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BALANCING ISLAMIC AND CONVENTIONAL BANKING FOR ECONOMIC GROWTH

Empirical Evidence from Emerging Economies

Edited by
Murat Ustaoğlu
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macmillan

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ISBN 978-3-319-59553-5 ISBN 978-3-319-59554-2 (eBook)
DOI 10.1007/978-3-319-59554-2

Library of Congress Control Number:2017944098

Printed on acid-free paper

This Palgrave Macmillan imprint is published by Springer Nature
The registered company is Springer International Publishing AG
The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

Spread wheat on mountains so that people would not speculate that birds starve in the lands of Muslims.

Umar ibn Al-Khattāb,
The Second Khalif

To my mentor Muharrem Balcı, Esq

Preface

The regulation and institutionalization of the borrowing transactions has been done only a few centuries ago. The sector that first emerged in the West has spread all over the world in a way to meet the financial needs of the real sectors, also contributing to the development and growth. A small margin in the growth rate leads to dramatic gaps between the welfares of the nations. For this reason, growth is extremely crucial for a society to keep its prosperity. Economists focusing on this issue have investigated the dynamics to analyse the impact of technological developments upon growth. It is unrealistic to expect that an economy where technology fails to provide sufficient contribution will attain stability in the long run. Technological development depends upon promotion of new investments. The financial markets are now growing fast due to the advanced technology used in communication. The financial system provides the funds for the investment projects needed for further development.

Particularly the studies analysing the developments after industrial revolution are focused on the contribution by the financial markets to the physical capital stock because the technological investments affecting the efficiency of the production factors can be made through financial capital. For this reason, in an economy where the financial markets do not operate well, a productive and competitive real sector cannot be expected. In a well-operating financial market, the borrowing transactions are also competitive because the interest rate is determined theoretically by the balance between supply and demand of the loan in a free market. At the optimum equilibrium, if the financial resources are used wisely, the physical capital stock increases and makes contribution to the competitiveness of the economy.

The importance of the financial sector becomes clear when all the sectors are affected by the malfunction of the system. At times when proper solutions are not offered, the problems turn into structural flaws, taking the economy to deeper crises. For this reason, the relevant institutions, monitoring the economic developments, take measures to regulate the system. A quick look at the history of economy in the world tells us that the adequacy of the conventional measures remains controversial. It is not possible to argue that the interest-based conventional measures have worked well to resolve the economic issues. Major crises still emerge, affecting the lives of billions all around the world and exacerbating the global poverty. Despite this, nothing has been done to offer an alternative up until recent decades.

The global crisis in the American financial markets in 2008 has deeply affected the world. On the other hand, the good performance of the Islamic finance has attracted attention during the crisis. For this reason, it has become a major discussion in the Muslim world and the Western countries. The debates in the Muslim countries (most of which are developing nations) have been focused on a wide range of issues including the legal status of Islamic finance and the managerial performance.

Some Muslim scholars argue that Islamic finance is nothing more than a slightly different version of the interest-based conventional system; but those who subscribe to a moderate view are of the opinion that it is a promising alternative financial model that may contribute to addressing the gap between the Muslim world and the modern developed world. Both approaches offer solid arguments; the first group of scholars refers to the technical details in the Islamic law because the Islamic financial institutions in the different parts of the world have to comply with the rules of a secular legal system. This often leads to complexities and issues because of the detailed approaches employed in Islamic law.

Obviously, a financial system that does not make any major difference cannot be expected to serve as an alternative. For this reason, the ability of the Islamic finance to hold its potential of serving as an alternative depends upon its capability of growing further and proving its success in the markets. A moral alternative can be offered only if its remains attached to the main precepts of Islam. For this reason, it has to observe major priorities including protection of the environment, loss- and profit-sharing and a balanced approach to the markets.

If these main principles are eroded, it will eventually lose its popularity and assertion of becoming an alternative to the conventional model even if it is still successful in terms of contribution to development and real sector. This has to remain one of the priorities of the sector in different parts of the world. Given that major breakthroughs have been performed in the Western world and that the Muslim nations have remained mere bystanders, the importance of a successful Islamic finance becomes clear. In case of stable success, the Islamic finance may become the global brand of Islam. One of the goals of this study is to contribute to this process.

Istanbul, Turkey, 2017 Dr. Murat Ustaoğlu

Acknowledgements

Authors would like to thank *Dr. Halis Yunus Ersöz*, *Marwah Maasarani, Ahmet Buğra Aydın, Zehra Betül Ustaoğlu, Sadri Özturan, Semih Boybay, Serkan Kırkyaşaroğlu, Bilal Cantaş, Mustafa Atas and Ayhan Sağır* for their contributions to this research.

The authors also offer special thanks to *Dr. Cenap Çakmak* who has spent a great deal of time and effort on this research, the process would not have been completed without his valuable assistance.

Additionally, appreciate and recognize the *Istanbul University Scientific Research Projects Department's* financial support.

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