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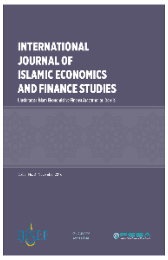


# Bridging the Gap: The Restitution of Historical Cash *Waqf* Through Vakıf Participation Bank[*]

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ABSTRACT

Financial needs have been met through formal or informal institutions throughout history. Some of these institutions have been operating for many years and have developed and adapted to suit the current time. In the Ottoman Empire (1299-1923), cash *waqfs* were served as financial and social institutions in the society since the early cash *waqfs* were established in the period of Murad II and Mehmet II in the 15th century. The main aim of a cash *waqf* is to provide financial services to the different strata of the society, ranging from poor people to merchants, and to generate income, which would be used for the specific purpose of the *waqf*. They operated until the first years of the new Turkey after the collapse of the Ottoman Empire. As to the Islamic finance in Turkey, it has not been applied as a formal institution in many years and the history of Islamic banking in Turkey goes back to the legislation in 1984, which allowed the establishment of Islamic banks (IBs) under the name of Special Finance Houses (SFHs). The name of these institutions was changed to Participation Banks (PBs) in 2005 and the Islamic finance sector has been a strategic sector especially in recent years. The aim of this paper is to give a brief history of Islamic finance in the Ottoman Empire through cash *waqfs* and in modern Turkey through PBs. Thus, the process of the change of the Islamic finance applications, from cash *waqfs* to state-owned PBs, within six centuries, will be explained by giving a chronological outline. And finally, the bridging purpose of the recent government between cash *waqfs* and Vakıf PB will be evaluated and some suggestions will be proposed to PBs, Vakıf PB in particular, to improve the social aspects of them through the benefit from the cash *waqf* experience.

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## Introduction

One of the significant issues for an entrepreneur is to reach the working capital. Especially for microenterprises, getting funding to realise their business plans are quite difficult. They must have collateral, a good track record and credibility in order to obtain sufficient funds from financial institutions. Conventional banks (CBs) exclude poor people from financial services due to their high-risk which arises from not having sufficient collateral and credit history. Apart from intrinsic weaknesses of these segments of the society, geographical reasons are also effective for their exclusion by CBs. The majority of low-income people and microenterprises live in rural areas; thus, CBs considers that bringing financial services to them will be costly or not feasible. Therefore, all of these factors lead to the involuntary exclusion of low-income people from financial services.

Conventional banking practices compromise *riba* (interest) and *gharar* (excessive uncertainty), thus many Muslims have been kept away from them. This voluntary exclusion has been solved to some extent thanks to the start of the Islamic Banking practices in 1963 with the Mit Ghamr Islamic Bank, which was founded by Ahmad al-Najjar in Egypt. Even though, there were also several other local Islamic financial institutions (IFIs) operated in Muslim countries before the Mit Ghamr, such as Muslim Pilgrims Savings Corporation in Malaysia in the 1960s and the interest-free credit institution in Pakistan in the late 1950s (Warde, 2000), it is seen as the first IB. In the 1970s, many commercial IBs have started to be established in many Muslim majority countries thanks to the petrodollar accumulation, especially in Gulf countries. These institutions aim to provide financial services in a *Sharia*-compliant (Islamically-permissible) way in which transactions are free from *riba* and *gharar*.

IFIs have shown much development and success for more than 40 years. The total amount of the Islamic finance industry had reached US$2,293 trillion at the end of 2016, and it is expected that this amount will be US$4,362 trillion in 2020 (Elbiz, 2017). IBs have the biggest share in the Islamic finance sector which is followed by Islamic capital markets (such as *Sukuk*, Islamic indices, etc.) and *takaful* (Islamic insurance). Apart from Muslim-majority countries, there are several non-Muslim countries, such as UK and Luxemburg, which have seen the Islamic finance as a strategic market and target to obtain a significant share.

There are many criticisms towards the current state of IBs though they have indicated successful financial performance. According to Asutay (2007, p. 3), IBs are "moving in a 'capitalist' direction away from an Islamic economic value system". In other words, IBs are converging towards conventional counterparts, not only through mimicking the instruments and operations, but also with priorities (Asutay, Aysan, & Karahan, 2013). It is argued that they are not in touch with the life of the low-income people in the street of Muslim countries (Zaman & Asutay, 2009). They have been serving the creditworthy, advantaged people who are able to find low-cost financing easily. Thus, IBs contribute to the inequality in wealth distribution by excluding poor people from financial services, in opposition to how they IBs emerged.

As to the Islamic finance in the Ottoman Empire and Modern Turkey, there is a time gap between cash *waqf* and participation banking, but they have some similarities such as common financial products, which is valuable to investigate. To illustrate this, both of these institutions have been operated in a *Sharia*-compliant way, which is based on the prohibition of the *riba* and *gharar*. On the other hand, cash *waqfs* were founded mostly for the purpose of promoting social welfare, however, PBs are a kind of for-profit commercial institutions and not established as charities. The Turkish government established the first state-owned PBs, which are Ziraat Participation Bank (2015) and Vakıf Participation Bank (2016), and would like to increase the share of PBs in the banking sector. Apart from its economic importance, Vakıf PB has a symbolic meaning which carries *waqf* in its name and has shareholders from historical *waqfs*. Therefore, Vakıf PB can be seen as a link or bridge between the contemporary and the historical experience.

Cash *waqfs* in the Ottoman Empire*,* would be quite beneficial to suggest alternative interest-free models, products or philosophy to nowadays IFIs. The Ottoman Empire, as an Islamic state, applied various systems through cash *waqfs* regarding trade applications in Islamic history. In this paper, the brief history of Islamic banking in the Ottoman Empire through cash waqfs and in modern Turkey through PBs will be given. Thus, the process of the change of the Islamic finance applications, from cash waqfs to state-owned PBs will be explained by giving a chronological outline. And as a final point, the bridging effort of recent government between cash waqfs and Vakıf PB will be highlighted and some suggestions will be proposed to PBs to improve the social aspects of them through the Vakıf PB's benefit from the cash *waqf* experience.

## 1. History and Structure of Cash *Waqfs* in Ottoman Empire

*Waqf* (plural *awqaf*) is an Arabic word and means 'to the stoppage, immobilization, or preserve' and is defined as "the act of founding a charitable trust, and, hence the trust itself" (EI, Second Edition, "*Wakf*"). Kahf (2003, p. 2) describes waqf as "holding certain property and preserving it for the confined benefit of certain philanthropy and prohibiting any use or disposition of it outside its specific objective". *Waqf* is religious endowments of assets voluntarily for the benefit of society with from the expectation of reward from God only. The *waqf* assets must be used only in line with the corpus, which is a statement by the endower about how and in which ways the assets must be used. The charitable property of the *waqf* is in the state of the public good and cannot be sold, donated and cannot be appropriated in any way (Günay, 2012), thus, it differs from donations.

*Waqfs* had chief roles for the sustainability of the social system in the Ottoman Empire and various *waqfs* were founded and served in specific areas such as economic, social and cultural. Furthermore, the Ottomans founded *waqfs* not only for the benefit of the people but even for the sake of animals. To illustrate this, there was a *waqf* called *Gurabahane-i Laklakan*, which was responsible for the burial of birds (white storks). This example is mostly given to show the sensitiveness of the Ottoman Empire for all needy beings and the powerfulness of the civilized state structure that was founded through *waqf*.

*Waqfs* are the best expression of solidarity among Muslims. Therefore, the revelations reflect this in the *Vakfiye* books, which were promissory notes for how the charitable deed will be used and managed. The particulars expressed in these verses can be listed as follows: lending with the pleasure of heart (al-Hadid 57/18; al-Muzzemmil 73/20), spending goods in the way of Allah (al-Baqarah 2/195, 261), to feed poor and to drink (al-Fajr 89/18, al-Māûn 107/3), to give alms (al-Nisa 4/114) 148; Âl-i Imran 3/114) (Özgüdenli, 2012).

In the *waqf* system, cash can be endowed as well as real estate assets. The endowed capital of the cash *waqf* was extended to borrowers and after exact maturity, such as one year, they were paid back to *waqf* with the principal plus profit. Then, this money was used and spent for the social purposes of the *waqf*. This type of *waqf* was called as a cash *waqf* and there were many active cash *waqfs* in most of the cities in the Ottoman Empire, such as in Istanbul, Bursa and Selanik. The exact date for the first cash *waqfs* in the Ottoman Empire is not clearly known, but according to historians, the first known examples of cash *waqf* is in the period of Murat II and his son Mehmet II, i.e. by the beginning of 15th century. According to Mandaville (1979) cash *waqf* was approved by the Ottoman courts by the early fifteenth century and was popular in Anatolia and Rumeli until the end of the sixteenth century. One of the most famous example of cash *waqf* was the devotion of 24,000 gold dinars, which were given to *Yeniçeri* soldiers, to be used for a subsidy of meats (Döndüren, 2008). Afterward, the importance and the amount of cash waqfs within *waqf* system of the Empire increased. *Tahrir* records *(waqf censuses)* of Istanbul *waqfs* in the first half of 16th century shows that the total share of cash ones is around half of the total operating *waqfs* (Barkan &

Ayverdi, 1970). This figure shows the significance of the cash waqf in the Ottoman Empire. Revenues, which were generated from the utilization of cash *waqf* money, were used for the social purposes. Çizakça (1995) indicates the social role of the cash *waqf* through social services to the society, some of which are; organizing and financing expenditures on education, health, and providing food, etc., during the relevant period.

The legitimacy of cash *waqf*s has been widely discussed throughout Ottoman history. The first author to write a *risala* about this topic was Ibn Kemal (d.1533 CE) who defended the legitimacy of cash *waqf*s. Then, one of the most famous figures in the Ottoman Empire, Abussuud (d.1574 CE) stated similar ideas to Ibn Kemal about this system. In contrast, some prominent scholars opposed the legitimacy of the cash *waqf*, such as Birgivi (d.1573 CE) (Özcan, 2010). Despite these scholars' conlicts[1] on the legitimacy of cash *waqfs*, the continuity of cash *waqf*s was endured because cash *waqf*s have several advantages to the real estate *waqf*s in terms of functionality and endowment of cash. These superiorities are as follows:

i. The cash *waqf* is an alternative to usury, which charges high-interest rates,
ii. The transaction (profit/loss) rates of cash *waqf*s play a key role in determining credit cost and stability of the credit market.
iii. Cash *waqf*s provide an opportunity for people to give money to a charity who cannot endow any real estate. (Özcan, 2010, p.130)

### *Financing Methods of Cash Waqf*

Cash *waqf*s were used intensively for financial needs of the society in line with the interest-free principle. Capital in the cash *waqf*s was lent to people in several ways.[2] The main methods, which were used in the operations of the funds are as follows:

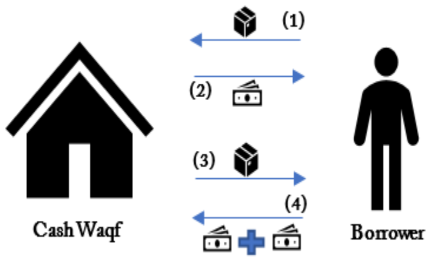
***(i) Muamele-i Şer'iyye / bey'ul-'iyne:*** Cash *waqf*s provided solutions for the cash needs of the borrowers by ensuring profit without violating the prohibition of the riba principle of Islam. For this reason, the excess was legitimated through structuring the transaction on a sale contract. The cash *waqf* gave the requested amount of money to the borrower by buying the one financially insignificant asset and generated profit by adding a surplus onto the deferred payment. The aim of this method was to meet the cash need of

[1] Cf. Günay, Hacı Mehmet "Vakıf", TDV Encyclopaedia of Islam, 42(2012), p.477.

[2] These methods can be found from *waqf* censuses (*Tahrir* records). A typical eighteenth-century *waqf* censuses contains information such as: the name of *waqf* and trustee, the purpose of the *waqf*, the capital amount, the 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 borrower within the framework of Islamic jurisprudence and to gain profit from this transaction for the *waqf*. There is no intention to trade the asset, therefore this type of contract is also named *hile-i şer'iyye* (*hile*: 'trickery').

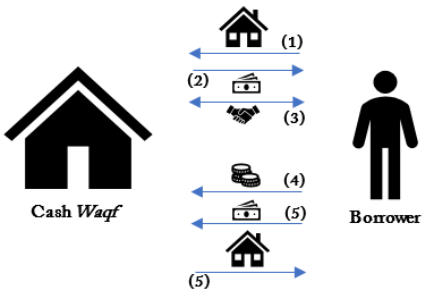
**Figure 1:** The Process of *Muamele-i Şer'iyye*




(1) Borrower sells the asset to the cash waqf, i.e. property symbolically worth 100 kuruş.
(2) Cash waqf pays 100 kuruş to the borrower
(3) Cash waqf resell the same asset to the same borrower at 120 kuruş and request that he pay it one year later.
(4) One year later, the borrower pays 120 kuruş to the cash waqf.
*20 kuruş is the profit of the cash waqf and to be spent for the purpose of the waqf.

***Bey' bi'l-vefa* and *Istiğlal:*** In the *bey' bi'l-vefa* contract, the borrower sells his/her property (real estate or movables) to the cash *waqf* for cash money with the condition that the property would be resold to the borrower when the debt is repaid. The cash *waqf* makes benefit from this contract by using the relevant real estate or collecting its receivables, such as its rent. On the other hand, *istiğlal* is a kind of *bey' bil' vefa*, but it includes the lease condition of the real estate by the borrower (Kaya, 2010). In other words, the borrower leases the real estate from the cash *waqf* for a certain period and pays rent. Ownership of the property is transferred back to the borrower, who repays all the debt to the cash *waqf* (Kurt, 2010). The *mutevelli*[3] preferred *bey' bil' istiğlal* instead of *bey' bil' vefa* because the return of the money was certain, like in the case of the *muamele-i şer'iyye* for the waqf (Kaya, 2010).

**Figure 2:** The Process of *Bey' bi'l Istiğlal*

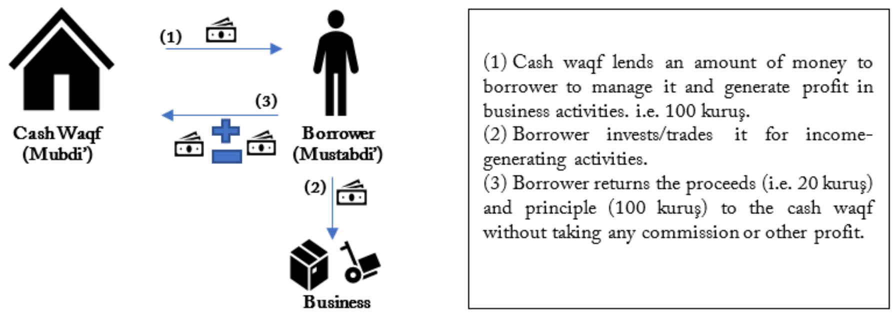



(1) Borrower sells the real estate to the cash *waqf*, i.e. at a value of 1,000 kuruş.
(2) Cash *waqf* pays 1,000 kuruş to the borrower
(3) Borrower leases the real estate from the cash *waqf* for specific time, i.e. 1 year.
(4) Borrower pays the rent, i.e. 10 kuruş per month, total for 1 year is 120 kuruş.
(5) Borrower repays the full debt at the end of 1 year (1,000 kuruş) and retakes the ownership of the real estate
*120 kuruş is the profit of the cash waqf and is to be spent for the purpose of the waqf.

[3] The founders or managers of the *waqf*.

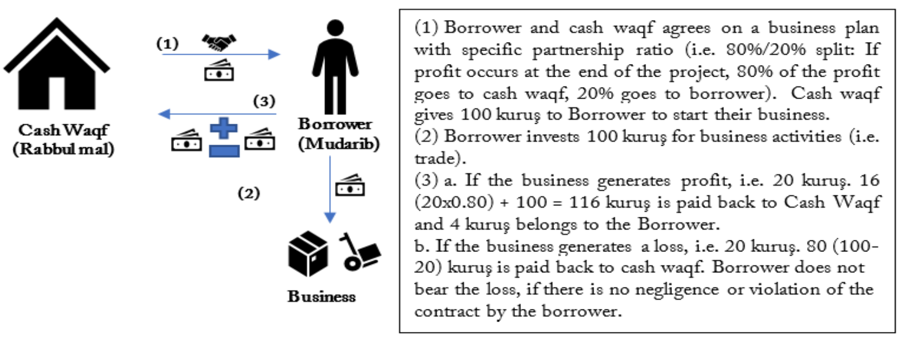
***Bida'a (Ibda'):*** The cash money of the *waqf* was given to the creditworthy merchant to manage it in a feasible way, aiming to generate a profit for the *waqf*. In the *bida'a* contract, this *waqf* money was used by the merchant for the sake of the *waqf* and the entire proceeds, which was earned from the business activity, and the principle were given to the *waqf*. The capital owner and cash receiver are called *mubdi'* and *mustabdi'*, respectively. The establishment and legal consequences of the *bida'a* contract do not differ from the general rules of the *mudaraba* contract (Gedikli, 1999). Therefore, if any loss occurs, neither the *mubdi'* nor the *mustabdi'* bear any special liability (Udovitch, 1970).

**Figure 3:** The Process of *Bida'a*



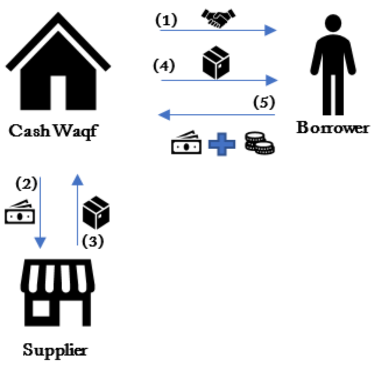

***Mudaraba:*** It is an equity partnership contract and is seen as the most suitable model in the spirit of Islamic economics. This is because the profit and loss is shared between the *mudarib* (the borrower from *waqf*) and *rabb'ul mal* (the *waqf* itself) according to a pre-agreed ratio. This type of financing is similar to the contemporary risk venture capital applications. Although *mudaraba* is considered as the best model for Islamic financial institutions, it possesses substantial risk. Thus, it was used limitedly by cash *waqf*, just as it is in the modern Islamic banking practices.

**Figure 4:** The Process of *Mudaraba*



***Murabaha:*** It is a sale-based contract and simply works to generate profit by buying assets with *waqf* money and selling it with a mark-up to the borrower in a deferred payment. The profit of the transaction is fixed; therefore, it is easy to follow up the payments in the contract term. The risk in this type of financing model is transferred to the borrower rather than risk sharing (which is the case in the *mudaraba*-based partnership). While many scholars do not mention *murabaha* in the financing method of cash waqf, Döndüren (1998) classifies it as *muamele-i şer'iyye* due to its sale-based structure. However, the aim of the borrower in the *murabaha* contract is to acquire the asset in deferred payment rather than to get cash (to get cash is the main purpose in *muamele-i şer'iyye* or *istiğlal*).

**Figure 5:** The Process of *Murabaha*




(1) Borrower comes to cash waqf to buy a specific asset with deferred payment and they agree on the mark-up (i.e. 20%).
(2) The cash waqf pays the price of the asset to the supplier in cash (i.e. 100 kuruş).
(3) The supplier delivers the asset to the cash waqf.
(4) The cash waqf resell the asset for 120 kuruş to the borrower for deferred payment, i.e. monthly instalment for one year (12×10=120).
(5) The borrower repays the instalment and principle to the cash waqf.

***(ii)*** ***Qard al-hasan:*** It is a benevolent loan and praised in the Quran as "If you loan Allah a goodly loan (*qard al-hasan*), He will multiply it for you and forgive you. And Allah is most appreciative and forbearing." (Tagabun, 16). Only the principle of the loan is required during the maturity. In practice, cash *waqf* gave a *qard al-hasan* to the especially needy people to meet their consumption needs.

**Table 1:** Comparison of Financing Methods of Cash *Waqfs* in Different Periods

| | Özcan (2003) | | Kaya (2010) | |
|---|---|---|---|---|
| Period | 1520-1566 (Kanuni) | | 1783-1787 | |
| Location | Uskudar | | Uskudar | |
| Financing Methods | Number of Transaction | Percentage | Number of Transaction | Percentage |
| *Mu'amele-i şer'iyye* | 875 | 82.5% | 432 | 58.3% |
| *Bey' bi'l-vefa* | 11 | 1.0% | - | - |
| *Bey' bi'l-istiğlal* | 62 | 5.8% | 256 | 34.5% |
| *Bey'i bat* | 60 | 5.7% | - | - |
| *Ferâğ bi'l-istiğlâl* | - | - | 8 | 1.1% |

| | | | | |
|---|---|---|---|---|
| *Mudaraba/Musharaka* | - | - | - | - |
| *Bida'a* | - | - | - | - |
| *Qard al-hasan* | 53 | 5.0 | - | - |
| *Used by Mutevelli* | - | - | 45 | % 6.1 |
| ***Total*** | **1061** | **100.0** | **741** | **100.0** |

**Source:** Compiled from Kaya (2010)

As indicated in the table, which consolidates the findings of two studies on historical cash *waqf* in Uskudar for different time periods, several financing methods have been used by cash *waqfs*. According to the Özcan (2003), *muamele-i şer'iyye* method has a significant share, with 82.5% of the transactions in the Kanuni period being of this type. It was followed by a similar sale contract, which was asserted by Kaya (2010), that possibly the "*bey'i bat*", "*bey' bi'l-vefa"* and "*bey' bi'l-istiğlal"* are the same and therefore they could be recorded as 12.5% in total. There were only 5.0% *qard al-hasan* used in the 16th-century cash *waqf* in Uskudar. On the other hand, Kaya (2010) and Durmuş (2016) investigated the similar period and location (1774-Uskudar) and found that *muamele-i şer'iyye* and *bey' bi'l istiğlal* compromise almost all of the transactions, only 6% were recorded as used by *mutevelli* without indicating the type of the method. Contrary to Özcan, later studies interestingly did not find any record for *qard al-hasan*. It is noteworthy that the use of equity-based partnership modes, i.e. *mudaraba* and *musharaka,* in the cash *waqfs* in question could not be found throughout all three studies. These results can be summarised that even though the *qard* and equity-based partnership modes are Islamically more preferable, and reflect the spirit of the Islamic economics, *waqf mutevallis* of the relevant period behaved as risk averse. In other words, they evaluated the cash money for more guaranteed methods, such as sale-based (originally debt-based) methods (*muamele-i şer'iyye* and *istiğlal*), which are very similar to conventional financing methods, however, they are structured in a "so-called" *Sharia*-compliant way.

Apart from these findings in the studies, Çizakça (1995) determines that cash *waqf* were not using equity partnership methods in their lending by analysing average profit/capital ratio in the Bursa example, which indicated a constant trend. This shows that these cash *waqfs* had a fixed income rather than fluctuations, which can be a proof for the equity partnership (profit and loss sharing). Also, unlike from Anatolian cities, Bulut & Korkut (2016) investigated the cash waqf in the Balkans in the period of late 16th and early 17th century, and found that *muamele-i şer'iyye* and *istiğlal / istirbah* were used in the transactions.

### *Beneficiaries of Cash Waqf*

As to the benefits of cash *waqfs*, the need of the society had been met by them in both providing financing to the borrowers and returning the generated income to the society in diverse ways, such as through charity. The beneficiaries in the financing side and their utilisation of the funds were different. Çizakça (1998, p. 59) asserts that "the borrowers were not entrepreneurs but consumers and that the capital supplied by the cash *awqaf* was not accumulated at the hands of a few enterprising individuals but was diffused throughout the society." He derives this conclusion by considering the small amount of credit which was given by the cash *waqf* to ordinary people, not traders. Kaya (2010) confirms this comment by asserting that the substantial portion of the borrowers were comprised of women, who were mostly spending this money for consumption needs. However, he also indicates that sometimes cash *waqf* lent a relatively large amount of money to the borrowers and there were many *esnaf* (tradesmen) among the borrowers as well. While the beneficiaries of the cash waqfs were from different strata of the society, there were some examples where the financing of cash waqf were restricted to the specific people, and also some group especially excluded from financing by the corpus of the *waqf*. For instance; while state officials were excluded from the financing, only activities restricted with traders in the *Waqf* of Salih Bey b. Hasan Pasha (Bulut & Korkut, 2016).

### *Transformation of Cash Waqfs*

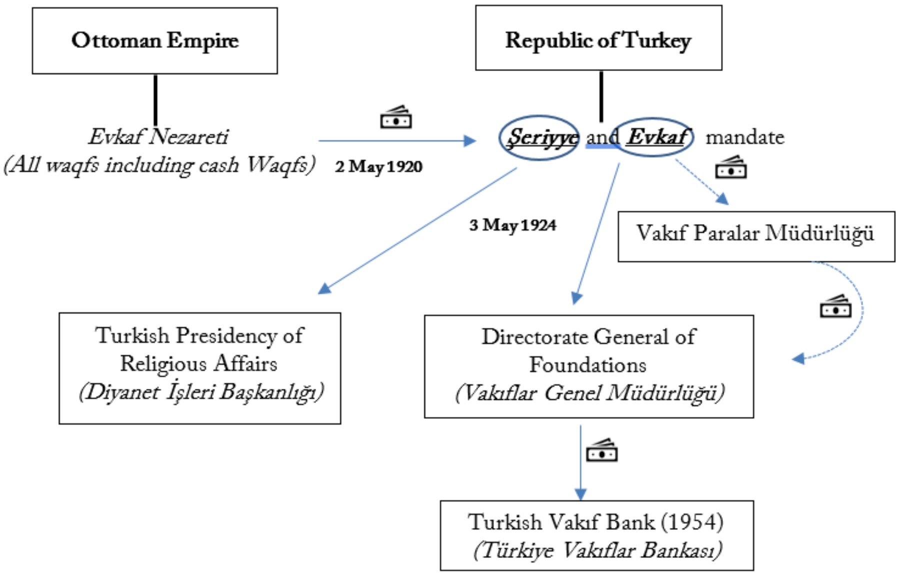
Cash *waqfs* were active from the 15th to 20th century in the Ottoman Empire and, following the collapse of the Empire in the 20th century, they were closed but tried to have a place in the newly-established Republic of Turkey. Following the establishment of *Evkaf Nezareti* (1826), a significant part of the *waqfs* had been passed under its administration and control. New departments were founded within *Nezaret*, such as *Terakat ve Nukud-u Mevkufe Kalemi* for directly managing the cash *waqfs* in the period of the second *Meşrutiyet* (1908-1920).

The *"Evkaf Bankası"* was founded after this date. It can be considered as the first attempt to establish a bank as well. But, unfortunately, the attempt was not successful because World War I started at this time. With the foundation of the new republic, the total money which was transferred to "*Şeriyye* and *Evkaf* mandate" from *Evkaf Nezareti,* was 321,989 Turkish Lira (TRY) and a report[4] (dated 1937) stated that *Vakıf Paralar Müdürlüğü* had 444,180 TRY *waqf* money under its control. Following the release of the sale of the foundation goods in 1935, the money of *Vakıf Paralar Müdürlüğü* increased and reached 4,879,090 TRY. The foundation of *Evkaf Emlak Bank* was discussed, but it was another failed attempt for the establishment of a modern bank. Finally, in 1954, "*Türkiye Vakıflar Bankasi*" was established with 50,000,000 TRY by obtaining its majority capital from *waqfs*. 1,069 cash

[4] In his work, Özcan stated this report but he did not give any reference for this.

*waqfs* composed a significant portion of the paid capital according to some of the bank's statements (Özcan, 2010, p. 145-147).

**Figure 6:** Transformation of Cash *Waqf*




As shown above, the treasury of the cash *waqfs* was used to establish a state-owned commercial bank. Because of the difference in the aims and structures between a commercial bank in the new Republic of Turkey and a cash *waqf* in Ottoman Empire, this transition process was quite problematic. Furthermore, any transition of *waqf* endowments was strictly forbidden[5] without the approval of the donators, most of whom were dead. The testament of the people, who gave their money for a certain *waqf* to use for the sake of society, was written in the *vakfiye* books. Thus there should be a compensation, such as restitution of the cash *waqfs* in a modern *Sharia*-compliant institution, to avoid misappropriation. Today, Islamic banks try to use Islamic methods in money transaction, likewise for cash *waqfs*. But the main difference for Islamic banks is that they are not working for the sake of society but for profit. However, a state-owned PB can achieve this restitution

[5] For example, this malediction part "It is not lawful to neglect, cheat, change, destroy, transmit, abolish, whoever changes or abolishes any of its conditions or any of its bases with a distorted interpretation and an invalid method, who believes in Allah and the Hereafter, who affirms the Prophet who is beautiful and clean, for any Sultan, Emir, Minister. If anybody intends to change, to be annulled or to be transformed into another, they will be punished on the day of the punishment. So the day the sinners are held captive and punished, Allah will see their account." was written in a Vakfiye book of a waqf which was endowed by Kanuni Sultan Süleyman. http://www.vgm.gov.tr/sayfahtml.aspx?Id=3 See Appendix 1.

by using Islamic methods in banking and extending its aims for the sake of the society. Before moving to the comparison of cash *waqf*s and state-owned PBs, and giving some offers to achieve this restitution, we should next focus upon the history of Islamic Banking following the foundation of the Republic of Turkey.

## 2. The Brief History and Current State of Participation Banking (Islamic Banking) in Turkey

Islamic finance has notable stages of change and development in the history of the Ottoman Empire and the Republic of Turkey. The new Republic of Turkey was founded in 1923 following the collapse of the Ottoman Empire (1299-1923) and the governmental model of the new state was changed in parallel to the change in state structure, which had been Islamic based in the Ottoman Empire and secular in the new republic. Hence, Islamic financial institutions such as cash *waqf*s were replaced with modern conventional banking models. By means of the brave attempt by the coalition partner of the government, i.e. Islamic MSP party, as well as the encouragement from the developments in other countries on the interest-free banking models, *Devlet Sanayi İşçi Yatırım Bankası* (DESIYAB) was established in 1975. The aim of this new institution was to evaluate workers' remittances abroad and to transfer their money to SMEs based on the profit and loss partnership. However, the main partner of the government did not accept the "profit and loss sharing concept" and left only the "profit" partnership in the statement of incorporation of DESIYAB (Özdemir & Aslan, 2017). Thus, DESIYAB can be seen as the first attempt to introduce the Islamic banking in Turkey, however, it is difficult to refer to it as the beginning of Islamic Banking in real terms. This institution continued its operations until 1978 and provided a very considerable experience for Islamic finance in Turkey (Bulut & Er, 2012, pp. 24-25).

In Turkey, the history of the Islamic banking, in today's meaning, goes back to 1983 with the Decree 83/7506 of the Council of Ministers and the decision published in the Official Gazette on 25 February 1984. Based on this legislation, the first interest-free financial institution was established. The legislation named them not Islamic Banks but Special Finance Houses (SFHs) because of the secular structure of the state. Permission for establishment of interest-free SFHs was criticised by secular groups within the country because they had thought that it was not suitable for a secular country. Also, some conventional bankers were not satisfied with these institutions although they did not see them as a real competitor (Baldwin, 1990, p. 38). The first SFHs to be founded were Albaraka Turk and Faisal Finance in 1985. Afterward, Kuwait Turk (1989), Anatolia Finance (1991), Ihlas Finance (1995), and finally Asya Finance (1996) were established.

In both the domestic and the foreign sphere, the name of SFHs led to some misunderstandings, resulting in SFHs to be exposed to some different procedures by foreign banks. These institutions do many operations like other banks but in accordance with the interest-free principle. They also provided International banking and foreign exchange services to the customers. However, SFHs had taken the category of non-bank financial institutions by some correspondent foreign banks due to the lack of the word bank in their titles. This situation caused customers who made exports and imports over the SFHs to be unable to do business with correspondent banks of these countries. This attitude prevailed even when it became a necessity to redefine the SFHs as PBs by nullifying SFH Communiqué issued in 1983. The Banking Law renamed the SFHs as PBs in 2005 and brought about radical changes in the banking industry. The new Banking Law 2005 eliminated the problem of misunderstandings in international banking operations as well as some other difficulties which the PBs had been facing.

**Table 2:** Turkish Banking Sector (as of year-end 2016)

| 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 | 2,455,367 | 89.9 | 1,377,764 | 94.4 | 1,587,244 | 89.5 |
| Participation Banks | 5 | 132,873 | 4.9 | 81,487 | 5.6 | 84,880 | 4.8 |
| Investment & Development Banks | 13 | 142,807 | 5.2 | 0 | 0 | 101,621 | 5.7 |
| **Total** | **52** | **2,731,047** | **100.0** | **1,459,241** | **100.0** | **1,773,745** | **100.0** |

**Source**: TKBB, General Presentation

The banking system in Turkey consists of three banking models, which are deposit, investment/development and participation (Islamic) banks. There are thirty-four deposit banks in Turkey, which have the biggest market share of 89.9%, 94.4% and 89.5% in terms of their assets, deposits and loans, respectively (Table 1). Deposit banks are followed by investment & development (I&D) banks with a 5.2% share in total assets. There are 13 ID banks operating in Turkey and these banks are not allowed to accept deposits. The operations of both deposit and I&D banks are interest-based.

**Table 3:** Historical Performance of PBs

| Years | PBs (million TRY) | Growth (YoY) | PBs' Market Share |
|---|---|---|---|
| 2001 | 2,365 | 4.4% | 1.1% |
| 2002 | 3,962 | 67.5% | 1.9% |
| 2003 | 5,113 | 29.1% | 2.0% |

| | | | |
|---|---|---|---|
| 2004 | 7,299 | 42.8% | 2.4% |
| 2005 | 9,945 | 36.3% | 2.4% |
| 2006 | 13,752 | 38.3% | 2.8% |
| 2007 | 19,445 | 41.4% | 3.3% |
| 2008 | 25,770 | 32.5% | 3.5% |
| 2009 | 33,628 | 30.5% | 4.0% |
| 2010 | 43,339 | 28.9% | 4.3% |
| 2011 | 56,148 | 29.6% | 4.6% |
| 2012 | 70,279 | 25.2% | 5.1% |
| 2013 | 96,075 | 36.7% | 5.5% |
| 2014 | 104,319 | 8.6% | 5.2% |
| 2015 | 120,183 | 15.2% | 5.1% |
| 2016 | 132,874 | 10.6% | 4.9% |

**Source:** TKBB, General Presentation

Due to the political atmosphere in Turkey[6], PBs have shown a significant growth performance during the last decade. The share of PBs increased from 1.1% to 5.5% in twelve years (2001-2013) in terms of the total asset (Graph 1). However, this growth trend was interrupted by the political problems in Turkey which started at the end of 2013. One of the PBs (Bank Asya) was affected financially: the total assets and other main items of this PB shrank more than 50%. The official authorization of the Bank Asya was canceled by the banking authority on 22 July 2016.[7] Therefore, an increasing trend in the share of PBs has reversed since 2013, even though two new state-owned PBs were established in 2015. The total market share of PBs decreased to 4.9% at the end of 2016.

**Table 4:** List of PBs in Turkey

| | Albaraka Turk | Kuveyt Turk | Turkiye Finans | Ziraat Katılım | Vakıf Katılım |
|---|---|---|---|---|---|
| **Asset Size (million TRL)** | 32.851 | 48.477 | 38.808 | 7.960 | 4.682 |
| **Market Share in PBs** | 25% | 37% | 29% | 6% | 4% |
| **Market Share in BS** | 1,2% | 1,8% | 1,4% | 0,3% | 0,2% |
| **Establishment/ Start Year** | 1984/1985 | 1989 | 2005* | 2015 | 2015/2016 |
| **Ownership** | privately owned | privately owned | privately owned | State owned | State owned |

[6] A conservative political party in Turkey, Justice and Development Party (Turkish: Adalet ve Kalkınma Partisi), has won pluralities in the five most recent legislative elections, those of 2002, 2007, 2011, June 2015, and November 2015 and has ruled for 15 years.

[7] http://www.bddk.org.tr/WebSitesi/turkce/Duyurular/BDDK_Kurul_Kararlari/153626947.pdf

| | | | | | |
|---|---|---|---|---|---|
| **Shareholder Structure** | Foreign (66%) Local (9%) Listed (25%) | Foreign (80%) Local* (19%) Other (1%) | Foreign (67%) Local (33%) | Ziraat Bankası (99.9%) | General Directorate for Foundations*** (100%) |

*Established by the merger of Faisal Finans (1985) and Anadolu Finans (1991) in 2005.
**General Directorate for Foundations
***Beyazid Han-ı Sani (II. Beyazit) Vakfı 2.012.500 %0.25, Mahmud Han-ı Evvel b. Mustafa Han (I. Mahmut) Vakfı (%0.25),
Mahmud Han-ı Sani b. Abdülhamid Han-ı Evvel (II. Mahmut) Vakfı (%0.25), Murad Paşa b. Abdusselam (Murat Paşa) Vakfı (%0.25)

**Source:** Compiled from annual reports of each PBs.

Currently, at the end of 2016, five PBs operate in Turkey: Albaraka Turk, Kuveyt Turk, Türkiye Finans, Ziraat Katılım and Vakıf Katılım. The market leader is Kuveyt Turk with its 48.5 billion TRY assets and 37% share, and it is followed by Turkiye Finans with a 29% share. Although Albaraka Turk is the oldest PB in Turkey, established after the legislation in 1984 and started operations in 1985, it is ranked third. The majority shareholders of these three banks are foreigners and the other two are already state-owned PBs. The Turkish government considers Islamic finance as a strategic sector and targets to increase PBs' market share to 15% by 2025 (TKBB, 2015). In order to achieve this target, they established the first state-owned PB, Ziraat Katılım in 2015. The capital of this PB was provided by Treasury of Turkey, but this capital is represented as coming from the biggest state-owned agricultural bank, Ziraat Bank. Although Ziraat Katılım is a subsidiary of Ziraat Bank, because of the Sharia compliance necessity Ziraat Katılım separates its activities strictly from Ziraat Bank, which is a conventional bank (not Islamic). They have separate headquarters and branch networks. In less than two years, the market share of the Ziraat Katılım in Islamic banking reached 6% with a 7.960 million TRY asset size in 2016. Amongst these state-owned PBs, Vakıf Katılım is the closest one to the historical cash *waqfs*. Not only by its name (*w-q-f/v-k-f*), but also its capital came directly from the prosperity of cash *waqfs* in the Ottoman Empire. Hence, considering the history of cash *waqfs* and Islamic banking in Turkey, Vakıf Katılım is the best candidate to embrace the heritage of cash *waqfs* as well as operate like other PBs in a *Sharia*-compliant way.

## 3. Vakıf Katılım vs. Historical Cash *Waqfs*

As was pointed out above, the Islamic finance in the Ottoman Empire and the Republic of Turkey has a considerable history in terms of their development phases. To rephrase, the cash *waqfs*, which operated for nearly six centuries, were the dominant financial institution in the Ottoman Empire as well as was a charity organization. There was a remarkable time interval between the foundation years of the new Turkish Republic (the 1920s) and the first attempts in terms of Islamic finance (the 1970s). From DESIYAB to state-owned PBs, the 45 years could be regarded as a constitutional phase of Islamic Banking in Turkey.

Today the Turkish government, arguably, seems to be motivated to restitute the cash *waqf* heritage in the structure of state-owned Vakıf PB, which was established in 2015 and started to operations in 2016. Vakıf PB (Vakıf Katılım) indicates that the foundation money came from some waqfs in the Ottoman Empire in its declaration. According to this declaration, the main co-founder shareholder of the Vakıf (*Waqf*) Participation Bank is the General Directorate for *Waqf*s with a 99% contribution of its money. And the other shareholders are old *waqf*s, which are Bayezid Han-ı Sani (Bayezit II) Waqf, Mahmud Han-ı Evvel b. Mustafa Han (I. Mahmut) Waqf, and Mahmud Han-ı Sani b. Abdülhamid Han-ı Evvel (II. Mahmut) Waqf ve Murad Paşa b. Abdusselam (Murat Paşa) *Waqf*. Although the share of these old *waqf*s is very small, their presence is symbolically important. The importance of reviving *waqf* culture was also emphasized as the missions and visions of Vakıf PB. Additionally, President Erdoganunderlines said that Vakıf PB should support charity activities such as education through scholarship and help needy people, like the *waqf*s in the Ottoman Empire.[8] These declarations show the link between *waqf*s – cash *waqf*s in particular – and this new state-owned PB; Vakıf Katılım.

Also, there is a plan to transfer the 58.5% shares of the General Directorate for *waqf*s in the other state-owned deposit bank, Vakıf Bank, to the Vakıf Katılım in 2017.[9] The nominal value of this 58.5% share is around 1.5 billion TRY, which can provide a significant opportunity to increase the total share of PBs. Also, the misusage of the *waqf* money or assets in the many years of interest-bearing activities through the Vakıf Bank would be ended and these sources could be used in a *sharia*-compliant way in the Vakıf Katılım.

**Table 5:** Comparison Between Cash *Waqf* and PBs

| | **Cash Waqfs** | **PBs** |
|---|---|---|
| **Type of Institution** | Financial and Social, Islamic | Financial Institution, Islamic |
| **Modes of Islamic financing** | - Sale and debt based (mainly *muamele-i şer'iyye* and *istiğlal*) | - *Murabaha* (more than 90%) |

[8] http://www.haberturk.com/ekonomi/is-yasam/haber/1201209-cumhurbaskani-erdogandan-onemli-aciklamalar

[9] https://www.haberler.com/vakiflar-genel-mudurlugu-nun-vakifbank-taki-9581013-haberi/

| | | |
|---|---|---|
| | - Very limited equity partnership and *qard al-hasan* | - Very limited equity partnership (*musharaka* only) and *qard al-hasan* |
| **Sharia Compliancy (Financing)** | More controversial (*muamele-i şer'iyye*) | Controversial (*tawarruq*) |
| **Sustainability** | Some of them operated for more than one century[10] | The oldest PB is around 30 years |
| **Profit Orientation (in main purpose)** | Not profit oriented | Profit oriented |
| **Financial Inclusion** | Served different strata of the society (including needy people) | Especially credible people, who have credit history and collateral |
| **Regulatory Flexibility** | Flexible | Strict (subject to the local and international banking regulations) |
| **Social Impact** | High | Relatively low due to exclusion of low income people in financing activities and the limitation of charity activities imposed by regulators. Also, shareholders and investment account holders' expectations for dividend and profit |

It is also worth noting that *waqf*s should be managed according to their regulations which define the scope of the activities. Thus, to be fitted to the moral of *waqf*, these founder *waqf*s should be examined. Using the lending methods of the cash *waqf*s and integrating them into current participation banking model may provide a solution to the current problems in this area, such as the scarcity of new products, etc. All in the state-owned PBs, arguably, were established to compensate the *waqf* donators' bequests, which were the use of the charitable property for only the sake of society. As to the similarities and differences of cash *waqf*s and state-owned PBs, they could be regarded as similar in terms of their main purpose, which is supporting the social wealth in the society. On the other hand, while cash *waqf*s were private foundations, state-owned PBs are state-dependent institutions. They are different in their financing methods, namely, cash *waqfs* had preferred *muamele-i şer'iyye* and *bey' bi'l-istiğlal*, while recent PBs – and state-owned PBs as well – prefer *murabaha* mostly. But it should be considered that cash *waqfs* can differ region

[10] Çizakça (1995) indicated that more than 20% of the cash waqfs in Bursa within a period of 268 years were operated more than one century.

to region and in this study the information of four different cash *waqfs* in two different cities was taken into consideration. In other cash *waqfs* in the Ottoman Empire, other various methods might be used and the borrower profile might be different.

Although the *murabaha* is seen as more satisfactory for *Sharia* than the *muamele-i şer'iyye*, PBs have been also criticised by intensively using *murabaha.* The main point of criticism for PBs in Turkey, as well as all Islamic Banks, is that they mimic conventional banks, which operate on the principle of debt financing and not on partnerships and a profit/loss sharing model. The total share of *murabaha* 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 al-hasan* have ~3.0% share and they have a limited *mudaraba*-type partnership.

The main problem behind why PBs do not use *mudaraba* and *musharaka* type financing is because of the short-term maturity of collected funds, whereas these financing models are long-term. So, according to Çizakça, cash *waqf*s would be integrated to PBs' funding sources as venture capital to finance entrepreneurs or feasible projects (Çizakça, 1993). Furthermore, PBs focus more on the credibility of credit customer, rather than their projects, like conventional banks. Accordingly, low-income people yet again cannot have access to financing from PBs due to lack of credibility, collateral, etc. Thus, we have another case which leads to social injustice and income inequality. This is a bizarre situation because one of the missions of the PBs should be to provide the low-income people with an opportunity to betterment in society and to facilitate the fair distribution of wealth and financing modes (such as *mudaraba, musharaka, qard al-hasan*, etc.) to achieve these goals. Cash *waqf*s also would have a key role to meet the financial need of low-income people because these institutions were using *qard hasan*-type financing without any return.[11] Thus, the integration of the establishment purpose of cash *waqf*s to PBs will be beneficial for serving Islamic microfinance to the needy people. Hence, because of the main purpose of a cash *waqf* is not generating profit and it only needs profit for its continuity, cash *waqf*s and state-owned PBs coincide with each other more than cash *waqf*s and private PBs. Thus, the new state-owned PB, Vakıf Katılım, can serve as a cash *waqf* if it rectifies the shortcomings and gaps in the application of private PBs.

[11] Although the proportion of *qard al-hasan* type is very low, *waqf* institution established in accordance with *sadaqa* principle.

## 4. Conclusion and Policy Recommendation for Vakıf Katılım

This study has gone some way towards enhancing our understanding of Islamic finance in the Ottoman Empire and modern Turkey. In the Ottoman Empire, one of the most important institutional tools of the state was *waqf*. As a social institution, *waqf* had a key role in the public life of the Ottoman Empire. Moreover, the cash *waqf*s can be regarded as the Islamic finance system of the Ottoman Empire. They met financial needs of the Ottoman society for many years. Compared to the today's PBs, cash *waqf*s – like all other *waqf*s – were founded not for profit but for the benefit of society. The cash *waqf*s were founded in compliance with Islamic values, such as solidarity, the interest-free principle and *sadaqa*. Although there was some misuse in the operations of *waqf*s or corruption in their organization in the last few centuries of the Empire, cash *waqf mutevelli* were mostly trying to use Islamic financing tools and to obey Islamic rules. But with the collapse of the Ottoman State, cash *waqf*s – like most of other *waqf*s – were closed as well. Later, Vakıf Bank was established with the treasury of the cash *waqf*s. But in this transitional phase, it is obvious that practices have not been in accordance with the original values of the *waqf*s. Putting aside the fact that any change, destruction, abolishment or transfer in a *waqf* body was strictly forbidden, the establishment of a commercial bank, which contains interest practice, with the donated money of *waqf*s was contradictory.

Although, Islamic scholars and politicians were aware of the necessity for the restitution of the historical cash *waqfs* which had closed in the republican years, the political atmosphere had not been available for an Islamic finance institution model like cash *waqf*s until the 1980s. The expansion and democratisation of the political sphere for the sake of pious people, meant that Islamic finance started with SFHs, continued with the establishment and development of PBs, and, lastly, the state-owned participation banks which were founded in the last decade. Taking the statement of the legislation of Vakıf PB (see Appendix 2), which indicates that this bank took over the inheritance of cash *waqfs* and the political opinion of the ruling party into account, it is obvious that these institutions will serve in parallel with cash *waqf*s. However, this will be understood by looking at the activities of these banks in the coming years. In principle, if a state-owned PB takes the lower-income people into account at first, it could operate like a *waqf*.

Vakıf Katılım can serve society as cash *waqfs* by allocating some of their profit to charitable activities. However, there is a threshold for donations in the Bankıng Authority regulation, which limits total donations within one year to a maximum 0.4% of the total equity of the bank (BRSA, 2006). Therefore, through a dividend distribution to the shareholders of the Vakıf

Katılım, which are the Vakıf Directorate and historical *waqfs*, Vakıf Katılım indirectly serves society through these *waqfs*.

Although Vakıf Katılım can exceed the legal limit for donations by distributing dividend to the current shareholders, it will face another regulative and economic limitation. In other words, PB, like other conventional banks, are subject to capital adequacy regulation, which impose a minimum capital adequacy ratio that is currently 12%. In order to distribute the dividend to the shareholder, it is required to request permission from BRSA, which generally allows around 10-20% of net profit as dividend payout, and sometimes (i.e. economic crisis period) they do not even permit any dividend distribution. Apart from regulatory limitations, Vakıf Katılım needs capital as a source of funds in order to increase market share by channeling them to clients as a funded credit. Therefore, CAR and the strategic growth target of Vakıf Katılım can keep themselves from distributing high dividend.

For this reason, the social aspect of the Vakıf Katılım can be realized in its banking operations by providing financial services to low-income people. In that point, Islamic microfinance is an appropriate tool to alleviate poverty. It includes not only financial services, mainly credit and saving products, but also non-financial services such as training of the poor people in accounting, financial literacy, etc. Therefore, Vakıf Katılım can allocate some of their funds to microfinance activities. They can provide a small amount of credit to low-income people without any collateral so that they can give opportunities to poor people who are excluded by the conventional banking sector, as well as PBs, to escape from unacceptable conditions. Also, non-financial services can be ensured by using the facility of the Vakıf Directorate. Thereby, the social aspect of the cash *waqf* will not just realized by donations but also in the financing side. Also, microfinance activities are not charity: in other words, the extended credit must be paid back. Therefore, Vakıf Katılım can also gain profit from these activities and expand its customer base. Vakıf Katılım can establish a special department within their organizational structure or establish a subsidiary for microfinance.

Nowadays, the public sphere is suitable for these state-owned PBs to act as *waqfs* in terms of their support for needy people. This is because the past decade has seen the rapid development of state-owned PBs as well as the development of PBs in many services. This development was achieved because of the change in the political climate and the growth of the national economy. PBs has 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 still at a very low level. This is a serious concern that has prompted the Turkish government to invest further into this sector through some state-owned banking conglomerates in order to achieve a 15% market share by 2023 within the context of the strategic plan that aims to turn Istanbul into one of the leading world financial centres. By providing microfinance to the wide strata of the society by Vakıf Katılım, market share and penetration of the PBs will be increased. Also, it will positively affect the image of the PBs in the society which is seen as mimicking conventional banks in terms of not only product but also mindset and approach to the client. In other words, PBs are heavily criticized by only focusing on profit maximization and for serving only creditworthy people. Microfinance activities by Vakıf Katılım will help to restore this perception towards a more socially-responsible image.

In terms of product diversity, unfortunately the cash *waqf* experience cannot provide new dimensions for PBs because *muamele-i şer'iyye* was mainly used in *waqf* operations. Although there is much criticism and controversy around the *murabaha* contract, *muamele-i şer'iyye* cannot be accepted instead. On the contrary, it may affect the image of the PBs negatively. Also, the current practices of *tawarruq* is very similar to the *muamele-i şer'iyye* and it is not approved by many sharia scholars and is used very limitedly by PBs. Instead of *muamele-i şer'iyye*, *istiğlal* can be seen as a more applicable for Vakıf Katılım; however, there is a regulation need to solve the cost arising from sell-lease back and buy transactions.

In conclusion, as was demonstrated in the paper, it is difficult to make a direct relation between PBs and cash *waqf*. However, to restitute the statements in the *Vakfiye* books, Vakıf Katılım can be structured as a social financial institution for the sake of society. Because of the legal and market constraints and complex structure of a PB, a direct mimic between cash *waqf* and Vakıf Katılım is difficult to establish. However, through some proposals, a bridge could be made between these two institutions, at least partially. The main recommendation is that Vakıf Katılım should give priority to products that will support the low-income class, which is lacking in other PBs. If it will act in this way, the historical expressions that are written in the organization will not remain as only symbolic, but live in practice. This is because *waqf*s were established and granted by the Ottoman Sultans for the sake of needy people and this purpose is indicated at the very beginning of the *vakfiye* books. Some financing methods of cash *waqfs*, which are derived from historical sources by studies on cash *waqf*, can be tried to be implemented by PBs in general and by Vakıf Katılım in particular. New studies on cash *waqfs* in different periods and locations may reveal new methods for PBs in the future as well.

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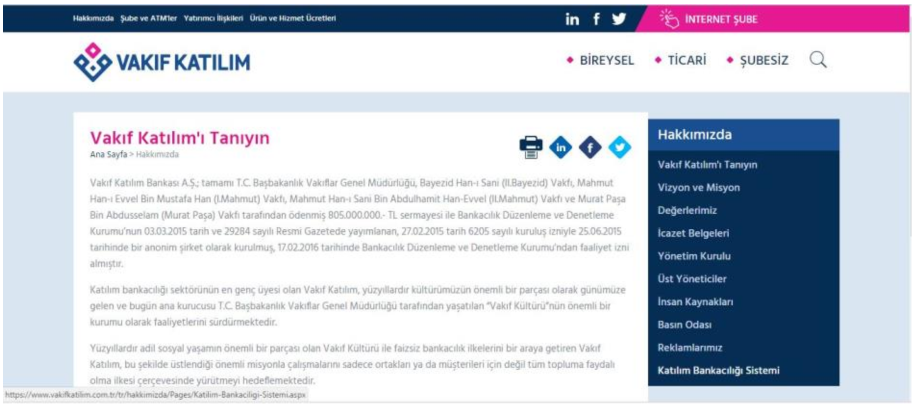
**Appendix 1:** Malediction part of a waqf which belongs to the Ottoman Sultan Kanuni

Source: http://www.vgm.gov.tr/sayfahtml.aspx?Id=3, accessed date: 21.06.2017

**Appendix 2:** Mission&Vision of Vakıf Katılım




Source: https://www.vakifkatilim.com.tr/tr/hakkimizda, accessed date: 15.06.2017. Note: Currently, Vakıf Katılım have only Turkish website.