

BANKING SYSTEM AND ECONOMIC DEVELOPMENT, THE CASE OF TURKIYE

Professor Dr. Sabahaddin Zaim, Dean

Faculty of Economics and Administration, Sakarya University, Turkey

I - INTRODUCTION:

The function of banking system in economic development.

The emergence of Islamic Economics and Islamic Banking.

Banking system, channelling the savings to investment on one side, and functioning as an intermediary in economic and commercial transactions on the other side, and dealing with the monetary policy has an important function in economic development. Banking sector is the backbone of the internal and international economic relations. For this reason, if banking sector fulfills its duties they become the main guiding instrument of economic development. But as we may observe in many developing countries they may even become as hindrance for development, and causes the disturbance of the division of national income, if they don't fulfill their functions as it should be.

In analysis of the functions of the banking sector they may be classified as public and private Banks, central Bank has an important place in the banking sector. Because, as the bank of banks, central bank, may regulate both the banking and monetary policy of the country. Up to the third quarter of the 20 th century, the concept of interest was the main instrument of the banking sector.

Islamic world, after having political independence, following the second world

war, has found two ways to follow for their economic development. Some of them followed either the root of capitalism, or socialism, or made a mixture out of them, for their economic policy pattern. But neither of them could succeeded.

After 1970's, due to the petroleum production some of the Muslim countries became rich. At the end of 1969, by the establishment of OIC, reawakening of the Islamic World, which had started with the foundation of Pakistan, gained a momentum.

Islamic banking has started officialy in 1976 with Islamic Development Bank related to oic in Jeddah and accepted internationally which was the conclusion of previously quarter century evolution of Islamic economics and Islamic finance institutions in th world.

IDB, which was established by the member countries of OIC, has started to function according to Islamic principles based on interest - free system. Later, according to this model different member countries, adopted Islamic banking system in two different models:

a - To establish the whole banking and financial system according to the model of Islamic economics, in context of an islamic society and islamic state, leaving aside the previous secular system, based on capitalist or socialist ideologies. Iran, Pakistan and partly Sudan adopted this model. b - preserving the current secular system, based on capitalist or socalist ideologis, adopting a gradual evolutionary strategy through establishment of Islamic institutions, and particularly Islamic finance institutions, individually.

The rest of the member countries of OIC, have adopted this second model. We should confess that in both models the islamic banking has not been improved successfully as it is intended and desired.

The main problem of the Islamic banking, in the first model is that, Islamic banking and financial institutions is a part of the model of Islamic economics. The behaviour of the people and society, composed of muslim men, the composition and function of the Islamic state, the total components and the general structure

of the economic life, which should be oriented according to the spirit of Islam are the main concomitance of the Islamic banking, which should be operated in such an environment.

In Islamic countries, which adopted the first model, the Islamic banking and financial institutions, which have been established, couldn't be surrounded with and integrated in such an environment.

The harmonisation and synchronization of the particular units, like Islamic bankings, with the totality of Islamic society, e.g. the social, political and economic order, organisation of state, Legal structure, behaviour of the people etc. couldn't be achieved.

In the second model, the Islamic banking and financial institutions, which were surrounded with an alien environment, could only survived, operating with their marginal functions.

There are some difficulties and deficiencies in the evolution process of Islamic banking, attributable to both models:

1 - The imperfection of a unified explanation of theoretical model of Islamic society and Islamic economics by current scholars, particularly among fuqaha and economists.

2 - As the most important factor, imperfection of the model of muslim man in practice, both qualitatively and quantitatively.

3 - Deficiencies, attributable both to managers, and lay - man in practice of the principles of Islamic economics in the field of Islamic banking and financial institutions.

4 - The lack of political will of the governors of the member countries (states), which reduces the speed of the Islamic evolution.

5 - The change of the political structure of the world, emergence of the so-called new - world order, and acceptance of Islam as a target under the slogan of fundamentalism by the West, and the disintegration of the Islamic world.

Under those conditions, Islamic banking institutions, after a particular

improvement in national and international level, slowed down.

But it seems to me that, in spite of all these discouraging factors, the Islamic reawakening, and return to the sources of muslim societies, shortly reemergence of Islam in the whole world is formidable.

At the beginning of this year, the problem of Islamic banking and economics were discussed in an International Conference, which was organized by private foundations in Ankara, turkiye(2), this time with the initiation of the Central Bank of the Islamic republic of Iran, the discussion of the problems of Islamic banking in the context of economic development, is an action of appreciation on the one hand, and the evidence of the continuing dynamism of the Islamic movement generally and Islamic banking particularly, which is mentioned above, on the other hand.

II - Influence of Islamic banking institutions on economic development:

the key factors may be summarised as follows:

1 - The main peculiarity of the Islamic banking and finance institution is Mudarab. By this function, an Islamic bank, joining to the risk of business, decreases the financial risk of the enterprise, compared to the riba - banking. Especially, during the increase of interest - rate and financial risk, mudaraba system encourages the investment - inclination of entrepreneur, and effects positively on economic development.

It is argued that: a) The uncertainty of profit in Mudaraba and b) the increase of project - evaluation expenses may discourages the investor(3). But there is no enough evidence in practice, to justify such misgivings. The increase of expenses in project - evaluation as a negative factor in micro - level, may be compensated by the increase of the productivity and profitability, as a positive factor in macro - level.

2 - the behaviour of the manager of Islamic bank, and entrepreneur, and depositor in economic life should be different in an Islamically oriented society,

compared to the secular ones.(6)

3 - the target of an Islamic bank should be to encourage the development - from below, by stimulating the saving capacity of small - savers, and guiding them through the institutions organized in community development, towards Islamic banks. The development process should be spreaded in the bottom of the society, instead of being satisfied with the relations of a limited number of rich people with Islamic banks.

4 - Islamic banking, as a method of project evaluation, may shift from traditional investment - project - planning to more successful program - planning. Since strategic - investment - program - planning is strongly oriented towards the bank's (companies') external environment, there will be need not just investment research, but particularly for more sophisticated investment - program - research. It needs multi - disciplinary approach to the investment process.(6)

5 - We need to improve the interrelations and cooperation among the Islamic banks in national and international levels. IDB and International Association of Islamic Banks should assume more responsibility on this field.

6 - IDB should also have responsibility, in bringing together the private and public capital resources in member countries and acting as an intermediary organisation, channeling them to the investment in the developing countries. Different local Islamic banks can be channelled through IDB for infrastructural and institutional development or for technical assistance.

7 - One of the roles of the Islamic banks in the Islamic capital markets, is to direct the fund's, generated by Islamic financial instruments to the productive investments.(8)

III - The effects of the Islamic banking on economic development of Turkiye:

If we take Turkiye, as an example of the second model of the Islamic banking, we may observe that the effect of the Islamic banks on economic development, is not

very influential. The reasons are as follows:

1 - Islamic banking has been improving in Turkiye on the line of the second model. According to the Decree, No 83/7506, dated 16-12-1983, regarding the foundation of private Financial Corporations, opportunity has been given to establish riba-free bank. Later with the amendments made in 1984 and in 25-2-1985, the legal structure had been finalized.

According to their legislation, "they collect funds, in addition to their capital, for allocation of funds to economy by means of private current accounts and those accounts giving the right of participation to loss and profit from foreign countries and native country, and, may according to the methods to be designed in notifications, make these funds available for the financing of all agricultural and commercial operations and services; for joint ventures; for the issue of letter of guarantees to abroad; for the financing of export and import, as well as supply of equipment related to investments, and offer the same for sale or lease to firms by instalments."

"Any real or legal persons, other than those authorised pursuant to this decision or its private codes, may not accept funds or make them available by essentially or secondarily acquiring it a profession."

These institutions do not function according to the Turkish Banking Law. Because, all financial institutions in Turkiye which are called Bank, are riba - banks. These new institutions which are called Private Finance House, have been authorized to collect funds, based on riba - free model and operates through participation to profit and loss system.

Up to now, four privat Finance House (PFH) have been established; three of them have native and international mixed capital (Faisal - Finance, Al-Baraka-Finance and Kuveyt-Turk evkaf Finance) and one has only native capital (Anadolu - Finance). PFH, has authority to operate like other Islamic banks in the world. Generally all the collected funds are classified under two categories as; current accounts and participating Accounts, like in other Islamic banks. PFH may

utilize these funds under the contracts of:

- a - Murabaha (providing riba - free fund for production or consumption),
- b - participation to profit and loss,
- c - Leasing,
- d - Providing fund for commodity based on documents.

The most important function of PFH is to attract the funds of the faithful muslims to the economy, which were idle, because of interest. Later, the other people have deposited their funds to the PFH, because of higher - returns expectation. PFH, although improved rapidly, and starting from zero, acquired a very high percentage of growth, still they have a very modest share in the total deposits of banking in Turkiye. (in 1993 % 2.96).

only about 8% of deposits are in current accounts, and the rest in participating account.

In utilization of funds, almost more than 90% of the funds are directed through contract of murabaha to the commercial and industrial sector (mostly in textile). During the last two years, some funds are invested in industrial sector through easing contract, Mudaraba contract, which should be the essential part of the activities of PFH, almost not exist.

The main reason may be explained as follows:

- 1 - There is a high chronic inflation in Turkiye since 15 years. Before Islamic banks, the people had two alternatives of investments to keep the real value of their assets: a) real estate, b) Bank - interest, c) Foreign exchange.

(During Ozal, time, selling and buying of foreign exchange, and deposit of it in and out of Turkiye became free. Interest rate also is left to the market.)

After joning of PFH into the financial market, two more alternatives were provided to the saver: a) To deposit their saving in to PFH on riba - free model, or b) To buy participating Shares based on profit and loss for a particular period of public investments like tall - bridge, tall - ways, dams etc., sold by the treasury. There is competition among the return of real estate, bank interest, and foreign

exchange in financial market. when the riba free financial instruments joined to the market, they had to compete with the previous ones. It means that PFH, had to provide higher return to attract the funds, therefore instead of channelling the deposited funds into the industrial investment, providing long run returns, they preferred to utilize the funds in the commercial market, to get immediately higher returns, through murabaha contracts.

Another reason is that, the majority of the participating accounts are deposited in foreign exchange (Because of high inflation, saver prefer to keep their assets in foreign exchange). the percentage of foreign exchange, raised to 72.6 % in 1992, and to 77.4 % in 1993.

PFH has to provide returns to the depositors in the same currency what they had deposited. There fore, PFH has to utilize such funds in foreign trade, through export and import.

Finally, we can say that, PFH has a positive contribution to the economy by attracting the idle funds and utilize them mainly in commercial sector and particularly in foreign trade. But as the total fund, attracted by the PFH, is only 3 % of the total deposits of the banking sector, they have no capacity to guide the direction of the economy. And the funds which are collected by the PFH are not utilized in industrial investment.

Although the PFH in Turkiye is gradually improving, they have a marginal effect on the economic development, which is the current subject of our conference. In the other member countries of OIC, which follow the second model, the case, seems so far similar.

The evaluation of mudaraba function of Islamic banking system, may only possible in an Islamic state, where the total banking system operate in riba - free system, which is mentioned as the first model. therefore we have to evaluate the banking system of the follower of the first model, e.g. Iran and Pakistan. Up to now, the current data as far as we know, have not been enough for a sound evaluation on this subject. We hope that InshaAllah, the papers, which will be submitted in this

conference will enlighten us.

Finally I would like to express my gratitude and congratulations to the Central Bank of the Islamic Republic of Iran, for organizing such an interesting and fruitful conference for Muslim Ummah, and also wish and pray to Almighty God (ALLAH) that, Islamic Republic of Iran may contribute successfully in the field of Islamic Banking.

Wallahu a'lam