

**Islamic Banking and Finance in Emerging
Countries:
A Study of Post-Soviet Central Asian
Republics**

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Abstract

Till late 1980s most Central Asians were still deeply secular in outlook, a legacy of 70 years of communist rule. Since the breakup of the Soviet Union, each of the Central Asian Republics joined the largest Islamic banking institute IDB: Kyrgyzstan (1993); Turkmenistan (1994); Kazakhstan (1995); Tajikistan (1996); and Uzbekistan (2003). By 1997, the IDB established a regional office in Almaty, Kazakhstan, to foster its efforts to enhance the socio-economic development of the region. The regional office in Almaty has effectively become the hub for IDB group operations in the whole area. The regional decision makers, investors and private bankers are gradually opening up to Islamic financial products. Responding positively to the growing customer demand, local governments like Kazakhstan, Kyrgyzstan and Uzbekistan have made some significant amendments in their respective state constitutions. Such amendments were meant to provide a legal platform for the industry where it could facilitate its *Shari'ah* based financial instruments and could also generate a healthy market share. The present paper would be an attempt to examine the present nature and status of Islamic banking and finance industry in the five emerging economies of Post-Soviet Central Asia.

Keywords: Post-Soviet Central Asia, Islamic finance, Emergence, Development

Introduction

Central Asia¹ defines a region housing five republics of: Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Located on the cross-roads of grand Silk Route, the region is flanked by East China, Iran and Western Caspian Sea. The region is homeland to a variety of ethnic populace and the five largest ethnic groups are, in descending order of size, the Uzbek, Kazakh, Tajik, Turkmen, and Kyrgyz [1]. The total population of the region as per 2013-2014 census report is about 66 million [2]. The majority (80%) of the population are adherents of Islam despite the Tsarist and Soviet domination and persecution against the Islam in different ways [3].

The epoch making of 1991², has been a challenging task for the whole region to frame-up new policies and to develop new geopolitical strategies in order to built-up relations with the countries around. In an “authority vacuum” like situation, some Muslim countries like Turkey, many Arab countries and Iran, with good availability of funds, find out an opportunity to get engaged in the region. Apart from strengthening their economic and political ties with the region, these countries reinforced the local Islamic factors by providing them ideological and material support. Huge amount of funds were spent on rebuilding the mosques and other socio-religious institutions in the region. Such profound religious

¹ Central Asia covers an area of 3,994,300 square kilometers which includes some of the most sparsely populated regions in the world. Its population of only 51 million people includes more than 100 different ethnic groups. Houssain Kettani writes in his article “Muslim Population in Asia:1950-2050” that the related percentage of Muslims in this region increased from 89% in 1870, to 75% in 1950 and it expected to reach 91% by the end of 2020.

² By the end of the 19th century, the Russian Empire had won control of Central Asia. In the 1920s, the Soviet Union took control and governed the region until 1991. Since the collapse of the Soviet Union, the Central Asian republics have been independent.

developments encouraged people to get engaged in religious activities and to think of their cultural roots. The growing rate of practicing Muslim population who believed Islam to be a comprehensive system steadily rose in countries like Kazakhstan, Azerbaijan, Tajikistan and Uzbekistan. A significant portion of the population, for whom the religious beliefs and conventional financial practices had remained inaccessible, responded positively to the very currents of Islamic revivalism. As a result of this, many Central Asian Muslims started to demand, what Islam has termed legal (*Halal*) and, avoid what Islam has termed illegal (*Haram*). Meanwhile, the integration of Central Asian republics with other Muslim geographies through the membership of Organization of Islamic Conference (OIC) and other similar organizations proved to be another upward push to the existing reviving trends. Along with many other requirements, Muslim customer demand was a newly emerging trend in the market and the same demand was felt in banking and financial sector too. To get this demand fulfilled, the respective authorities brought up new (*Halal*) projects and products in the market. In the banking and financing sector some constitutional reforms were approved in order to develop a sophisticated work culture for newly established Islamic banks and *Shari'ah*¹ complaint financial units in the region.

Foundations of Islamic Banking and Finance

Islam is a system and codification of general standards of behavior that reach far beyond the contents of belief. It asserts

¹ The term *Shari'ah* means "way" or "path"; it is the legal framework within which the public and private aspects of life are regulated for those living in a legal system based on Islam. *Shari'ah* deals with all aspects of day-to-day life, including politics, economics, banking, business law, contract law, sexuality, and social issues.

a holistic approach to life and regards all social structures whether it is economic, political or religious as closely interlinked. Connected with this holistic approach of Islamic faith, the individual agrees to observe the instructions of Islamic law (*Shari'ah*) in private and public affairs. This agreement also applies to economic and financial matters [4].

The economic system propounded by *Shari'ah* scholars in the light of *Fiqh ul-mu'amalat* (Commercial Jurisprudence) substantially differs from the Western or conventional financial intermediation as the former is strictly rooted in Islamic *Shari'ah*. In this regard Muslims are expected to respond with enthusiasm to banks and financial institutions that offer products which are in line with Islamic principles of banking and finance. The principal foundations of Islamic banking and finance industry are based on four major principles which have been explicitly referred in the text of *Quran*, and *Hadith*. These principles are: *La-Riba* (no-interest), *La-Gharar* (no-uncertainty), *La-Maisir* (no-speculation), and *La-Haram* (no-unlawful) [5].

Emergence of Islamic Banking and Finance in Post-Soviet Central Asian Republics

The continuous double-digit average annual growth rate and geographical expansion, irrespective of religious affiliation, of Islamic banking and finance industry has been the significant development of the present century. The industry has now become an integral part of the global financial structure and presently it has more than 500 operational units in about 75 countries of the world. Nevertheless, the emergence of *Shari'ah* compliant business operations has not a long history in Post-Soviet republics of Central Asia [6]. Till late 1980s most

Central Asians were still deeply secular in outlook, a legacy of 70 years of communist rule. Since the breakup of the Soviet Union, each of the Central Asian Republics joined the largest Islamic banking institute IDB: Kyrgyzstan (1993); Turkmenistan (1994); Kazakhstan (1995); Tajikistan (1996); and Uzbekistan (2003). By 1997, the IDB established a regional office in Almaty, Kazakhstan, to foster its efforts to enhance the socio-economic development of the region. The regional office in Almaty has effectively become the hub for IDB group operations in the whole area. The regional decision makers, investors and private bankers are gradually opening up to Islamic financial products. Responding positively to the growing customer demand, local governments like Kazakhstan, Kyrgyzstan and Uzbekistan have made some significant amendments in their respective state constitutions. Such amendments were meant to provide a legal platform for the industry where it could facilitate its *Shari'ah* based financial instruments and could also generate a healthy market share [5].

Kazakhstan

Kazakhstan¹ is pioneer in the region in terms of introducing the principles of Islamic finance. According to the results of a national survey conducted by Kazakhstan Institute for Strategic Studies under the President of the Republic of Kazakhstan in April-May of 2011 year, 35.9% of respondents are in favour of Islamic finance against 22.2% of those who

¹ Kazakhstan holds a unique position among the countries that gained sovereignty after the collapse of the USSR. According to 2013 World Fact Book report Kazakhstan, economically developed country in Central Asia, is the ninth largest country in the world in terms of area. It occupies more than 2.7 million square kilometers (over one million square miles) and more than 70.2% of the residents of Kazakhstan are Muslims.

support Western banking [7]. By 2014, there are more than a dozen Islamic financial institutions operating successfully in Kazakhstan (see Table.1). These included; an Islamic Bank, an Investment Fund, a *Takaful* Company, the *Hajj* Fund, and Brokerage and Consulting companies. According to Zaman Bank some *Shari'ah* approved financial institutions have been established in Kazakhstan since it adopted legislation on Islamic banking and finance [8].

Table 1 Source: Al-Hilal bank Kazakhstan, 2014.

Kazakhstan Islamic Finance industry	
No. of Islamic Banks	1
No. of Takaful Operators	1
No. of Islamic Funds	1
Islamic Banking Assets	US \$75.93 mil.
Total Sukuk Issuance	US \$76.7 mil.

Kazakhstan was the first country in Central Asia to experience profit-loss sharing system of banking and finance when in 1996 Islamic Development Bank (IDB) opened its representative office in Almaty, then capital of Kazakhstan. Since operations began, the IDB has spent almost US\$700 million in Kazakhstan, which puts the republic ahead of its Central Asian neighbors in terms of received funding. It is important to mention that for most of its engagement the IDB employs conventional instruments, even if *Shari'ah* conformity is being observed on a case-by-case basis. As an important engine for the further development of Islamic finance in Kazakhstan the IDB has emerged, nonetheless, during the unfolding of the global financial crisis when it supported first

attempts to launch reforms [9]. Moving forward, Kazakhstan became the only IDB member country in the Central Asia Region which joined the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) in 2002. During the Member Country Partnership Strategy (MCPS) Technical Mission, potential opportunities in the provision of Shari'ah-compliant export credit and investment insurance in Kazakhstan were identified. In order to enhance Islamic banking finance in the country the MCPS Work Program proposed the following programs and capacity development activities:

- Technical Assistance to develop the Enabling Environment (regulatory and supervisory frameworks) for Islamic finance;
- Technical Assistance for developing the Takaful sector;
- Equity investment in an Islamic bank to expand the sector, as well as joint initiatives and programs with key institutions, including the Development Bank of Kazakhstan; and
- Assistance to build capacity of the Zakat Fund [10].

Kazakhstan banks demonstrated a strong interest in Islamic financial services since early 2000's. In 2003, Kazakhstan's largest bank, Bank Turan Alem (BTA), became the first Central Asian financial institution to draw on an Islamic-backed line of credit when it borrowed US\$250 million from Arab, UK and Malaysian Islamic lenders [11]. Since 2006, other Kazakh banks such as Centre Credit and Alliance have started using Islamic financial practices. In the spring of 2007, Bank Turan Alem signed a memorandum of understanding with Dubai-based Emirates Islamic Bank to promote *Shari'ah*-compliant banking in Kazakhstan and other CIS states, where BTA has a number of subsidiaries [12]. Initiatives for the

development of Islamic finance in Kazakhstan in 2007 did not only result in new legislation, but also led to new corporations and agencies being formed and established. First to appear was “Fattah Finance”, a consultancy and financial broker for Islamic investment and securities. Fattah Finance and its staff were behind the establishment of the “Association for the Development of Islamic Finances” in 2009.

The first full-fledged Islamic bank in Kazakhstan is Al-Hilal Islamic bank. The bank was founded in 2009 based on an agreement between the governments of the Republic of Kazakhstan and the United Arab Emirates. In line with this agreement, Al-Hilal Bank from Abu Dhabi owns 100% of the JSC Islamic Bank Al-Hilal which has its headquarters in Almaty, with branches in Astana and Shymkent and each branch is targeting to offer a wide range of products for both retail and corporate customers [13]. Al-Hilal Bank in Abu Dhabi in turn is 100% owned by the UAE government. The young bank, founded in 2008, has become a major player on the UAE financial market, with 97% of its activities in retail and only 3% in corporate financing. Quite to the contrary, Islamic Bank Al-Hilal in Kazakhstan operates solely in corporate financing, with state holdings being the main recipient of investment and service, and big infrastructure projects as the target market segment for loans. Furthermore, having considered the need of an independent *Shari'ah* Panel as specified in the Al-Hilal Islamic Bank's JSC charter and the Banking Law of RK (Article No. 52-2), the Bank's Shareholder has appointed the Islamic Finance Principles Board of scholarly qualified individuals to issue opinions (*Fatwa*) according to *Shari'ah* Principles with specialized and comprehensive knowledge in Islamic Jurisprudence, Finance,

Banking and Laws. It has been put at the helm of the bank to ensure all the activities are carried out in strict compliance with *Shari'ah* rules and principles [5]. The Bank's mission is to advance the profile of Islamic banking in the CIS countries whilst contributing to Kazakhstan's national growth and prosperity and also strives to understand its customers' needs and provide the right Islamic finance solutions to meet these needs. Although, Al-Hilal holds 33rd rank out 39 Kazakh banks as per 2011 banking record but while looking at its positive growth curve upto year 2012 (see Fig. 2) it looks that it will play a significant role in the financial market of Kazakhstan in the coming times.

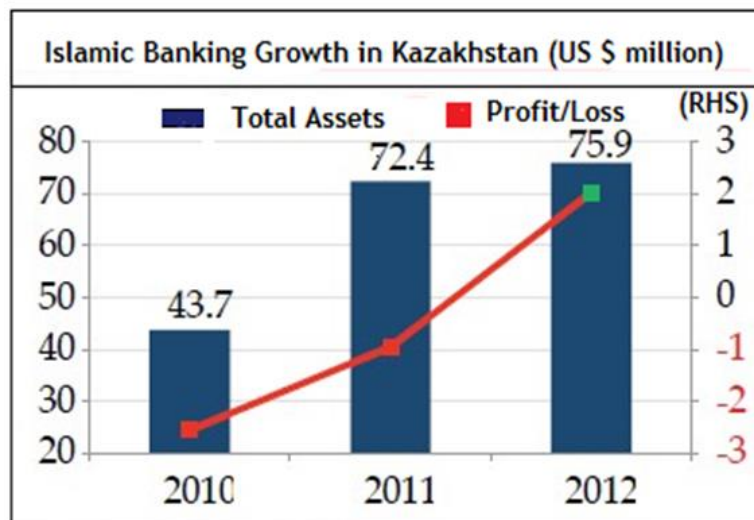


Fig. 2 Source: Al-Hilal Bank, 2012.

According to the Bank's annual report the main products offered to the corporate clients are commodity *Murabaha*

(58%) and *Ijarah* (42%). The retail banking presents a current account based on *Qard al-hassan* and a deposit based on *Mudarabah* contracts. It is supervised in its activities by the Islamic Finance Principles Board (IFPB) which consists of three members that are specialists in *Shari'ah* law and yearly issue a *fatwa* on the bank's overall performances [14]. The bank is considering its presence in the neighbouring geographies in 2015. According to banks chief executive, Prasad Abraham,

“Our medium-term strategy is to test the effectiveness of the Kazakhstan model and then use that as a base for further expansion into other regions of the CIS (Commonwealth of Independent States) as appropriate which would not get materialized on practical terms unless proper legal space is provided” [16].

The Government of Kazakhstan plans to develop and promote Almaty as the Central Asia's regional financial center, and mandated the Regional Financial Center Almaty (RFCA) for achieving this goal. More recently, in November 2011, the National Bank of Kazakhstan was admitted as an Associate Member of the Islamic Financial Services Board, based in Kuala Lumpur, Malaysia. Furthermore, in July 2011, the Kazakh President signed into law, the amendment “On alteration and addition to some legislative acts of the Republic of Kazakhstan on the organization of Islamic finance”, paving the way for issuance of *Sukuk*, Islamic Bond [10]. In July 2012 the Development Bank of Kazakhstan became the first in the region to issue *Sukuk*. In May 2013, the Islamic Corporation for Development (ICD) announced its initiative to convert Zaman Bank into Islamic Bank with an investment of

up to 35% of capital. The local Bank will be the second Islamic Bank in the country [8].

The first Islamic leasing (*Ijarah*) Company was established in Kazakhstan in April 2013 named as Kazakhstan *Ijarah* Company (KIC). It is the first *Shari'ah* compliant leasing company in Kazakhstan established by a diverse group of international and local investors in partnership with the Islamic Corporation for Development of Private Sector as the principal shareholder. The main function of KIC is to support the development of small and medium enterprises (SMEs) by providing alternative sources of “*Shari'ah* compliant” financing for their projects. The initial paid up capital of the *Ijarah* Company was estimated to be around US\$35 million [16].

The government of Kazakhstan passed a set of legislations in order to facilitate Islamic banking and finance. This way the Republic became the first country in the CIS to introduce fundamental legislative amendments after identifying the volume and future prospectus of Islamic finance in the country. In 2009, after President Nursultan Nazarbayev ordered a bill on Islamic financing, the government revised existing laws on banks and the securities market and several other laws pertinent to Islamic financing. The country's powerful president has issued an edict calling for use of Islamic finance as a measure “for attracting resources for further development” [17]. Such amendments were made to a number of Kazakhstan's legislative acts like in the Civil Code, the Tax Code, the Law on Banks and Banking Activities, the Law on Financial Markets and others. The 2009 amendment in Banking Law allowed Islamic banking operations and to establish a separate license for Islamic banks and stipulated

the Islamic financing products. However, the law does not recognize Islamic ‘window’ operations [10]. To develop these amendments, a group of specialists was formed that actively cooperated and continues to cooperate with government bodies on issues related to the development of Islamic finance in Kazakhstan. The main principles used in developing the amendments to Kazakhstan’s legislation were the following:

- Equalization of the taxation of Islamic financial products with the taxation of conventional financial products
- Expansion of existing concepts to include specific definitions of Islamic financial instruments
- Extension of tax benefits applied to traditional financial products to Islamic financial products
- For tax purposes, Islamic financial products are classified as such only for the purposes of transactions carried out by Islamic banks.
- The following main amendments to the Tax Code were also introduced:
 - The list of types of income received by residents and non-residents was expanded to include income received from an investment deposit placed in an Islamic bank. Such an amendment allows the taxation of such income to be defined and makes the tax consequences of investing in Kazakhstan, including foreign investments, more transparent.
 - The provision of Islamic financial products was generally exempted from value added tax, which is a significant achievement in equalizing the taxation of Islamic and traditional financial products.

The implementation of Islamic finance at the legislative level in Kazakhstan is expected to play an important role in

the development of the country's economy and infrastructure. In particular, it extends the range of financial services which makes Kazakhstan's financial market more competitive and is a means of attracted investments from the worldwide Islamic financial industry to Kazakhstan [18]. The Government and NBK continue to demonstrate a political will to support the new industry. The 41-point government road map "Road Map for Development of Islamic Finance by 2020" released on March 2012 exhibits Kazakh governments' interest in expansion of Islamic banking and finance industry in the country. The road-map includes besides other things following provisions:

- Legislation Improvement;
- Educating Market;
- Islamic Finance Infrastructure Development.
- Public Sector Development.
- Islamic Financial Services Development;
- Science and Education;
- Investors Relations [19]

The Ernst and Young analyze the road-map in the following words:

"The Government's commitment to make Kazakhstan an Islamic finance center, coupled with the country's current leadership in the CIS in making legislative changes to allow the operation of Islamic finance institutions, should give Kazakhstan a unique competitive advantage in attracting Islamic finance investments and help the country achieve its goal of becoming a leading financial centre for the region" [18].

Kyrgyzstan

The Republic of Kyrgyzstan¹ has made a significant progress in introducing Islamic banking and finance. The interest free banking and financing is functioning in the republic since 2009 and has established its value in practice. The share of Islamic financing upto June 2011 out of total share was 5% which is believed to increase up to 10-12 % by the end of 2015. Although, the Kyrgyz authorities approved the minimum requirements on risk management in the banks performing transactions according to Islamic principles of banking and financing in 2009 but till date the process of development is very slow [20]. The local bankers and financiers plan to implement Islamic assurance, Islamic paper securities and other financial instruments but that needs improvement of legislation and political will to a greater level. It would be appropriate to put it in words of Shamil Murtazaliev, who is an adviser on business development to the Board of Directors of Eko Islamic Bank, he says,

“any significant improvement in the existing banking legislation will help to attract investments of richest countries of Arabia, Malaysia and other Muslim countries into economy of the republic” [21].

The republic was the first Central Asian republic to join the IDB in 1993, following the liberal agenda of then president Askar Akaev [22]. Nevertheless, this early engagement, investments by the IDB in Kyrgyzstan have been the lowest

¹ Kyrgyzstan is the fourth largest country of the five central Asian countries occupying an area of about 1.95 million square kilometers. According to World Fact Book 2014 report the total established population of the republic by the end of July 2014 is 2,604,212 million. The same report mentions that 75% population is of Muslims.

among the Central Asian countries, amounting to only US\$159 million until mid-2012 [23]. Until 2006 there was no understanding of Islamic banking among the customers. As a result, IDB was rising its funding mostly into infrastructural projects, especially transportation. To promote Islamic banking in the country IDB and the Kyrgyz government signed an agreement for technical assistance worth US\$193.000 million for “further development of Islamic financial services in the country” in June 2012 [24]. This agreement was actually the result of a memorandum signed by the Kyrgyz government, the IDB, and the ‘Eko bank’, a commercial bank operating in Kyrgyzstan, in May 2006 to facilitate Islamic banking and financing products and services into the Kazakh market. The memorandum is valid still, and it covers a few areas: the birth of a pilot research institution (one of the elements of his work is the creation of legal and regulatory framework for the "*Takaful*" and the issuance of "*Sukuk*"-Islamic bonds). This agreement has also unlocked the doors to new legislation which provided one of the most advanced legal regulation systems for Islamic financing business in the region in the following years [25].

After the overthrow of Askar Akaev during the Tulip Revolution (2005), president Bakiev worked about the liberalization of the economy to some extent. Following the memorandum, he signed a decree in July 2006 “On the Pilot Project of Introduction of Islamic Financing Principles in the Kyrgyz Republic”. This decree facilitated the National Bank of Kyrgyzstan to move forward establishing new regulatory framework for *Shari’ah* based financial institutions. In October 2006 the National Bank of Kyrgyzstan accepted a ruling for Islamic financing principles, stating in detail

conditions for Islamic banking instruments like *Mudarabah*, *Ijarah*, *Murabaha*, *Musharakah*, or “*Istisna’a*” (deferred production sale). In December 2006 the National Bank was entitled to hand out licenses to Islamic finance institutes operating in Kyrgyzstan. This leading role of the National Bank was further consolidated with two laws adopted by the parliament in March 2009 that made changes to the law “On the National Bank of the Kyrgyz Republic” and to the law “On banks and bank operations in the Kyrgyz Republic” [9]. Now the National Bank stipulated in Article 4 as one of its major functions the regulations of financial operations, including operations in line with the principles of Islamic banking. In addition the bank had been entitled to formulate normative regulations to further organize the market for Islamic finance in the republic.

The government of Kyrgyzstan is well aware of this fact that Islamic banking and finance has great potential in the country and is taking active steps in this direction. In September 2009 the government took the decision to prepare the market for the introduction of Islamic securities in form of *Sukuk* and *Takaful*. The decision took its practical shape finally, when the government representatives in Kyrgyzstan concluded talks with consultants from the IDB and investors from Malaysia to introduce an Islamic insurance company in the republic. To open up Islamic financing for the fast growing micro-finance sector in the republic the National Bank adopted further resolutions, allowing such institutes to offer micro-credit lines in form of *Mudarabah*, *Musharakah*, *Ijarah* and others [9].

Based on the 2006 memorandum, Eko bank became the first pilot-project for interest free banking in the republic and

was eventually renamed Eko Islamic bank in July 2010. The bank has been growing, opening branches in all major cities across the country and gaining market shares since 2007. According to the yearly audit report of the bank released in 2011, the bank was having assets of 48 Mill. US\$ and reported a net profit of more than 60 million som (about US\$1.2 million). Most of deposit holders in Eko Islamic bank are former clients of the branch of the Russian institute, yet the bank management was able not only to keep this mostly non-Muslim clientele but to expand its base of customers. In 2010 the bank managed to sign 2.274 agreements with customers, in total worth 867 million som (about US\$19 million). Eko Islamic bank is not only engaging into typical Islamic banking operations, but also cares about the expansion of knowledge connected with Islamic finance. It opened the educational center “Barakat”, where the bank trains future staff and invites for cooperation. For example, in December 2009 representatives from financial institutes and supervisory bodies from Tajikistan visited Barakat to receive the training in principles of Islamic financing. Furthermore and independent of Eko Islamic bank, a small corporate investment firm, called “Muslim” started operating in March 2012 in Bishkek. The two micro-credit institutes, handing out loans in compliance with *Shari’ah* law have started working in the country. Moving one more step towards the development of PLS industry, the Kompanion in November 2011 founded Kompanion Investment. This initial market outreach and growing public awareness develop a scalable model for the PLS industry in the region. The republic has proven a promising market for Islamic finance products, with 5% market share in the retail sector in 2012, and with predictions of 10%-12% in 2015, following here the

general positive development of Islamic banking on a global scale [9]. Following the national policy of economic development, the Kyrgyz authorities are in strategic ties with OIC and its largest financial unit IDB. Very recently, on April 8, 2014, the First vice Prime Minister of Kyrgyzstan Tayirbek Sarpashev received the delegation of the IDB. In the meeting, the sides (IDB and Kyrgyz officials) discussed the state of implementation of the principles of Islamic banking in the country and agreed to take additional measures to speed up the process [26].

Tajikistan

Tajikistan¹ has the lowest per capita income among the fifteen former Soviet republics. Due to the civil war (1992-1997) the industrial and agricultural production was further damaged resulting in economic instability in the republic. The lack of employment opportunities in Tajikistan, more than one million Tajik citizens work abroad - roughly 90% in Russia - supporting families in Tajikistan through remittances. About 35.6% population is surviving under below poverty line [27]. Under such scenario, the economy of Tajikistan is in sharp need of investments and the Islamic banking principles are expected to help in expanding a range of banking transactions, finding new sources of external financing and internal deposits. In such a situation, one would expect the Republic of Tajikistan to be an attractive place for Islamic forms of finance, considering the significant role Islam occupies in the society. While talking to Central Asia Online Olim

¹ According World Fact Book 2014 report the total population of Tajikistan by the end of July 2014 was 8051512 million. As per the 2003 WFB survey about 85% of Tajiks are Muslims.

Zainiddinzoda, an instructor in finance and economics at Tajik National University maintained “The Islamic model could very well thrive in Tajikistan given the majority of Muslim population”. Similarly, Farrukh Umarov, chief specialist in the Administration for Analysis and Prognostication of Foreign Policy and Islamic Studies within the Presidential Strategic Research Centre said that Islamic banking could psychologically attract a big chunk of population [28]. Showing a positive signal to Islamic banks and financing companies, in its recent statement, the National Bank of Tajikistan announced that most banks operating in Tajikistan are interested in introducing the Islamic banking principles in their activity [29].

Like the other states in Central Asia, Tajikistan joined the Islamic Development Bank Group after independence a bit later in 1996 for reasons of the ongoing civil war. Since then the country had received financial support to invest into infrastructural projects, especially power generation and transportation. According to IDB’s 2012 Annual Report, 289.6 million US\$ were allocated to projects in the republic. To strengthen the business and development ties with IDB, the Tajik authorities again in November 2011 signed an agreement on Technical Assistance to introduce Islamic banking in the republic and pursue the goal to have a first institute operating by 2013. Since then the legal framework has been under examination and changes to relevant laws have been discussed. In October 2012 the National Bank of Tajikistan signed an agreement with Zaid Ibrahim & Co, a Malaysian consuler and the biggest law firm in the Kingdom, to assist in drafting a law “On Islamic banking in the Republic of Tajikistan” [9]. In May 2014, the Islamic banking and

finance team, headed by Dr. Aida Othman and Mr. Madzlan Mohamad Hussain, completed the consulting project for the central bank of Tajikistan with recent engagement in handling a two-day seminar on Islamic banking, themed “The Possibility of the Introduction of Islamic Banking in Tajikistan: The Basic Requirements”. The consulting project was to seek technical assistance from IDB and handout a draft for Islamic banking law. The seminar was attended by ministries and agencies, commercial banks and micro-credit institutions of Tajikistan. The success story of the seminar was kept available to public on the official website of National Bank of Tajikistan and was picked up by the local press broadcasting on the news – Taj News, Central Asia News Service, and Khovar [30].

In August 5, 2014, new legislation on Islamic banking comes into force in Tajikistan. According to the National Bank of Tajikistan (NBT) “a plan of events on putting this law into practice has been drawn and the NBT is carrying out negotiations with the IDB on receiving technical assistance (grant) for preparation of statutory acts for introducing the Islamic banking principles in the country” an official source at Tajik central bank told Asia-Plus in an interview. Structural advantages and the agreements for the further promotion of principles of Islamic financing will most likely contribute to improving conditions for the establishment of Islamic banking in Tajikistan in the nearer future [31].

Uzbekistan and Turkmenistan

Both Uzbekistan and Turkmenistan are politically authoritarian in nature. It seems that such a tough political atmosphere, with long-serving Islam Karimov as president in

Uzbekistan and Gurbanguly Berdy Mukhammedov as successor to tyrannic Turkmenbashi in Turkmenistan, makes any independent business operation including Islamic banking a challenging endeavor. The only significant development in terms of Islamic financial capital entering the Uzbek and Turkmen economies is connected to projects of the Islamic Development Bank. Throughout the last decade IDB has developed relations with both these countries and managed to negotiate and agree on country development programs. To both countries the IDB has channeled funds worth more than half a billion US \$10 [25].

Uzbekistan, with its 30-million strong population and traditional Islamic roots could probably become one of the most promising markets for Islamic banking and finance industry in Central Asia. But currently Islamic banking suffers due to lack of awareness, understanding and exposure. Despite the active presence of the Islamic Development Bank (IDB) and its investment programmes Uzbekistan has not adopted appropriate approach towards Islamic finance. Considering its secular political framework, Uzbekistan has traditionally been selective in its approach to foreign borrowing with very low levels of reliance on world capital markets for funding its domestic economy. Although, the demand for Islamic finance instruments is growing but authorities are still consistent with the overarching philosophy of cautious and gradual implementation of reforms [32].

In the republic the IDB has involved in the 90s with small scale funding for the Spiritual Board of Muslims to help the community to restore the *madrassa* Mir-Arab and Dar-el Khadis in the ancient city of Bukhara and to help rebuild dormitories and hospitals. Only after Uzbekistan became a full

member, the cooperation developed into periodical programs, first for the period from 2004-2007 and since then in three year terms. For the period 2011- 2013 projects worth US\$ 655 million were being planned. Examples of such cooperation are the agreement between Uzbekistan and the “Coordination Group” to finance the construction of the “Tashfaki” canal in the Khorezm region; or further investments into the modernization of hydroelectric power stations (“Farkhad dam” and “Lower-Bozsuy dam” in the Tashkent region) [9]. This multilateral engagement suggests an improving relation between the Uzbek government and Arab investors. From the perspective of the IDB, cooperation since 2008 also entails increasing investments into the small and medium business sector. To support the locals business on longer terms, IDB’s large business unit “Corporation for Development of Private Sector” signed a memorandum of understanding with the republic of Uzbekistan. The Halk Bank of Uzbekistan and ICD signed a line of financing agreement aiming at allocation of a \$15 million *Shari’ah* compliant Line of Financing (LOF) facility to the bank to finance eligible small and medium enterprises (SME) in Uzbekistan. This facility was part of the \$50 million SME line of financing facility approved in 2013 which brought total amount of LOF facilities to US\$133 million approved by ICD for Uzbekistan since 2007 [33]. The IDB also started to lend funds on the basis of Islamic principles and does so next to donors which operate with conventional financial instruments. In several memorandums and agreements the support to the development of Islamic finance practices has been mentioned, yet not much has been done in terms of implementation. Aliyev, reports the existence of two IDB credit lines, mainly leasing, and “Ipak Yuli Bank”

and “Uzbek Leasing International” as the two institutes operating these funds. In April 2012, Ipak Yuli bank's leasing line was renewed by the IDB and additional credit line was granted to “Uzpromstroy bank” [9].

Uzbek banks are now concerned about the adoption of Islamic way of doing banking to fill-up the vacuum created by *Shari'ah* consciousness. Very recently, Uzbekistan-based financial institution Hamkor bank has planned to collaborate with selected international organizations to become the first entity to provide Islamic banking solutions to the country's 29 million Muslims. The chairman of the bank's supervisory board, Ikram Ibragimov, said that Hamkor bank is looking to ensure Uzbekistan's Islamic banking and finance aspirations are being started with "sound foundations". In an official press release available on official website of Al-Huda CIBE, the chairman has added that the bank, which focuses mainly on SMEs, is the only bank in Uzbekistan which is looking to collaborate with international financial institutions, such as the World Bank, Islamic Development Bank and Asian Development Bank for this purpose. The Hamkor bank in its initiatives towards Islamic banking and finance appointed Pakistan based Al-Huda CIBE as its advisor on 12th February 2013. According to reports, Muhammad Zubair Mughal, Chief Executive Officer of Al-Huda Centre of Islamic banking and Economics met with Ikram Ibragimov, the chairman of supervisory board of Hamkor bank in Uzbekistan's capital, Tashkent. Both parties discussed various ways and methods for the advancement of Islamic banking in the republic and consequently Hamkor bank is happy to announce that Al-Huda CIBE Pakistan will be its advisor. The main function of Al-Huda CIBE, as an advisor, will be Consultancy, *Shari'ah*

Advisory and Human Capital Development so that Islamic banking can develop in the republic on sound foundations. Today, the Hamkor bank has a wide network in Uzbekistan through which it wishes to render the services of Islamic banking [34].

Turkmenistan

The Turkmen¹ financial sector is at a very early stage of development, with total assets of the banking sector representing only 22% of Gross Domestic Product (GDP). The banking system is predominantly state owned, and most of the lending and services are provided to state owned enterprises (85% of total lending) [35]. In such an underdeveloped financial market the conditions for Islamic finance practices to take root in the economy looks grim. Although many announcements have been made in the past to incorporate Islamic banking practices in the country but till date any amendment or reform from the legislation point of view has not been made.

To promote awareness campaigns and favorable ground for the introducing Islamic banking and finance in the country in June 2009 Turkmenistan hosted the annual meeting of the IDB group and also organized a series of forums and seminars dedicated to Islamic finance [9]. This engagement did not translate into any real attempt to introduce Islamic banking in the country. However, the meeting resulted in an agreement

¹ Turkmenistan is largely a desert country with a total area of 488, 100 square kilometers. According to World Fact Book 2014 report the established GDP of the republic for the year 2014 is US\$ 14200. The established population by the end of July 2014 of the republic is 5,171,943 and 89% population is associated with Islamic faith.

signed by the Turkmen government and the IDB to fund the construction of the railway line from Bereket (Turkmenistan) to Gorgan (Iran), as part of the wider North-South transport corridor that aims to connect the Russian railway system with the railway network of the Persian Gulf states.¹ The republic, being an early member of IDB, prepares to establish the first investment company jointly with the State Bank for Foreign Economic Affairs of Turkmenistan and the Islamic Corporation for Private Sector Development. As Turkmenistan's Vice Premier Tuvakmamed Japarov reported at a government meeting on September 17, the main task of the investment company will be to revitalize activities related to direct investments in Turkmenistan through equity capital of small and medium-sized businesses enterprise. Because of Turkmenistan's underdeveloped socio-political structure IDB has not been able to facilitate its operations and investment programs in the country [9].

Conclusion

Islamic banking and finance is an interesting phenomenon in view of its current status. It presents itself as a viable alternative to conventional banking and financial intermediation not only in Muslim countries but in the rest of the world as well. Since the day of its inception, Islamic banking and finance industry has been engaged in developing a new range of *Shari'ah* compliant financial products and services which could relate the industry with the global banking and financial scenario. The industry has been raising its market share by

¹ The IDB granted more than US\$ 370 million to this project and continued talks with the Turkmen side concerning a variety of projects estimated at a total value of US\$ 950 million.

exposing new emerging economies especially in Middle-East and North-Africa and Asia. The overview of Islamic banking and finance industry in Post-Soviet Central Asian republics and the steps taken by the respective authorities reflects a healthy and promising trend. The changes and decisions including; the legislation framework, the road-maps and opening of the pioneering projects promise a potential opportunity for the industry in the region. The study of some major indicators like, religious participation, behavioural economics, demand and supply, banking penetration analysis and case-study of Islamic banking and financing in countries like Kazakhstan, Azerbaijan, Kyrgyzstan and Tajikistan allows us to forecast that the market share of Islamic banking out of the total banking market may rise upto 10%-15% by the end of 2015. At the moment, decrease in trust to the banking sector globally and in Central Asian countries particularly offers firm grounds for Islamic finance to become a viable alternative to conventional financial system. However, this requires the former to distinguish itself from the latter both theoretically and technically. To avoid criticism that overwhelms Islamic finance for its mimicry of conventional products, Islamic banks and financing companies operating in Central Asia have to maintain the product uniqueness and authenticity. Therefore, all new ventures as well as existing institutions must revise Islamic finance underlying principles, its mission and goals. On the micro-level the Islamic banks must increase financial services' accessibility to all the population in order to stimulate an economic activity in a just and fair way primarily based on the principle of sharing risks and profit. The evaluation of available data persuades that a comprehensive education and marketing communication

program on Islamic banking and finance has not yet been introduced in the region which obviously could have raised the industry to higher level.

Recommendations

The present study has following recommendations for investors as well as authorities:

1. The newly opened Islamic banks should focus on small and medium enterprise (SME) and the use of the debt-based financial instruments should be limited.
2. In order to ensure that the 'value proposition' is being delivered the Islamic banks should introduce 'Socio-Economic Better-Off Tests' in order to assess the betterment of their customers and overall contribution to the overall prosperity from socio-economic perspective.
3. To increase awareness of Islamic finance principles, its mission and goals and also to communicate the bank's 'value proposition' to the market the Islamic banking and finance industry should conduct comprehensive marketing and educational programmes throughout the region.
4. The banks should organize required resources for smooth and timely opening of outlets because branch network deployment can play a vital role for a successful business plan execution.
5. More investments can be attracted from capital rich Muslim countries if there are more local *Shari'ah*-compliant financial institutions, investors and projects. Hence the Governments should continue to improve the regulation environment and develop the local Islamic finance component.

6. The stock market development in countries like Kazakhstan should be a priority for the regulators. Effectively operating capital market with long-term higher-return and higher-risk equity instruments can be supportive for Islamic banking industry, providing liquidity and promoting risk-sharing culture.

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