributed to softening Islamic identity politics in recent years.
- Some of these studies conducted locational analysis to establish correlations in the stronghold of religiously conservative locations and the expansion of Islamic banking branches.
- However, these studies have been constructed around particular perceptions rather than providing an in-depth understanding.
- For instance, initially when the Special Finance Houses were established quite number of Islamic groups and individual Muslims were very much sceptical about the Islamicity of these institutions.



- Secondly, if the developments in Islamic finance were to be explained by the expansion of political Islam through Welfare Party of Erbakan in 1990s and the current governments of AKP since 2002, then just about 3.6% of the role of participation banks is rather perplexing, as such political developments should have resulted in an extensive expansion of these banks.



VI. Turkish Islamic Behavioural Norms

- It is important to note that individuals mostly respond to economic incentives rather than economic incentives (Timur Kuran);
- This is particularly the case in modern societies; and hence in Turkey as compare to other Muslim societies and communities;
- Because, in Turkey, religion is mostly experienced as cultural rather than political or legalistically oriented due to the extensive changes in the political culture since the formation of the new republic in 1923;
- Therefore, the discussion on Anatolian Calvinism and the relative ease and acceptance with this notion provides evidence for this statement.
- In other words, Turkish Islam is mostly devotional rather than *fiqh* oriented. Therefore, there has been less awareness and acknowledgement on economic and financial perspectives of Islam in Turkish society.




VII. European Futures

- It is hoped that EU accession process will bring about a great deal of changes in Turkish political culture by relaxing its 'straight jacket' and liberalising political area, which will complement the liberalisation in economy and financial sectors since 1980s.
- Such changes is hoped to bring a positive changes for Islamic finance and banking in particular as well.
- As, the EU accession process will create further opportunity spaces for the developments of Islamic banking and finance in Turkey by relaxing the political culture.



VIII. Conclusion: Progress – From Islamic Banking to Islamic Finance

- Future prospects of Islamic banking in Turkey will be brighter if the political environment abandons the perception of Islamic finance as a political agenda.
- Such perception is no longer valid considering the involvement of the Western countries in its growth and development.
- In addition, Turkey needs foreign capital and Islamic finance has the potential to bring such foreign capital. Expansion in Islamic finance will also help to channel the savings of Islamically orientated individuals at home and abroad into such banks.
- While the recent government's regulative provisions has contributed to the development of Islamic finance in recent years, it should be encouraged to undertake further expansionary policies and attract more Islamic finance into country.

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- In concluding, the potential for Islamic finance in Turkey is immense. With the right strategies, not only will more people move towards Islamic finance, which has positively occurred in other parts of the Muslim world, but more investors will utilise the services provided by such banks.

Thank you.