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Importance of the Diversification of Interest-Free Financial Products and Interest-Free Banking from the Turkish Perspective

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ABSTRACT*: With the entrance of interest-free banking system to the Turkish banking sector in 1984, this system started to finance the reel sector. Already in its current state, this system presents banking services to customers while seeking its needs and also growing in the meantime. Development of the interest-free financial tools along the potential that came with this growth is inevitable. As interest-free financial products are relatively strong against speculations, manipulations and their funding probabilities are more flexible, there is an increased demand for them.*

Global Islamic Finance Development Center that World Bank opened in Istanbul is a support for Turkey's policy of becoming a financial center for interest-free financial products. In our country, interest-free banking and usage of interest-free financial products has not been an alternative for Turkish Banking System. Instead, it became a supplement for the system.

In recent years, the companies and individuals that show sensitivity in interest related gain has a higher economic development rate. The result of integrating this value to the economic system is the increase in the number of interest-free banks. Also, Gulf region and Asian countries are orienting towards interest-free financial products that they can safely invest their disposition surplus. Regarding this need, Capital Markets Board is making important regulations continuously in interest-free finance.

KEYWORDS*: Interest-Free Banking, Interest-Free Financial Products, Capital Markets Board*

I. INTRODUCTION

There are religious, economic and political reasons behind the formation of no-interest or Islamic finance. One of them being the desire to process the savings of the Muslim population, which do not enter the bank deposit system, as the interest is forbidden in religion. Another reason is to regenerate the social, cultural and economic relations between Islamic countries, alongside achieving fund transfer from these countries who have them in abundant to those who have not. Additionally, the funds that were collected in appropriate conditions aid the economic development of countries. As a result, no-interest banking has emerged as an alternative to conventional finance. The interest in this sector has been increasing, not only in Islamic countries, but also in highly-developed western countries like USA, England and Germany. No-interest finance transactions are taking part in banking, debts, stock-exchanges, house loans, risk capital transactions, derivations and insurances and almost all areas of finance.

Islamic banking, which started around the late 1940s, provided its first products in Egypt Myt-Gamr, in 1963. Many no-interest banks were established around the world after that successful example. Islamic Development Bank and Dar Al-Maal Al-Islam that were established in the Gulf Region are the first modern no-interest banks for no-interest banking operations

First modern no-interest banks in Turkey started operating in the year 1985. At first, they started operating as private finance institutions. Later, as they based their operations on contributing to profit-loss and they started to realize regular banking transactions (in Islamic conventions), they earned the title of participation banks.

The main issue in financial markets is the use of resources effectively and efficiently, towards achieving a determined aim. No-interest finance institutions, unlike regular banking, do not collect funds based on profit/loss and make covenants for the owner of the savings. Instead, the distributed profit can vary as a result of profitability after the fund processing. Another important function of the no-interest finance institutions is to connect Turkey with Islamic countries to enable an increase in external trade and the better process the economic capabilities. Participation banking in Turkey, adds the idle financial sources to the economy in no-interest banking terms. Furthermore, as it develops the relationships between Turkey and Islamic countries, it enables the transfer of goods from oil rich countries. Its capability of preventing off-the-record, with preventing all non-accounted trades, aids the country by increasing the tax income. To give an example; in the purchases of vehicle and residence, Islamic banks require to record the purchase by administrative authorities, thus taking the sales in record. Furthermore, their flexible fund collection policies and trade based financial departments increase their supply to decrease standing credit interest rates. As a result, they increase the value of products, or in other words, expand the national revenue by increasing the number of investors. These Islamic banks passed the major 4 crises in Turkish economy (1990 Gulf crisis, 1994 financial crisis, 1998-1999 South-Eastern Asia crisis and 2001 crisis) with minimal losses and without using community resources.

World economy's crisis after 2008 showed the importance of Islamic finance instruments and thus has increased their usage. Islamic finance, which is a completing element in financial instruments, encourages people that wish to invest in a just, contributive and sharing manner to join the economic system. This in turn creates a sustainable prosperity, due to the increased ease in reaching the financial system.

After the global financial crisis, financial system has been in dispute. Academic studies in this period focused on the elements that make the financial system fragile. As a result of these studies, an increasing number of criticisms have been proposed, such as the increasing complexity of financial institutes that act as a mediator between the advancer and the debtor and making processes at high leverage rates. In this period, no-interest finance model has been influential in both Islamic and non-Islamic countries, as an alternative to conventional finance.

As interest free banking supports profit-loss sharing based production, do not have an interest risk to be affected from crises and have positive effects on the public prosperity, some of the classic banks are interested in and embodied parts of no-interest banking products. As examples, the following famous classical banks created no-interest based units; Citibank, HSBC, Union Bank of Switzerland, Kleinwort Benson, ANZ Grindlays, Goldman Sachs.

As customary in the whole world, interest free banking in Turkey continue their attempts to vary no-interest instruments. However, in contrast to 52 no-interest tools used in the world, very few are being used in Turkey. Most popular of those are "sukuk" and "murabahadir".

To continue the development of Turkish economy, apart from a strong banking sector, capital markets must present alternative financial sources to companies and different investment opportunities to investors. In that respect, Turkey's becoming a cultural center with no-interest finance products is inevitable. Turkey has a high potential in supply and demand due to its regional advantages. Capital Markets Board continues to make regulations on no-interest instrument based retirement funds and no-interest finance in general, to diversify no-interest financial instruments.

II. CONCEPTUAL FRAMEWORK

In Turkey, Islamic Banking that is named as Participation banking is the banking system where people participate in profit and loss and there is no interest involved. This model involves every banking act that agrees with this principal. These banks collect funds from its customers and use these funds as credit to gain profit, which is distributed among its customers. Thus the term “participation” refers to the participation to profit and loss. In the world, this system is labelled as “no-interest” or “Islamic” banking.

Islamic banks offer other services to its customers that are offered by trade banks. Examples include bail letter delivery, foreign currency exchange, all transfers, issuing letter of credit and internet/telephone banking.

Islamic banking system, with its increasing share in financial world, is also being used as an alternative in developed markets, in addition to Islamic countries [1; p. 18]. As the competition increases, banks develop different products to attract customers.

In the literature, no-interest financial products are also referred as “No-interest investment tools” and “Islamic investment tools”. The interest in Islamic banking products is high in international markets. Sukuk (Islamic bond), tekaful (Islamic insurance), risk funds, asset management, risk and liquidity management, immovable and corporate finance are receiving an increased rate of investment.

Islamic banking use private current accounts, participation accounts, cumulative participation accounts and private fund collections as means to collect funds. They use profit-loss partnership (Mudarebe), capital partnership (Muşareke – Risk Capital), ready money purchase – future sale (Murabaha), Teverruk, Leasing (Icara) and blank credit (Karz-I Hasen) as the means of fund usage. In the context of structured finance on the other hand, conversion of the financial product (to a movable property) is included. Insurance based structured tools (disaster bonds, conditioned debts, conditioned movable assets), synthetic short/long position swaps and options, multiple short/long swap connections, guaranteed investment funds, shareholding deed convertible bonds, call option bonds, put option bonds, unbundled bonds could be included in the group of structured financial tools [2; p. 13].

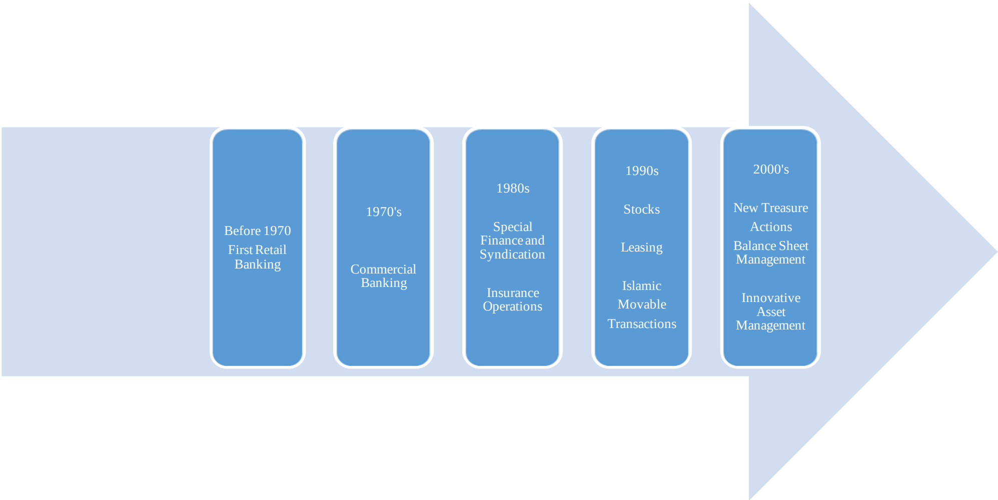
Investors use Islamic forex accounts to gain benefit when making trades, with using local valuing differences in buying and selling. Islamic index and investment funds include making index of publicly available corporations traded in stock exchange that follow Islamic rules, following the movements of these deeds, announcing these to the public with regarding conventions, creating “investment funds” that enable participation to these deeds and other financial operations.

III. DEVELOPMENT OF ISLAMIC BANKING

With the birth and diffusion of Islam, concepts that are included in interest banking like taking debts, partnership are organized and found large application areas. Constructing a bank that bases on profit sharing is first seen in Malesia around 1940s. Again, in 1950s, similar attempts were made in Pakistan. In 1969, Indian-Islamic guild developed a no-interest lendingsystem. First successful experience in modern terms was MitGhamr savings bank, founded in Egypt, 1963 [3; p. 324]. This bank however degraded in the period of 1967 and 1971, resulting a loss of operational independence [4; p.61]. Another important Islamic banking establishment is Islamic Development Bank, founded in 1975. Turkey started to give associates to the board of directions, starting from 1984. Turkey thus gained recognition in this bank which was founded to solve the financial problems of public projects in countries that have Muslim populations. For providing consultancy service to Islamic Banks, in 1977, International Association of Islamic Banking (IAIB) and Islamic Banking and Economy Association in Nicosia, were found [5; p. 12]. In 1990, Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) was founded in Algeria to establish a standard in accounting and auditing among Islamic financial institutions. Islamic Financial Services Board, again participating in Islamic banking system was founded in 2003 to establish universal standards and guide the industry. In principal, they participate in developing Islamic financial services sector (banking, capital market and insurance). Furthermore, International Islamic Liquidity Management Corporation (IILM) was founded to ease liquidity management in times of financial recession, improve the integration of Islamic banks and local and global markets, enable the correct pricing of Islamic products and develop markets.

Islamic finance tools are especially used in Middle East and Southeast Asia, but they attract the attention of the whole world. It spans in United States of America, as well as European countries like England and Germany. The diversification and development of financial tools with respect to the people's needs are important aspects, just like in Figure 1 [6; p. 110].

Figure 1. Changes in Islamic Finance



Source: [6; p. 110].

When we inspect the history of Islamic finance in Turkey, first, Islamic banks are constituted as special finance institutions in 1983. In 1999, they are included in the extent banking law to be fully included in banking law in 2005 to become equal to deposit and investment banks. If we look at the Islamic banks' active capacity as of 2013; Qatar with 9%, Indonesia 4%, Saudi Arabia 43%, Malesia 22%, United Arab Emirates 15% and Turkey 7% are the countries that help the globalization of Islamic banking. As of 2016, 90% of the Islamic banking is represented in Bahrain, Qatar, Indonesia, Saudi Arabia, Malesia, United Arab Emirates, Turkey, Kuwait and Pakistan [7; p. 4].

IV. PURPOSE OF THE STUDY

The emerging point of the study is to determine the enlarging position of Islamic banking and its financial products in world markets. The purpose of this study is to investigate the diversity and importance of no-interest banking products, in Turkey's perspective.

Diversification methods of no-interest financial products are also included in the literature study. Studies that state the importance and ways of wide spreading of no-interest banking and the diversification of its products for Turkey are elaborated. Also, regarding this subject, conferences, news, articles of magazines and newspapers and related constitutions are investigated. During the study, it was observed that no-interest banking system and its tools vary in different countries. There is a potential for Turkey to become a pioneer in no-interest banking. Obtained data on world's Islamic banking assets are based on related data that are publicly available.

V. FINDINGS

While it is possible for the no-interest finance sector to develop drastically, globally, it is still in the early-development phase. For the enlargement and development, universal standards need to be established, as well as products and institutions must be established to compete with their traditional counterparts [8; p. 5]. To respond to the increased world population, no-interest finance is constantly changing – creating a standardization issue, which can only be countered with up-to-date education. This education must be developed by high-tier experts in related financial institutions.

No-interest banks in Turkey use two account types to collect resources, just like Islamic Banks in other countries. First one of them is the “Private Current Accounts” that constitute the no-time limit accounts and second one is the “Participation in Profit and Loss Accounts” that constitute timed accounts. Participation accounts are known as investment accounts in many countries [9; p. 33]. To manage or control the risks in Turkish markets, diversified no-interest financial tools are used. For Turkey to gain a larger share in 2 trillion-dollar Islamic finance market, it has to diversify no-interest financial tools, as Turkey has the potential to be the most important actor in no-interest finance sector. Today, it has the 7% share in Islamic banking sector.

Turkey is possibly going to be the pioneer in designing up-to-date technical aids and consulting services, as well as producing knowledge for the development and spread of Islamic finance – in addition to becoming a center for related knowledge.

VI. CONCLUSION

Islamic banks have significant benefits to the Turkish economy. They enable the circulation of savings that were excluded from standard banking operations. Especially, transfer of money from Gulf region to Turkey is both beneficial to Turkey and Gulf region countries. This banking system also helps to limit off-the-record economy. Working with people that originally did not work with commercial banks enabled these people to do their banking operations – resulting in a limited tax loss. Another benefit of this system is the increase in national income, primarily due to the increase in amount of investors. Finally, these Islamic banks create additional job opportunities. However, no-interest banking instruments that are used in Turkey are far below world averages of regular instruments. Therefore, it is required for us to produce and use no-interest tools that comply with world’s and country’s needs.

Legal arrangements and standardizations can help Turkey to produce a unique no-interest banking application.

Turkey has to produce its own terminologies in no-interest finance. Experts of the topic must conduct university level studies to reach large audiences. Diversification of no-interest tools is a proven must. We must use the potential of Turkey to form a globally acclaimed center by diversifying no-interest financial tools. Many no-interest financial tools are processed in world markets that are not used in Turkey. Some of them include retirement funds, loan certificates, teverruk, muşareke, karz-ıhasen, tefakül, selemisticrar, menafaa, müsaveme and musakaat – which seem possible to be used in Turkish no-interest institutions. As a result, no-interest financial institutions must take their customers into account, who are in different needs that of conventional banking, when developing products.

Islamic economy investigates the judgements of daily economical production, goods and money exchange whereas economy investigates general rules and planning of these exchanges with considering these lodgments’ transfer to investments. Turkey also needs to have thorough studies in these contents.

In international scale, no-interest finance must be controlled to prevent a loss of publicity. Especially, circumstances of accordance to AAOIFI and IFSB standards must be arranged. In global scale, for financial tools to be exported, IIRA grading alongside exports is important to designate the risks of such tools.

No-interest financial audit is also very important for no-interest financial products’ life-cycle. Audit is principal for partners' product launches and security of incoming terms.

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