

Islamic Finance in the Republic of Kazakhstan

Finanzas Islámicas en la República de Kazajastán

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ABSTRACT:

The purpose of this article is to consider the development of the Islamic financial system and to determine its state in the Republic of Kazakhstan. The article discusses the introduction of Islamic banking in the financial structure of Kazakhstan and considers the prospects for its development in the country. The study shows that one of the main reasons hindering the development of the Islamic banking sector is that Islamic banks cannot yet offer analogues of all financial instruments and banking products used by traditional banks. It is believed that the introduction of Islamic banking will promote the development of economic ties with Arab countries and their financial and credit institutions, and create a good opportunity to attract investments from the Middle East.

Key words Islamic finance, banking, financing, financial organizations

RESUMEN:

El propósito de este artículo es considerar el desarrollo del sistema financiero islámico y determinar su estado en la República de Kazajstán. El artículo discute la introducción de la banca islámica en la estructura financiera de Kazajstán y considera las perspectivas de su desarrollo en el país. El estudio muestra que una de las principales razones que obstaculizan el desarrollo del sector bancario islámico es que los bancos islámicos todavía no pueden ofrecer análogos de todos los instrumentos financieros y productos bancarios utilizados por los bancos tradicionales. Se cree que la introducción de la banca islámica fomentará el desarrollo de lazos económicos con los países árabes y sus instituciones financieras y crediticias, y creará una buena oportunidad para atraer inversiones de Oriente Medio.

Palabras clave finanzas islámicas, banca, financiamiento, organizaciones financieras

The government of the Republic of Kazakhstan made a decision to establish the development of Islamic finance based on certain grounds. One of the main tasks was to attract steady flows of long-term investments from outside, which would be involved in the development of industrial areas. The second task was to manage diversification by investment flows aimed at reducing dependence on a single source of financing. Another task involved economic stability and regulation of the functions of Islamic finance systems based on: (1) attracting investment capital for the formation of the current added value as well as directing these investment flows towards the real economy; (2) simplifying interest rates; (3) banning speculation on transactions involved in risky enterprises; (4) dividing risks between parties involved in transactions; and (5) concentrating activities in the social sphere (Islamic finance in Kazakhstan, 2011).

In recent years, the introduction of Islamic banking in the financial structure of Kazakhstan has been widely discussed. In order to understand the essence of Islamic banking, one should first try to define Islamic finance and the Islamic economy. The Islamic economy is understood as a financial and economic system, which is based on moral values and legal regulations of the Islamic religion. The ideological foundation of this system is formed by the economic views of Muslim scholars and Islamic law, the Sharia, based on the dogmas of the Koran. Great importance is attached to the norms and rules of adherence to the principles of justice in the relations between economic entities in the structure of the Islamic economy. From the point of view of Islamic law, any economic activity that has elements contradicting the norms of the Sharia is inadmissible (Baudaulet, 2011).

The main feature of the activities of Islamic banks is the prohibition of charging an interest rate – *riba*, which, translated from Arabic, means “an increment”, “an increase”. The Sharia considers *riba* to be an unfair profit, since the creditor makes no effort to receive it (Zhdanov, 2003).

Classical Islamic types of equity financing - *mudaraba* and *musharaka* – require that both the lender and the borrower participate in the project. The schemes used by Islamic banks can be compared with the activities of investment banks and venture funds in the process of project financing. Islamic trade financing differs from a conventional loan in that it is carried out for the purchase of a product by the bank with subsequent sale or transfer to the client for use. The schemes of *murabaha* and *ijar* are based on these principles (Kuran, 2008).

Contrary to popular belief, Islamic finance, or rather the Islamic financial system, is not limited to the activities of Islamic banks. There are Islamic insurance companies, investment funds and other financial institutions; Islamic stock indices are calculated, etc. However, it was the Islamic banks in recent history that had to be the driving force of a new economic model. Currently, only three countries – Iran, Sudan and Pakistan – are trying to create a financial and economic system that fully complies with the norms of the Sharia. However, in spite of this, the Muslim economic doctrine has not been fully realized anywhere in the world (Aryspaeva, 2015).

In 2008, there were 371 Islamic financial organizations (commercial and investment banks, asset management companies, insurance companies) and 163 management companies operating in accordance with the Islamic principles of the branch of traditional financial organizations. At the same time, the total amount of assets of these organizations amounted to more than \$900 billion, which roughly corresponded to 1.2% of world GDP. Recently, the pace of expansion of the Islamic banking sector in the world financial system has been an average of 15-20% per year. In 2008, this figure was even 28.5% (The Banker, 2009).

The real boom of Islamic banking began in Arab monarchies about five years ago (Table 1). If ten years ago there were no Islamic investment banks in the world, now there are 33 Islamic banks in Arab countries alone. Most of them are relatively small in the framework of national markets. At the same time, the sphere of activity of the largest Islamic investment banks covers not only the Middle East and Asia, but also the United States, Europe, and Japan (Market Review, 2006).

Table 1
Islamic banks in the largest Arab monarchies

Country	Banks, total	Including Islamic commercial	Share of Islamic banks, %			Name of Islamic banks (year of creation – in brackets)
			by assets	by investment	by loans	
Saudi	16	2	13,1	13,8	18,4	1) Al-Rajhi Banking and Investment

Arabia						Corporation (1988); 2) Noor Islamic Bank (2006)
United Arab Emirates	47	6	16,4	17,0	20,0	1) Dubai Islamic Bank (1975); 2) Abu-Dhabi Islamic Bank (1997); 3) Sharjah Islamic Bank (2002); 4) Emirates Islamic Bank (2004); 5) Al-Bilad Bank (2005); 6) Dubai Bank (2006)
Bahrain	29	6	22,8			1) Bahrain Islamic Bank (1979); 2) Al-Baraka Bank (1984); 3) Shamil Bank of Bahrain (2000); 4) Kuwait Finance House Bahrain (2002); 5) Khaleeji Commercial Bank (2004); 6) Al-Masraf (2006)
Kuwait	14	3	26,5	25,3	26,1	1) Kuwait Finance House (1977); 2) Bubiyan Bank (2004); 3) Kuwait Real Estate Bank (2004)
Qatar	15	3	14,6	15,3	15,0	1) Qatar Islamic Bank (1983) 2) Qatar International Islamic Bank (1990) 3) Al-Rayan (2006)

Note. Compiled by the authors based on data from Global Investment House (www.globalinv.net), Central Bank of Bahrain (www.cbb.gov.bh), Zawya (www.zawya.com).

Despite the rapid growth of their assets, Islamic banks cannot yet offer analogues of all financial instruments and banking products used by traditional banks. This is one of the main reasons hindering the development of the Islamic banking sector in the world. Currently, it is concentrated in several regions and in a limited niche, but its potential, an important element of which is an interest on the part of non-Muslim investors, allows it to be globalized both in the sectoral and geographical context (Merton, 2000).

Today, Islamic banking has good prospects for development in Kazakhstan. Domestic bankers are interested in diversifying their risks. In addition, the introduction of Islamic banking will promote the development of economic ties with Arab countries and their financial and credit institutions, and create a good opportunity to attract cheap money from the Middle East (Islamic Finance in Kazakhstan: New Amendments, 2015).

For the development of Islamic banking in Kazakhstan, relevant amendments were made to the domestic legislation. With the aim of introducing Islamic financial instruments in Kazakhstan in October 2008, the Parliament of the Republic of Kazakhstan introduced a bill "On Amendments and Additions to Some Legislative Acts of the Republic of Kazakhstan on the Organization and Activities of Islamic Banks and Islamic Finance", which was put into effect in February 2009 (Law of the Republic of Kazakhstan..., 2009). According to this Law, additional amendments were made to the banking legislation in order to exclude the possibility of collecting

remuneration within the framework of Islamic lending in any form, and not only in the form of interest payments (Chapra, 2001).

It should be noted that in Kazakhstan both government bodies and commercial structures show an increased interest in the possibility of introducing Islamic financial products. The practical aspect of introducing Islamic financial principles in Kazakhstan becomes a relevant issue, which implies the regulation of this activity at the level of legislative acts. In this regard, the above-mentioned law amended the Civil Code of the Republic of Kazakhstan (Special Part), particularly the laws "On Banks and Banking Activity in the Republic of Kazakhstan", "On the Securities Market", "On Investment Funds", "On State Registration of Rights to Immovable Property and Transactions with it" (Maksimov and Miloslavskaya, 1982).

For example, the Civil Code was amended to regulate the peculiarities of buying and selling goods by Islamic banks, property trust management when carrying out banking activities, and attracting bank deposits. Separate features of the activity of Islamic banks (for example, the provision that bank loans of Islamic banks are issued without collecting remuneration for the use of money) may be established by legislative acts of the Republic of Kazakhstan regulating banking activities. Amendments to the Law "On Banks and Banking Activity in the Republic of Kazakhstan" are aimed at creating legal bases for the functioning of Islamic banks, removing restrictions that prevent the introduction and integration of Islamic banks in the financial system of Kazakhstan, determining the forms and methods of state regulation and supervision over the activities of Islamic banks, defining the list and procedure for the implementation of Islamic banking operations, as well as establishing a ban on the implementation of Islamic banking operations by traditional banks. Amendments to the Law "On the Securities Market" provide the concept of Islamic securities, the procedure for their issuance and circulation. Amendments to the Law "On Investment Funds" determine the requirements for Islamic investment funds. Amendments to the Law "On State Registration of Rights to Immovable Property and Transactions with it" provide for the state registration of rights to immovable property acquired by an Islamic bank as a trustee at the expense of investment deposits (Khodzhanazarov, 2009).

The main feature of Islamic banking, which contradicts the current banking legislation of the CIS and Kazakhstan, is the sharing of profits and risks between an Islamic bank and a client. There are a number of other features such as, for example, the participation of the bank as an intermediary in trading activities with the provision of commercial credit, or the absence of a refinancing rate as the main principle of usury, which are not regulated by the current legislation. In addition, the issues of tax regulation and accounting standards, which must be coordinated with the Tax Committee and developed jointly with the National Bank of the Republic of Kazakhstan, remain open and unresolved (Zabolotnikova, 2015).

Among Kazakhstani financial institutions, one may single out BTA Bank JSC, which became the first Kazakhstani bank to use Islamic financial instruments, having started cooperation with the Islamic Development Bank in 2003. In early 2009, Kazakhstan established the first brokerage company FATTAH FINANCE JSC, which provides services on Islamic financial principles. The creation of this company demonstrates the interest of market participants in the development of instruments of the Islamic financial system in Kazakhstan. Currently, FATTAH FINANCE JSC registers the first risk-based mutual investment fund in Kazakhstan, the Amana Mutual Funds Trust, which will work according to the Islamic norms of the Sharia.

In conclusion, a number of conclusions can be drawn. In the coming years, the following socio-economic changes regarding the introduction of Islamic banking are expected in Kazakhstan's economy:

- 1) organization of the activity of Islamic banks, Islamic investment funds, as well as introduction of Islamic financial instruments in Kazakhstan, including the issue of Islamic securities;
- 2) development of a competitive environment in the financial market through the creation of

financially sustainable alternative forms of financing of Kazakhstan's economy, which will help to reduce interest rates and commissions for services of traditional banks;

3) creation of a legal framework for attracting foreign investments from the countries of the Middle East and South-East Asia with excessive liquidity to the financial sector of Kazakhstan, and diversification of the investor base by shifting the focus to investors from these countries.

The adoption of the relevant law on Islamic finance will give a powerful impetus to the development and organization of Islamic banking activities and the introduction of Islamic financial instruments in Kazakhstan. Large Islamic banks in the Middle East and South-East Asia recognize Kazakhstan as an experienced partner with steadily growing financial institutions and have an interest in investing their assets both in the banking sector and in various investment projects in Kazakhstan. In addition, the adoption of the law will give the opportunity to organize Islamic investment funds in Kazakhstan. In this market, Islamic financial instruments, such as Islamic commercial notes and Islamic bonds (*sukuk*), are gaining considerable popularity.

It should also be noted that the government supports the development and dissemination of Islamic financial principles in Kazakhstan. In particular, the Agency of the Republic of Kazakhstan on Regulation of Activities of the Regional Financial Center of Almaty (RFCA) is carrying out large-scale works to attract investors from the Middle East and South-East Asia. At the same time, the Agency actively cooperates with Kazakhstani enterprises in attracting investment capital for the implementation of projects, both through direct financing and through Islamic financial instruments.

The creation of a legislative framework for the development of Islamic financial principles, state support and interest in cooperation with foreign representatives of Islamic capital markets – all these factors contribute to the fact that the world's Islamic financial experts see Kazakhstan's position as a developing Islamic financial hub in the CIS and Central Asia. Thus, the positioning of the RFCA as a regional center for Islamic financing will provide the country with an additional opportunity to gain a number of advantages over the other countries of the region. On the one hand, the acquisition of a new status of the RFCA will attract representations of international organizations. On the other hand, increasing the confidence of Islamic investors will help to expand opportunities for business cooperation for the business sector in Kazakhstan.

In conclusion, one cannot but mention the existence of pessimistic forecasts about the development of Islamic banks in Kazakhstan. Firstly, they are based on the still very small scale of their operations compared to the largest traditional banks, secondly, on the growing competition with traditional banks, including the opening of Islamic "windows", thirdly, on the continuing shortage of short-term liquidity associated with the underdevelopment of Islamic short-term financial instruments and the secondary market of Islamic securities. Finally, they are connected with the fact that in recent years, the rapid growth in profits of Islamic banks has been partly due to the growth in oil prices.

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