

FROM CASH *WAQFS* TO STATE OWNED PARTICIPATION BANKS: THE BRIEF HISTORY OF ISLAMIC FINANCE IN OTTOMAN EMPIRE AND MODERN TURKEY

Mücahit ÖZDEMİR

Department of Islamic Economics and Finance
Institute of Social Science, Sakarya University, Turkey

Öznur ÖZDEMİR

Department of Islamic History
Theology Faculty, Sakarya University, Turkey

Abstract

Throughout the history of Ottoman Empire, it is known that the early cash *waqfs* were in the period of Murad II and Mehmet II. Some technical terms which are used in modern Islamic Banking (this type of banking model is named as Participation Banking -PB- in Turkey) are seen in the written sources related with the cash *waqfs*. This situation can be evaluated as a sign for that cash *waqfs* and PBs were structured on the same basis. Cash *waqfs* were founded exactly for the purpose of social welfare, however PBs are kind of commercial institutions and not established as charities. At the same time PBs are not exactly different from cash *waqfs*, they also operate in line with the interest free principle of Islam. On the other hand, establishment of state owned PBs is able to serve in parallel with cash *waqfs*. In this article, the history of Islamic Finance in Ottoman Empire and modern Turkey will be described by defining applications of cash *waqfs* and the current PBs. The paper will also present that how the Islamic finance applications have changed from cash *waqfs* to state owned PBs within six century by giving chronological outline. At the end of the article, possible similarities between state PBs and cash *waqfs* will be discussed and some suggestions will be presented to current Islamic financial institutions.

Key Words: Cash Waqfs, Turkey, Islamic Banking, Participation Banking

Introduction

One of the significant issue for entrepreneur is to reach capital. Especially for small ones, it is so difficult to get funding to realize their business plans. They have to show collateral, possess deep experience, good track record etc. to obtain sufficient funds from financial institutions such as banks. One way in solving this problem is venture capital system which has been used for many years in Western countries. However, in Muslim population majority countries especially due to the limitations of Islam, finding money as “*halal*” is difficult. Islam does not allow Muslim entrepreneurs to take fund from interest based institution for their business. This limitation has been tried to be solved in Muslim countries by Islamic Banking System. However, some methods of Islamic Banks are very close to other Banks and mimics their products. Muslim entrepreneur or basically a buyer have some hesitates about Islamic banks. For this reason, too many problems are waiting to be solved in Islamic Finance systems. Exploring historical experiences would be beneficial to suggest alternative interest free model or product to nowadays Islamic finance institutions. We can find applications parallel to today’s Islamic finance models in history such as *cash waqfs*. Ottoman Empire as Islamic state applied many systems through cash waqfs. The experience of cash waqfs in Ottoman Empire and Islamic banking history in modern Turkey are going to be discuss in this article.

History and Applications of Cash Waqfs in Ottoman Empire

Waqf is Arabic word and means to stoppage, immobilization, or preserve. In the Islamic point of view, waqf can be defined as religious endowments of assets voluntarily for the benefit of society with expecting award from only God. Waqf asset have to be used only in line with the corpus which is statement of endower about how and which ways the assets have to be used. Waqf is perpetual until principle disappears and cannot be donated as a gift, inherited or sold. For this reason it differs from donations.

Waqfs were also so important for the continuation of the social system in the Ottoman Empire. Wide range of waqfs were founded and served in very specific areas from economic and social. For example, it is seen that Ottomans founded waqfs not only for the benefit of people but even for animals such as some waqfs were responsible for the problems of burial birds.

Apart from real estate assets, cash can also be endowed for waqf. The endowed capital of the waqf was extended to borrowers and after exact maturity such as one year, paid back to

waqf with principle plus profit. This money was used and spent for social purposes of waqf. There were many active cash waqfs in most of the cities in Ottoman Empire such as in Istanbul and Bursa, etc.

Absolute date of the first cash waqfs in Ottoman Empire have not been known and according to some researchers, first known samples of cash waqfs is in the period of Murat II and Mehmet II, mainly by the beginning of 15th century. The most famous example which is known as cash waqf is devoted 24.000 gold dinars to be used for subsidy of meats which were given to *Yeniçeri* soldiers. (Döndüren, 2008, p. 4) Afterwards, the importance and ratio of cash waqfs within waqf system of Empire increased. *Tahrir records* of Istanbul waqfs in first half of 16th (Barkan & Ayverdi, 1970) shows that total share of cash ones is around half of the total operating waqfs.

Cash waqfs were used intensively for financial needs of the society in line with the interest free principle. Capital in the cash waqfs were lent to people in various ways. We can find these methods from waqf censuses (*Tahrir records*). A typical eighteenth century waqf censuses contains some information as; the name of waqf and trustee, purpose of the *waqf*, the capital amount, returns from the investment, the names of the borrowers and their borrowed amount of capital and some other details about borrowers. (Çizakça, 1995, p. 323)

The funds collected in cash waqfs had to be managed according to the conditions of endowments. The main methods used in the operations of the funds are as follows;

1. ***Mudaraba***: Profit/loss partnership,
2. ***Murabaha***: Getting profit by buying asset with waqf money and selling it with mark-up,
3. ***Bida'a***: Operating waqf money for charity and giving the entire profit to waqf,
4. ***Mu'amele-i Şer'iyye / bey'ul-îyne***: Cash waqf gives requested amount of money with also selling one –insignificant- asset (such as dress, book etc.) by adding profit on it in deferred payment. The aim behind this method was to meet the cash need of the borrower within the framework of Islamic jurisprudence and to gain profit from this transaction for waqf.
5. ***Qard al-hasan***: Only the return of the principled is required during the maturity of the loan and it is an interest free. (Izadyar & Ragnath, 2013, p. 45)
6. ***Istiğlal***: Borrower sells his/her property (real estate or movables) to waqf for getting cash money and hires this property for certain period. Property is passed back into

the ownership of the borrower after paying back all his/her debt to cash waqf. (Kurt, 2010, p. 180)

In any case, the legitimacy of cash waqfs has been discussed through history. The first author of *risala* related with this topic is Ibn Kemal (d.1533). He defends the legitimacy of cash waqfs. Then, the famous figure in Ottoman, Ebussuud (d.1574) shares same opinions with Ibn Kemal. On the other hand the important figure who opposed to these two scholars is Birgivi (d.1573). (Özcan, 2010) The continuity of cash waqfs was endured despite these discussions. Because cash waqfs have number of advantages to the real estate waqfs in terms of functionality and endowment of cash. These superiorities are as follows:

1. To be an alternative to usury which charges high interest rates,
 2. To play an important role of the transaction (profit/loss) rates of cash waqfs in determining credit cost and stability of credit market.
 3. To provide opportunity for people who cannot endow real estate for charity.
- (Özcan, 2010, p.130)

We have seen that cash waqfs were active from 15th to 20th century in Ottoman Empire. With the collapse of the Empire in the 20th century, cash waqfs have been also tried to be positioned in the founded new republic. After the establishment of *Evkaf Nezareti*, significant part of the waqfs have been passed to administration and control of the *Nezaret*. New units were founded such as *Terakat ve Nukud-u Mevkufe Kalemi* for directly management of cash waqfs within *Nezaret* in the period of *II. Meşrutiyet*.

Some attempts have been made for setting up a new bank by evaluation of cash waqfs and some land belongs to cash waqfs by *Evkaf Nezareti* in the early 20th century. However, this attempt was left half-finished due to the beginning of the war in 1914. With the foundation new republic, total money which was transferred to Şeriyye and *Evkaf* mandate was 321,989 lira. Also, according to the report dated 1937 stated that *Vakıf Paralar Müdürlüğü* had 444,180 waqf money in its control. Foundation of new "*Evqaf Emlak Bank*" has been discussed after this date however unfortunately this attempt also has not been succeed. But "*Türkiye Vakıflar Bankası*" was established in 1954 with 50,000,000 by obtaining its majority capital from cash waqfs. 1,069 number of cash waqfs composed significant portion of paid capital according to some advertisements of this Bank. (Özcan, 2010, p. 145-147)

History of Participation Banking (Islamic Banking) in Turkey

New republic of Turkey was founded in 1923 with the collapsed of Ottoman Empire (1299-1923) and governmental model of new state was also changed from Islamic based to secular. For this reason, Islamic financial institutions such as cash waqfs were replaced with modern conventional banking models. Thanks to the loosening in local political atmosphere and new developments in abroad in terms of interest free banking models, Devlet Sanayi İşçi Yatırım Bankası (DESIYAB) was established in 1975. Aim of this new institution was to evaluate deposits of people and canalize this money to Small-Medium Enterprises in line with the interest-free principle. DESIYAB is seen as the first step in interest-free finance field in some researches. This institution has continued operations until 1978 and provided very significant experience for Islamic finance in Turkey (Bulut & Er, 2012, pp. 24-25).

According to most researches, history of the Islamic banking in Turkey goes back to 1983 with the Decree 83/7506 of Council of Ministers and the decision published in the Official Gazette on 25th, February 1984. Based on this legislation first interest free financial institution were established and legislation named them not Islamic Banks but as Special Finance Institutions (SFIs) because of the secular structure of the state. Permission for establishment of interest-free SFIs was criticized by secular groups within the country because they were thinking that it was not fitting to secular country. Also some conventional bankers negatively evaluated these institutions although they did not see them as competitor exactly (Baldwin, 1990, p. 38). Albaraka Turk and Faisal Finance have become operational at first in 1985. Afterwards, Kuwait Turk (1989), Anatolia finance (1991), Ihlas Finance (1995), and finally Asya Finance (1996) has been established.

The name of SFIs has led to some misunderstandings in either domestic or also abroad, which cause these institutions to be exposed to some different procedures. These institutions do many operations as other banks, however in accordance with the principle of interest-free. International banking and foreign exchange services were also provided by them. However, SFIs was taken the category of non-bank financial institutions by some correspondent foreign banks due to the lack of bank word in the titles of them. This situation caused that the customers who make export and import over the SFIs could not do business with correspondent banks of these countries. This attitude prevailed all along even when it became a necessity to redefine the SFHs as PBs by nullifying SFH Communiqué issued in 1983 integrating the SFHs as PBs into the Banking Law reinstated in 2005 which brought

about radical changes in the banking industry. The new Banking Law 2005 eliminated the problem of misunderstanding especially in international banking operations about the PBs along with some other difficulties that these banks were facing.

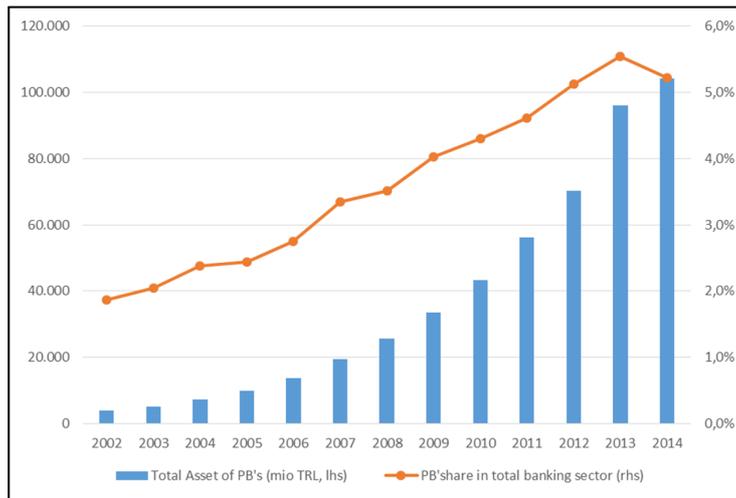
Banking system of Turkey consists of three banking models which are deposit, investment/development and participation (Islamic) banks. There are four participation banks (PBs) now operate in Turkey which are Albaraka Turk, Kuveyt Turk, Bank Asya and Türkiye Finans and their consolidated summary financial positions were stated here below by comparing with the other banking groups:

Table 1: Turkish Banking Sector (as of year-end 2014)

Bank Type	Number of Banks	Total Assets		Collected Funds (Deposit)		Funded Credits (Loan)	
		mio TRL	Share (%)	mio TRL	Share (%)	mio TRL	Share (%)
Deposit Banks	34	1,805,427	90.5	987,463	93.8	1,118,887	90,2
Participation Banks	4	104,163	5.2	65,230	6.2	64,065	5.2
Investment & Development Banks	13	84,570	4.2	0	0	57,756	4.7
Total	51	1,994,160	100.0	1,052,693	100.0	1,240,708	100.0

Source: Data compiled from Banking Regulation and Supervision Agency (BRSA)

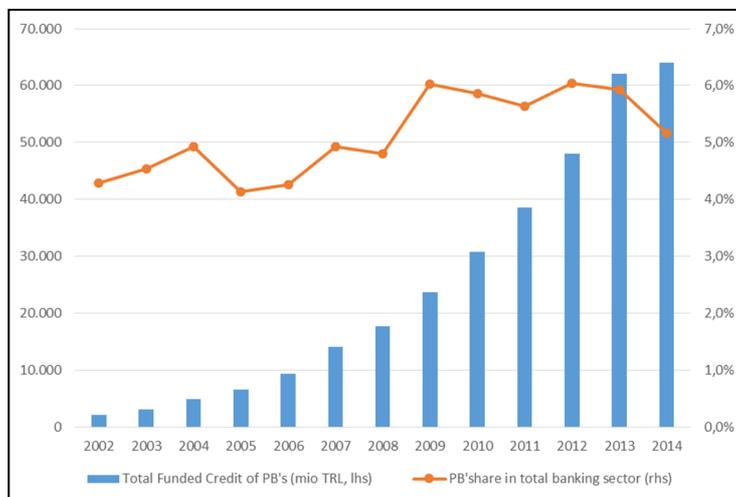
PB's has shown very good growth performance in recent years especially at last ten years. They increased their share in total banking sector and reached to 5.2% at the end of 2014 in terms of total asset (Graph 1). At the same period, the size of assets reached TRL 104 million with an increase in the 8% compared to the end of previous year. While compounded annual growth rate (CAGR) of PB between 2002 and 2014 is 29%, this figure is 18% for total banking sector. It is also be noted for asset share and the forthcoming figures, one of the PBs Bank Asya have faced with some political and management problems started with at the end of 2013 and total assets and other main items of this bank shrank more than 50%. For this reason, total share of PBs in some figures as of 2014 does not show exact performance and trend.



Graph 1: Total asset size and market share of PBs

Source: Data compiled from Participation Banks Association of Turkey (PBAT), BRSA

Funded credits constitutes the large portion of the total assets because of the availability of limited sharia compliant securities to be invested by PBs. The share of funded credits is ~70%. The total amount of funded credits at the year-end 2014 increased to TRL 64 billion. Share of the PBs in total banking sector was 2.2% in 2002 and increased to 6.2% in 2014 in terms of total funded credit (Graph 2). CAGR of total credits of PBs between 2002 and 2014 is 30% which is above the banking sector (29%).

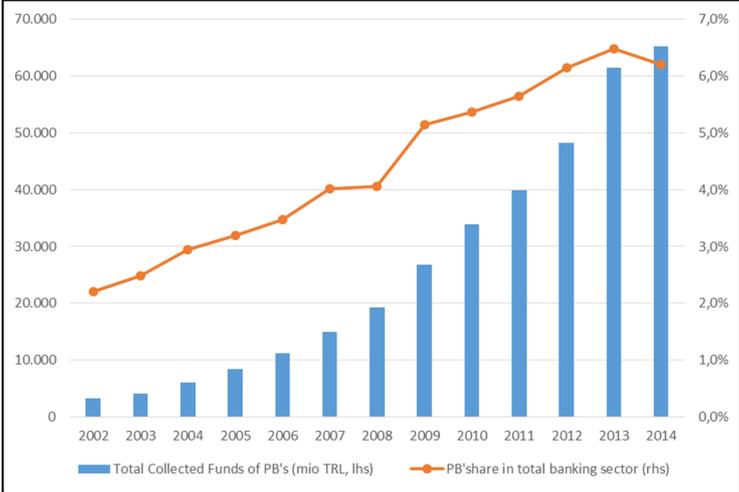


Graph 2: Total funded credit size and market share of PBs

Source: Data compiled from PBAT, BRSA

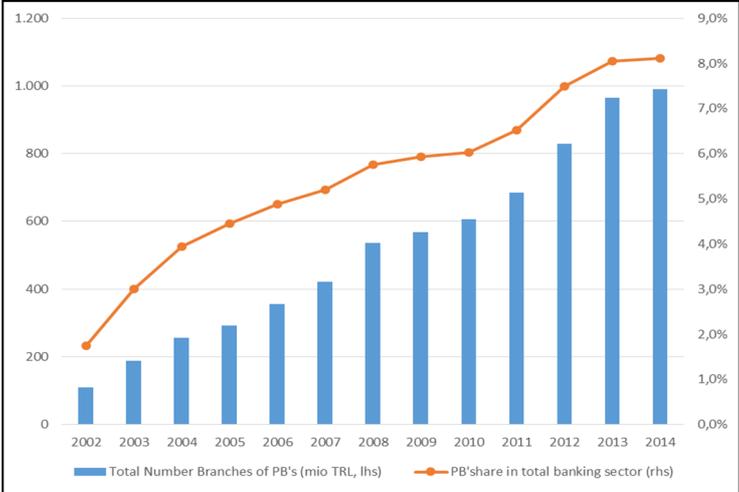
PB's collected deposits in two ways which are special current accounts and participation accounts (profit and loss sharing). Current accounts is same as conventional banks and does not provide any return to the deposit holders. However, participation accounts is different and does not guarantee any return to account holders contrary to the banks. PB extends this funds to credit customer and get return in monthly installment. After

that process share profit/loss with accountholders in agreed profit/loss sharing ratio. The amount of funds collected in participation banks at the year-end 2014 increased 6% and reached to TRL 65 billion. PB's share in the total banking sector was 2.2% in 2002, increased to 6.2% in terms of collected funds at the same period.



Graph 3: Total collected funds size and market share of PBs
Source: Data compiled from PBAT, BRSA

Branch penetration of PBs expands in line with the growth of the balance sheet. PBs mainly focus on the main cities of Turkey especially Istanbul and Ankara. In recent years, they have started to open new branches in other cities of Anatolia but still there are not PBs branch available in some cities. PBs have to be increased their branches especially the places where there is no PB branch exist in order to continue to balance sheet growth. While there was only 110 branches in 2002, the number of branches reached 990 at the end of 2014. Total market share of PBs in terms of branch number is 8.1% at the same period.



Graph 4: Total number of branches and market share of PBs
Source: Data compiled from PBAT, BRSA

Conclusion

With the help of the change of the political climate as well as the growing economy, PBs also blossomed and increased their market share to over 5%, which was around 1% until the 2000s. However, considering the potential for this type of banking in Turkey (~95% Muslim population), the current market share is also considered very low. This is a serious concern that prompts the Turkish government to invest further into this sector through some state-owned banking conglomerates in order to achieve the target of more than %10 share for this banking model by 2023 within the context of the strategic plan that aims to turn Istanbul into one of the leading world financial centers. New three state owned PBs (names are Ziraat PB, Halk PB and Vakıf PB) are expected to be operative at the end of 2015. Cofounder shareholders of the Vakıf (Waqf) Participation Bank are General Directorate for Waqfs, Bayezid Han-ı Sani (II. Bayezit) Waqf, Mahmud Han-ı Evvel bin Mustafa Han (I. Mahmut) Waqf, Mahmud Han-ı Sani bin Abdülhamid Han-ı Evvel (II. Mahmut) Waqf ve Murad Paşa bin Abdusselam (Murat Paşa) Waqf. Founders of Vakıf PB are historical waqfs which were not active and this situation would be seen as symbolic. Because General Directorate for Waqfs of Turkey announced that they will be the major shareholder and provide paid capital (USD 300 million) from Islamic Development Bank. Apart from symbolic importance, the question is that “Will Vakıf PB operate in line with the historical waqfs (cash or not) or as of current private PBs?” It is also be noted waqfs have to be managed according to their corpuses which define scope of the activities. For this reason, in order to be fitted to the soul of waqf, these founder waqfs have to be examined. Using lending methods of the cash waqfs and integrate them to current participation banking model may provide solution to the current problems in this area such as scarcity of new products, etc.

The main point of criticism about PBs in Turkey as well as all Islamic Banks is that they mimic the conventional banks which operate on principle of debt financing, not on partnerships and profit/loss sharing model. The total share of murabaha (cost + financing) financing in Turkey is more than 90% while ijara (leasing) and musharaka (partnership) constitute ~4% and 0.4%, respectively. Also, the credit cards which may be classified as a qard-hasan has ~3.0% share and there is limited mudaraba type partnership. This huge concentration on murabaha based financing is one of the most controversial issues for PBs and many people, including practitioners from these institutions complain about this situation to no avail.

Cash waqfs experience would contribute to elimination of this criticism somewhat by its characteristic which is perpetuity. The main problem behind why PBs do not use mudaraba, musharaka type financing is the short-term maturity of collected funds whereas these financing models are long-term. For this reason, according to (Çizakça, 1993) cash waqfs would be integrated to PBs' funding sources as venture capital to finance entrepreneurs or feasible projects.

Also, PBs focus more on credibility of credit customer rather than their projects like conventional banks. Accordingly, low-income people yet again and cannot have access to financing from PBs as well due to lack of credibility, collateral quality etc. Thus, we are having another situation that is leading to social injustice and income inequality. This is a bizarre situation, because, one of the mission of the PBs is to provide the low-income people with an opportunity to betterment in the society and to facilitate the fair distribution of the wealth and financing modes such as mudaraba, musharaka, qard hasan, etc. to achieve these goals. Cash waqfs also would have key role to meet financial need of low-income people because these institutions were using qard hasan type financing without any return. Therefore integration of cash waqf to PBs will be beneficial for serving Islamic microfinance to the needy people.

Similarities of state one PBs with cash waqfs are more than private PBs. Because the main purpose of a cash waqf is not generating profit, only need profit for its continuity. At this point, the purpose of cash waqf and state owned PB would coincides. For this reason new Vakıf PB can serve as a cash waqf thus it completes shortcomings and gaps of private PBs.

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