

palgrave▶pivot

BALANCING ISLAMIC AND CONVENTIONAL BANKING FOR ECONOMIC GROWTH

Empirical Evidence from
Emerging Economies

**Edited by
Murat Ustaoglu
Ahmet Incekara**



Balancing Islamic and Conventional Banking for Economic Growth

Murat Ustaoglu · Ahmet Incekara
Editors

Balancing Islamic and Conventional Banking for Economic Growth

Empirical Evidence from Emerging Economies

palgrave
macmillan

Editors

Murat Ustaoglu
Istanbul University
Istanbul, Turkey

Ahmet Incekara
Istanbul University
Istanbul, Turkey

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

© The Editor(s) (if applicable) and The Author(s) 2017

This work is subject to copyright. All rights are solely and exclusively licensed by the Publisher, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilms or in any other physical way, and transmission or information storage and retrieval, electronic adaptation, computer software, or by similar or dissimilar methodology now known or hereafter developed.

The use of general descriptive names, registered names, trademarks, service marks, etc. in this publication does not imply, even in the absence of a specific statement, that such names are exempt from the relevant protective laws and regulations and therefore free for general use.

The publisher, the authors and the editors are safe to assume that the advice and information in this book are believed to be true and accurate at the date of publication. Neither the publisher nor the authors or the editors give a warranty, express or implied, with respect to the material contained herein or for any errors or omissions that may have been made. The publisher remains neutral with regard to jurisdictional claims in published maps and institutional affiliations.

Cover illustration: © saulgranda/Getty

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 Balci, 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 it 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 Ustaoglu

ACKNOWLEDGEMENTS

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

The authors also offer special thanks to *Dr. Cenan 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.

CONTENTS

1	Introduction	1
	Ahmet İncekara and Murat Ustaoglu	
2	Dual Banking Systems' Dynamics and a Brief Development History of Islamic Finance in Select Emerging Islamic Economies	9
	Halil Şimşek, Servet Bayındır and Murat Ustaoglu	
3	Financing Economic Growth in Emerging Economies: A Theoretical Approach	27
	Selim Demez, Hülya Deniz Karakoyun and Elif Haykır Hobikoğlu	
4	The Turkish Economy and Financing Growth by Dual Banking: Empirical Evidence	47
	Ferda Yerdelen Tatoğlu, Halil Tunalı and Murat Ustaoglu	
5	Financing Economic Growth by Dual Banking in Malaysia: Empirical Evidence	69
	Mehmet Akyol, Ferda Yerdelen Tatoğlu and Murat Ustaoglu	
6	A Quantitative Reassessment of the Dual Banking–Growth Nexus in Indonesia: Comparative Analysis	85
	Adem Levent, Murat Ustaoglu and Ferda Yerdelen Tatoğlu	

7	Economic Development and Financing Growth in a Hydrocarbon Economy: Qatar	103
	Murat Ustaoglu, Selman Yilmaz and Ferda Yerdelen Tatoğlu	
8	Findings and Conclusion	119
	Zeynep Karaçor and Murat Ustaoglu	
	Glossary of Arabic Terms	125
	Index	127

EDITORS AND CONTRIBUTORS

ABOUT THE EDITORS

Dr. Murat Ustaoglu is an Associate Professor of Islamic Economics. He was born in Turkey, and educated at the Ramapo College of New Jersey (B.A.) and the City University of New York (M.A.), and holds a Ph.D. degree in Economics. Dr. Ustaoglu has worked at Bank of New York and JP Morgan Chase Bank in US. He is, most recently, co-author of *Islamic Finance Alternatives for Emerging Economies* (2014), *Post-Conflict Syrian State and Nation Building* (2015) and many research articles focusing Islamic Finance and Economics. Additionally, he teaches undergraduate and graduate level various courses in Economics.

Dr. Ahmet Incekara is a Professor of Economics at the Istanbul University and Head of the Department of Economics. He was born and educated in Turkey, and has taught various courses in there. Prof. Incekara has published many books including *Islamic Finance Alternatives for Emerging Economies* (2014), and research articles in the field of Economics. He is also head of the Economic Research Foundation in İstanbul since 2009.

CONTRIBUTORS

Mehmet Akyol Istanbul University, Istanbul, Turkey

Servet Bayındır Istanbul University, Istanbul, Turkey

Selim Demez Istanbul University, Istanbul, Turkey

Elif Haykır Hobikoğlu Istanbul University, Istanbul, Turkey

Hülya Deniz Karakoyun Istanbul University, Istanbul, Turkey

Zeynep Karaçor Selçuk University, Konya, Turkey

Adem Levent Istanbul University, Istanbul, Turkey

Halil Şimşek University of Toronto, Toronto, ON, Canada

Ferda Yerdelen Tatoğlu Istanbul University, Istanbul, Turkey

Halil Tunalı Istanbul University, Istanbul, Turkey

Selman Yılmaz Istanbul University, Istanbul, Turkey

LIST OF TABLES

Table 4.1	Variables used in the econometric analysis	60
Table 4.2	The correlation matrix between the loans offered by CF institutions by sectors and the GDP	62
Table 4.3	The correlation matrix between the loans offered by IF institutions by sectors and the GDP	62
Table 4.4	SUR estimation for relationship between loans by CF–IF institutions for construction sector and GDP	63
Table 4.5	OLS estimation for relationship between loans by CF and IF institutions for agriculture sector and GDP	64
Table 4.6	SUR estimation for relationship between loans by CF–IF institutions for manufacturing sector and GDP	64
Table 4.7	SUR estimation for relationship between loans by CF and IF institutions for tourism sector and GDP	65
Table 4.8	OLS estimation for relationship between CF and IF loans for mining sector and GDP	65
Table 5.1	The matrix of correlation between the loans offered by CF on sector basis and the GDP	79
Table 5.2	The matrix of correlation between the loans offered by IF institutions on sector basis and the GDP	80
Table 5.3	Estimation of the relation between loans offered by CF and IF for construction sector and the GDP by reliance on SUR	80
Table 5.4	Estimation of the relation between loans by CF and IF institutions for agricultural sector and GDP through OLS	80
Table 5.5	Estimation of the relation between loans by CF and IF institutions for the manufacturing industry and the GDP through SUR	81