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Between consumer demand and Islamic law: The evolution of Islamic credit cards in Turkey ☆

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ABSTRACT

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The elimination of interest from financial transactions has been a salient goal of Islamization movements around the world. Its proponents have had to balance this objective, which they claim to draw from Islamic law (Sharia), against consumer demand for convenient products. In general they have opted to accommodate consumer demand, but surreptitiously, using legal ruses to disguise their compromises. Turkey's experience with credit cards offers a revealing case of the obfuscation in question. Having denounced credit cards as un-Islamic, Turkey's Islamic banks have all proceeded to issue credit cards of their own in order to remain competitive with their openly interest-friendly, conventional rivals. With local variations, the Turkish pattern resembles that of other markets where Islamic credit cards have made inroads. In Malaysia and the United Arab Emirates, too, Islamic credit cards function like those of the conventional banks with which they compete for customers. The "Islamic" features of Islamic credit cards amount to branding. Contrary to the claims of their proponents, they do not involve fundamental financial innovations. *Journal of Comparative Economics* **43** (4) (2015) 862–883. Marmara University, Turkey; Duke University, USA.
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1. The compatibility of credit cards with Islamic finance

A credit card provides its owner a line of credit from which he can withdraw money as a cash advance or as payment to a merchant. For a cash advance, he begins to incur interest charges immediately. For a good or service bought from a merchant, he can avoid charges if he repays the bank within a specified period after the transaction appears on his monthly bill. If he fails to pay his bill in full within the alloted time, he starts to incur interest charges. The credit card's owner will continue to accrue interest debts until he pays a monthly bill in full, including accumulated interest charges.

One might expect Islamic banks to have ruled out the use of credit cards categorically. After all, their declared purpose is to conduct banking on an interest-free basis. Indeed, most Islamic scholars consider the conventional credit card un-Islamic (*haram*) even if the cardholder avoids interest charges by paying the full amount of each monthly bill. One reason is that his contract with

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the card's issuer commits him to paying interest in the event of a missed payment. Another is that he obtains access to cash advances at interest.

Practically all Islamic banks compete with banks that give and take interest openly and unapologetically. These interest-friendly banks, which may be called "conventional banks" as a short-hand, have no qualms about credit cards. As credit cards gained popularity, they simply fulfilled the swelling demand in order to augment their profits. The same profit opportunities have induced Islamic banks to offer an analogous product. They have responded by issuing ostensibly interest-free credit cards characterized as "halal," "Sharia-compliant," or simply "Islamic."

Our objective is to explore this response to the challenge of supplying credit cards compatible with the principles of Islamic banking. Turkey's Islamic banks differentiate their credit cards from those of conventional Turkish banks partly by disguising their interest charges through euphemisms. They also make their clients agree to refrain from using their credit cards for "un-Islamic" transactions, such as the purchase of alcohol or pork. As a matter of practice, however, the users of Islamic credit cards enjoy the same privileges as those of conventional credit cards. Likewise, the fees that they pay match those paid to conventional banks.

As we shall see, there are differences among the credit cards issued by Islamic banks in different countries. By and large, these cross-country differences mirror the corresponding differences across the financial sectors. In each country Islamic banks have adapted to the conditions of the domestic financial sector. Consequently, the Islamic credit cards of any given country function more like the conventional credit cards with which they compete locally than the Islamic cards in use elsewhere. Beyond symbolic features, the world's Islamic credit cards share no characteristics that distinguish them from conventional credit cards.

We start with a description of the Islamic banking sector that generated Turkey's first Islamic credit cards. Then the focus will turn to the credit cards themselves.

2. Turkey's Islamic banking sector

Turkey's first Islamic banks were established in 1984 and 1985 in accordance with a law passed in 1983. The pioneers were consortia led by Saudi Arabian and Bahraini investors.[1] Because of qualms grounded in Turkey's secularist principles, neither bank's name or charter referenced Islam. The Faisal Finance House and the Albaraka Finance House vowed to provide an interest-free alternative to conventional banking. In principle, they took deposits on the basis of profit and loss sharing; and, likewise, their depositors participated in an invesment pool whose returns would not necessarily be positive. If the bank's investments resulted in losses, deposits would shrink. Based on the premise that the depositors of finance houses accepted downside risk, their deposits were not insured. The commercial loans of Faisal and Albaraka were based, again in principle, on profit and loss sharing. They were to earn not interest but variable returns based on the profitability of the projects financed.

Several other finance houses were established over the following years, bringing the total to six by 1996. The largest of the six was the İhlas Finance House, whose capital came mostly from Turkish investors. It went bankrupt during Turkey's 2001 financial crisis (Eken, 2006). In the absence of deposit insurance, tens of thousands of its depositors and investors lost money, prompting massive withdrawals from all of the finance houses. In response to this shock, the law governing their operations was revised in 2005. Now called "participation banks" (*katılım bankaları*), their deposits would be insured, as with the deposits of conventional banks, up to TL 50,000.[2] The insurance limit has since been raised to TL 100,000.

Mergers and acquisitions reduced the number of participation banks to four by 2005. Three of these are primarily foreign-owned: Albaraka Turkey, Kuveyt Türk (Kuwait-Turkish), and Türkiye Finans (Turkey Finance). The only primarily Turkish-owned participation bank, Asya, is also the largest in terms of assets and depositors. Cumulatively, the participation banks held 5.54% of the Turkish banking sector's assets at the end of 2013, and 6.66% of the deposits. They had 966 branches, which represented 8.05% of all the bank branches in Turkey (Table 1).

Table 1
Share of participation banks in the Turkish banking sector, end of 2013.

Bank	Assets (%)	Deposits (%)	Credit (%)	Bank branches (%)
Asya	1.60	1.95	1.88	2.34
Kuveyt Türk	1.49	1.79	1.51	2.24
Türkiye Finans	1.45	1.59	1.66	2.09
Albaraka	0.99	1.32	1.11	1.39
All	5.54	6.66	6.16	8.05

Source: TKBB (2014).

[1] BDDK, 2011; Yılmaz, 2010. For an extensive bibliography on Islamic banking in Turkey, see Solak (2003).

[2] This happened on February 10, 2001, and eleven days later the remaining Islamic banks initiated efforts to establish a deposit insurance system of their own (Ntvmsnbc, 2009; Yeni Şafak, 2001). They were ultimately unsuccessful. Eventually, on November 1, 2005, a legislative change in banking regulations enabled the Islamic banks to join the insurance system long used by conventional banks. As part of this reform, their legal status changed from "private finance houses" to "participation banks."

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