Two track development

Mehmet Asutay ponders the future of Islamic banking in Turkey

The first Islamic bank in Turkey was established in 1985 during Halil Turgut Özal, the former prime minister's premiership. That financial institution was given the status of 'special finance house' to distinguish it from conventional banks operating in Turkey. Such a name was given with the objective of not disturbing the ideological sensibilities of the political establishment with the use of 'Islamic' as a descriptive label, despite the fact that it functioned with Shari'ah compliant products. Only in 2006, with regulatory change, was their status enhanced to 'participation banks', which are still not recognised as full banks.

Photo: Ali Riza Demir

ARAB LINKS

The creation of Islamic banking in Turkey was largely influenced by the economic and financial reforms pursued by Ozal. His close links with the Arabic world enabled him to see the remarkable potential of Islamic banking in terms of bringing hidden capital to the capital markets; markets which traditionally excluded many Muslims because of its basis on Riba.

Over the last 20 years, the growth and development of Islamic finance in Turkey has been slow. With a population exceeding 70 million and a 60 per cent urbanisation rate, having only four participation banks is a clear indicator of its sluggish growth. Notwithstanding that, comparative growth over the years, for instance in terms of number of branches has been remarkable, from two branches in 1985 to 368 in 2007. Islamic finance still remains a long way from reaching its potential in Turkey, which is the largest economy in the Muslim world in terms of GNP

In order to understand the slow growth of Islamic finance in Turkey, one must analyse the political attitudes of Turkish governments, the bureaucracy and the conventional financial and banking sector following Ozal's administration. The negative prevailing political attitude in Turkey since the establishment of Islamic banking institutions characterised these institutions as second class. More clearly, prevalent perceptions throughout the external working environment viewed Shari'ah compliant banks as a politically incorrect issue due to their radical secularist attitude. This strong ideological perspective prevented an acceptance of Islamic finance as another means of resource and wealth creation. The establishment, therefore, constantly made ideological objections to any attempt to nurture Islamic banking and finance. As an extension of such a negative attitude, they coined the derogatory term 'yeşil sermaye' or 'green capital' to describe the funds emanating from Islamic banks. Interestingly, such a narrow attitude has not only been expressed by politicians and policy makers but also by professional financiers.

It may be true that the initial impulse towards Islamic banking and finance in the world can be attributed to Islamic identity construction after 1980s, however, the current nature of Islamic banking and finance indicates that it is no longer a political or identity project but rather another means to make money. The large surge towards Islamic finance in Europe, in particular the UK, substantiates the claim that Islamic banking and finance is part of the international capitalist system and works within that framework.

POLITICAL ATTITUDES

Comparing Islamic banks with conventional banks in Turkey reveals similar performance and efficiency. Therefore, slow growth can be explained by external reasons rather than the internal dynamics of the banks. Clearly, the external working environment in Turkey does not possess this financial mindset and its corresponding political attitudes to understand the role of Islamic finance and the benefits of its enormous growth. For instance the UK government acknowledged the importance of developing Islamic finance, while emphasising the importance of attracting international Islamic finance institutions to its economy. It is terribly difficult to see that same political ingenuity from Turkish policy circles.

It is, therefore, difficult to expect Islamic financial institutions in Turkey to be successful in such a working environment. In other words, under the old secularist system, Islamic finance institutions have always worked with hesitance or timidity. However, recent regulatory changes and the enhanced status of being participation banks should alleviate the second class feelings. This has immediately showed positive results as some of these participation banks adopted self-confident plans of development and growth. Following Bank Asya, Albaraka is considering listing on the Istanbul Stock Exchange.

The role and functions of Islamic financial houses are now clearer to ordinary individuals and the business sector. These regulatory 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, providing normal banking services. This has increased the trust to these banks, as previous names did not make much sense to ordinary people in terms of their functions.

FINANCIAL APPROACH

The future prospects of Islamic banking in Turkey will be brighter if the political environment adopts a financial approach towards Islamic finance rather than a political perception. In addition, Turkey needs foreign capital, and Islamic finance has the potential to bring it. The British government's attitude should be taken as an example and a new financial strategy should be implemented that would benefit from the expanding Islamic global developments. This will also help to channel the savings of religiously-orientated individuals at home and abroad into such banks.

While the current government's regulatory provisions have 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. Having a specialist in the new cabinet who is in charge of the coordination of the economy, and also having some of the state owned banks now run by chief executives transferred from participation banks, it is expected that a more positive environment will be provided.

Strategies should be developed by Islamic banks to overcome the ideological divide in the country and derogatory labelling such as 'green capital' should be targeted with positive attitudes on the side of the Islamic finance. They should be more visible in every day life of people to contribute to the expansion of the sector.

Due to the regulatory environment and the political will associated with it, Turkey has not been able to issue a sovereign Sukuk, which will provide an additional capacity to the need of foreign capital. Thus, once the regulatory framework is provided, Sukuk will have great potential in Turkey, which can attract long-term investment financing, for instance, in infrastructure from international financial world.

An important area where Islamic finance can be promising is real estate and housing finance. The recent regulatory change towards mortgages in Turkey provides a golden opportunity for local as well as global Islamic banks and financial institutions to benefit. The growing urban population and population growth rate has led to a rising demand for housing.

LOW VISIBILITY

In most Muslim countries as well as western countries such as the UK, there are large numbers of financial institutions involved in Islamic financing through fund management and investments. However, such financial activities are not visible enough in Turkey. This is an indication that Islamic banking rather than Islamic financing is the prevailing concept in Turkey. This provides another important opportunity in Turkey for global financial institutions specialised in Islamic finance.

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 also more investors will utilise the services provided by such banks. In order to fulfil this potential, these banks need to open up and create links with the international financial markets in general and the global Islamic finance sector in particular, provided that a positive working environment is provided for them. For instance, participation banks can provide a largely untapped financial market to the excess capital accumulated in the Gulf in recent years. The recent interest from Gulf Islamic finance institutions looking to penetrate the Turkish market is a clear indication of this opportunity, which will contribute to the development and growth of Islamic finance in Turkey.

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