



## Islamic Finance in Central Asia: A Religious or Political Influence?

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As major Western powers have become less generous in international assistance programs since the 2000s, Islamic finance has managed to gain both visibility and respectability in the midst of a full economic and financial crisis.<sup>1</sup> It offers banking services in accordance with Sharia principles, which ban transactions that have recourse to interest (*ribâ*), to speculation (*gharar*), or to chance (*maysir*). A banking service is termed 'Islamic' when: 1) it proscribes loaning on interest; 2) it makes no investments in sectors considered illegal (gaming, tobacco, alcohol, etc.); and 3) it closely ties in the social responsibility of the investor. The Islamic bank is not conceived as a supplier of funds, but as a partner of the entrepreneur since it applies a principle of sharing risk with its client.<sup>2</sup>

Islamic finance has two faces which differ greatly from one another. The first is that of the Islamic Development Bank (IDB), joined by Kyrgyzstan in 1993, Turkmenistan in 1994, Kazakhstan in 1995, Tajikistan in 1996, and Uzbekistan in 2003. The IDB reports to the Organization of the Islamic Conference, itself financed primarily by Saudi Arabia and Kuwait. It operates according to modalities similar to those of other financial institutions, such as the World Bank, the European Bank for Reconstruction and Development and the Asian Development Bank: it offers loan mechanisms to its member states and thus expects a return on its investment, but that return must be in accordance with

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Sharia law. As the IDB's aim at developing communications and commercial links between Muslim countries, most of its projects are linked to the construction of infrastructure (roads, telecommunications, airports and canals) and to social development (construction and equipping of schools and hospitals, agricultural development).

Among its many other services, the IDB includes various specialized corporations. All five Central Asian republics are involved in the Islamic Corporation for the Development of the Private Sector (ICD), whose major function is to invest in the private sector in order to promote small and medium sized enterprises. Kazakhstan is a member of the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC). The mission of this corporation is to help states and large national companies to improve their export strategies and provide insurance instruments that are in keeping with Sharia law.<sup>3</sup> At the time of this writing, no Central Asian state has been involved with any of the other IDB entities.

The second face of Islamic finance is embodied by the numerous private Islamic banks (or stems from the sovereign funds of Gulf countries), which offer Islamic services to individuals. These alternative banking and finance systems, which have already been established in Muslim-majority countries, as well as in some European states, are officially well received by Central Asian governments. However, they are in fact regarded with much suspicion: most local governments fear political influence from Islamic states or the spread of a form of Islam they ban, such as Saudi Wahhabism.

#### *Kyrgyzstan, the originator of Islamic finance in Central Asia*

Kyrgyzstan was the first Central Asian country to pass laws in support of Islamic finance.<sup>4</sup> Starting in the 1990s, it positioned itself as the main recipient of Islamic finance earmarked for the region, a role which has since been gradually captured by Kazakhstan. In 1997, Shamil Murtazaliyev, a Kyrgyz businessman, bought the local branch of the Russian Credit Bank, which he renamed EcoBank the following year and then EcoIslamicBank shortly thereafter.<sup>5</sup> However, the country's first Islamic bank was set on edge by the then president, Askar Akayev. The second president, Kurmanbek Bakiyev, actively supported this bank and the arrival of Islamic finance in Kyrgyzstan between 2005 and 2010.<sup>6</sup> EcoIslamicBank would continue developing after Bakiyev's overthrow: today, it has 120 offices in the country and cooperates with several International Islamic institutions such as the IDB, the Malaysian Institute of Islamic Banking and Finance, and the Central Bank of Malaysia 'Negara.'<sup>7</sup>

The Muslim Spiritual Board of Kyrgyzstan, along with several governmental and independent institutions, also encouraged Islamic finance. A Committee for the Development of Islamic finance, created in March 2013, supports the engagement of private and public sectors in the Islamic economy. Several microcredit organizations work in accordance with the Murabakha principle and, in February 2014, Kyrgyzstan set up a pilot project to launch Islamic insurances (*takaful*).<sup>8</sup>

Islamic banks offer lower interest rates than traditional banks, and the market has subsequently grown. Despite the official support of the Kyrgyz government and senior civil servants, these officials have kept a cautious discourse over Islamic finances, insisting on the fundamentally secular character of the Kyrgyz financial system.<sup>9</sup> Today, national legislation concerning Islamic finance has limited the field of operations for Islamic banks, which are allowed only four or five possible banking operations, whereas Islamic financing actually offers more than twenty.

#### *Kazakhstan as a hub for Islamic finance?*

Starting in the 2000s, Kazakhstan sought to take the leadership of Islamic financing in Central

Asia<sup>10</sup> — and succeeded. It declared its will to become the regional center of Islamic finance,<sup>11</sup> not only for the entirety of Central Asia, but also for the post-Soviet space by the end of the decade. Kazakhstan's goal is threefold: to showcase its modern Islamic identity, in tune with the identity projected by the Emirates; to maintain the state's stranglehold on a sector that arouses political suspicion; and to shore up for itself alternative investments that come without political conditions.

The IDB has been very involved in Kazakhstan. In 1997, it opened a branch in Almaty from which to better approach the local governments. In 2013, the IDB and Kolon, a South Korean company, established a new Islamic leasing company, the Kazakhstan Ijarah Company.<sup>12</sup> According to a partnership program for 2012-2014, the IDB has invested \$1.2 billion into Kazakhstan's economy.<sup>13</sup> It will also allocate 411 million currency units for the completion of construction of water supply systems in Almaty, Kyzylorda, and North-Kazakhstan regions.<sup>14</sup>

For its part, the Kazakh government has multiplied its goodwill gestures toward Islamic finance.<sup>15</sup> In 2009, Kazakh legislation on Islamic banking activity was revised to make it more favorable to Islamic investment funds. In particular, it relaxed the conventional taxation system, which was too burdensome for banking mechanisms that do not operate through interest rates. That same year, the Association for Development of Islamic Finance (ADIF) was founded. Supported by the National Bank of the Republic of Kazakhstan (NBRK), it promotes the Islamic financial sector and cooperation with investors from the Gulf Cooperation Council and South East Asia. ADIF is the first legal entity in Kazakhstan to provide the full range of Islamic finance services, from training to attracting investments in the economy.<sup>16</sup>

In 2012, the Development Bank of Kazakhstan partnered with the Central Bank of Malaysia to issue a *sukuk*, i.e. an Islamic bond, for 73 million dollars. This *sukuk*, the first issued by a post-Soviet country, was intended to give rise to further *sukuk* from the main Islamic lenders.<sup>17</sup> That same year, Kazakhstan confirmed a new program to develop the Islamic banking sector by 2020. Specifically, this program would include the establishment of Islamic mechanisms for managing disputes.

The year 2015 was particularly favorable for Islamic finance in Kazakhstan. Facing a new financial crisis, the devaluation of the Kazakh currency, the tenge, and the slowdown of foreign investments, the government tried to diversify its sources of financing. In April, Nazarbayev passed a new law authorizing Islamic insurance, leasing, and deposits in compliance with Sharia.<sup>18</sup> The following month, the ADIF signed a memorandum of cooperation with the Shariyah Review Bureau (SRB), a bureau which is licensed by the Central Bank of Bahrain and works around the world to develop services in accordance with Sharia law.<sup>19</sup> In November, the parliament approved new Islamic finance laws and amendments to launch the nation's first sovereign Islamic bond—possibly in early 2016<sup>20</sup>—to authorize conventional banks to convert to Islamic banks,<sup>21</sup> and to open an offshore center in Astana, one of its aims being to attract Islamic finance.<sup>22</sup> Finally, in December, the Central Bank of Kazakhstan made plans to reduce the capital required from Islamic banks by half, decreasing from \$16 to 8 million. This measure was aimed at attracting both local and foreign investors and at diversifying the Islamic partners.<sup>23</sup>

There are more Islamic actors in Kazakhstan than in any other Central Asian republic. The Bank of the United Arab Emirates, in partnership with the private bank TuranAlem, has offered a range of Islamic banking products since 2007. TuranAlem obtained an Islamic loan of \$520 million from Arab, British and Malaysian investors. In 2010, the Al Hilal Bank, based in Abu Dhabi and owned by the Emirate government, opened a branch in Almaty, and in December 2015, it signed an agreement with the Development Bank of Kazakhstan.<sup>24</sup>

Several other financing and investment structures were created. In 2009, the company Akyl-Kenes Consulting started working in the sectors of Islamic finance and lean manufacturing.<sup>25</sup> Another company, Fattah Finance, proposes financial services in compliance with Sharia. In 2010, it signed an agreement with the Malaysian financial group AmanahRaya to create an Islamic bank.<sup>26</sup> In 2015, Zaman Bank (which had converted from a commercial to an Islamic bank two years earlier), started granting interest free credits under the umbrella of the National Bank of Kazakhstan.<sup>27</sup> Takaful, a society of Islamic insurance, was the first to propose Islamic insurance services, popularizing both this type of insurance and other forms of Islamic finance in Kazakhstan.<sup>28</sup>

Kazakhstan also supported the financial services with a social agenda. The Hajj Fund, created in June 2011, aims to help believers save funds to make the hajj.<sup>29</sup> That same year, the Muslim Spiritual Board of Kazakhstan launched Zakat, a fund for donation in compliance with Waqf principles and sharing with impoverished persons.<sup>30</sup>

Thanks to several legislative revisions and the multiplicity of actors involved, Kazakhstan has indeed become a regional hub for Islamic finance. However, it gained this access by default: Islamic finances still make up only one percent of the total banking assets in the country,<sup>31</sup> a very low volume compared to many other Muslim countries in the world, but higher than the other post-Soviet states—particularly Tajikistan, Uzbekistan and Turkmenistan.

*Tajikistan, Uzbekistan and Turkmenistan: Between the search for financing and the fear of a non-controlled Islam*

In Tajikistan, the dearth of investment opportunities and the weakness of the legal framework have not allowed Islamic financing mechanisms to develop significantly. The country is mired by a lack of corporate governance, a poorly regulated banking system, shallow capital markets, and limited integration into the global financial system. IDB loans to the Tajik authorities are focused largely on programs for technical aid with the goal of reforming the sectors of health, transport, education, energy, and irrigation.

President Emomali Rakhmon, however, saw the IDB as an opportunity to finance some of its otherwise unaffordable development projects. According to an agreement signed in October 2015, the IDB will provide \$70 million to Dushanbe to fund the electricity project of CASA-1000.<sup>32</sup> Moreover, since 2011, the lack of international financing has compelled Emomali Rakhmon's government to further open up this sector by allowing the poorest sections of the population to have access to basic financial services, such as microcredit, in a bid to develop private entrepreneurship and the agricultural sector. In August 2014, Tajikistan passed a law authorizing the introduction of Islamic finance principles.<sup>33</sup> The Development Bank of Tajikistan signed an agreement with the IDB to be converted into an Islamic Bank, becoming the first Islamic bank in the country.<sup>34</sup> In January 2016, the International Islamic Trade Finance Cooperation (ITFC), a member of the Islamic Development Bank Group, signed an MoU with Agroinvestbank, a private commercial bank, to enhance trade financing cooperation.<sup>35</sup>

In Uzbekistan, the regime of Islam Karimov takes a very political view of Islamic finance, which it suspects of promoting Wahhabi Islam from the Gulf countries. Uzbekistan was the last country to join the IDB. The latter mainly finances aid to the small private sector, including the modernization of irrigation networks and construction of electricity lines. Despite the political authorities' prudence, Uzbekistan is currently the Central Asian state in which the IDB has invested the highest amount – almost \$1.5 billion. The ICD granted a \$42 million credit to three Uzbek banks (the private bank, Ipoteka Bank, and the state banks, Asaka Bank and Uzpromstroibank) to support some mod-

ernization projects in the agriculture and transport sectors. In June 2014, the ICD signed an MoU with two commercial banks, Ipak Yuli Bank and Asia Alliance Bank, to deepen support of the Small Medium Enterprises and the development of Uzbekistan's private sector.<sup>36</sup> However, little progress has been made due to the lack of support from the authorities.

Little has been done in Turkmenistan in terms of Islamic finance either, and the banking sector in general is rather underdeveloped. In November 2011, the Islamic Corporation for the Development of the Private Sector signed an MoU with Ashgabat in order to establish a joint investment holding aimed at small and medium businesses in the sectors of agriculture, logistics and real estate. However, at the time of writing the institution is not operational and the IDB limits itself in offering loans for road and railway construction and the renovation of medical facilities.

*Table 1.*

*Total IDB Group Project Financing and Technical Assistance invested in Central Asian countries from their accession to the end of 2014 (in million US dollars)<sup>37</sup>*

<b>Kazakhstan</b>	545
<b>Kyrgyzstan</b>	215
<b>Uzbekistan</b>	1,494
<b>Tajikistan</b>	270
<b>Turkmenistan</b>	587
<b>Central Asia Total</b>	3,112
<b>World Total</b>	52,686

## Conclusions

Islamic finance and services in Central Asia remain very limited compared to their use in many other Muslim nations,<sup>38</sup> and have met with a number of obstacles in the region. Before the 2008 economic crisis, Kazakhstan had no great need to borrow from non-Western institutions, while the other Central Asian states were poor or unreceptive, and their banking systems rather underdeveloped. Moreover, the local taxation system—high taxes when loans change hands—constitutes an essential obstacle to Islamic financing. Last but not least, Central Asian economies are shaped by endemic corrupt practices, and tax evasion has become a systemic feature. Full transparency requested by Islamic finance—demands to disclose all parties' interests and shares of assets in an economic endeavor—as well as the exclusion of any kind of speculation, are all conditions for Islamic business that do not fully align with the principles of the shadow-based economies of Central Asia.<sup>39</sup>

Islamic finance supporters complain about the feebleness of Islamic banks and investment funds, which focus on large-scale infrastructure projects that have backing from local governments and leave aside individuals. Its detractors are mainly concerned about its hidden religious activities. These fears are not specific to Central Asia; they are fairly similar to those held, for instance, in France regarding massive investments from Qatar. In Central Asia, Sharia law is scarcely known and broadly associated with Islamic radicalism. The position of the Central Asian states is thus paradoxical, since they both want to attract additional investments that do not come with conditions in terms of politics or reforms, but fear radical influences.

Whereas Saudi Arabia uses the IDB as a vector of soft power over the entirety of the Muslim world,

the situation is somewhat different in Central Asia to the extent that the states of the region have thus far refused most investments with a religious character and only ratified those focused on infrastructure or agriculture. However, Central Asian governments tend indeed to confound the direct influence of Saudi Arabia, which seeks to finance local actors with a radical view of Islam, with that exerted by an internal financial institution such as the IDB, not so different in its functioning from the World Bank or the Asian Development Bank.

The influence of private banks and investment funds from the Gulf is probably less controllable. The Gulf countries often link their investments with some cultural measures (opening up cultural centers, financing mosques, madrasas, or charity associations), which can potentially contribute to the spread of a more radical version of Islam. As for the private banks, which focus on providing services to individuals or to businesses, they do not propagate radical Islam, though some of them do support a stricter reading of Islam. But these banks also consider Islam as a commercial niche among many others, and want to attract diversified clients for whom Sharia law is not necessarily an element of choice, but just a viable solution for their business.

The suspicion of Central Asian governments is thus only partly justified. What is really at stake in the region is not the ability of Saudi Arabia or the Gulf countries to foster radical Islam via Islamic banking services. It is instead the growing number of Central Asian citizens who perceive radical Islam as a solution to their problems. Islamic finance will indeed be able to take root in the region only if local actors seize upon it and transform it into an ideological tool.

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<sup>2</sup> A. Wolters, *Islamic Finance in the States of Central Asia: Strategies, Institutions, First Experiences*, PFH Private Hochschule Göttingen, no. 01, 2013.

<sup>3</sup> B. De Cordier, "The Development Space(s) of Non-OECD Aid Donors in Southern Eurasia: A Look at the Islamic Development," *Central Asia Economic Paper*, no. 3, September 2012.

<sup>4</sup> "Kyrgyzstan: Start na postsovetском prostranstve," *Islamic Finance and Business*, <http://islamic-finance.ru/board/11-1-0-57>.

<sup>5</sup> J. Vela, "Kyrgyzstan: Islamic Banking Offers Alternative to the 'European System'," *Eurasianet*, June 14, 2011, <http://www.eurasianet.org/node/63675>.

<sup>6</sup> See A. Wolters, *Islamic Finance in the States of Central Asia: Strategies, Institutions, First Experiences*, PFH Private Hochschule Göttingen, no. 01, 2013; B. De Cordier, "The Development Space(s) of Non-OECD Aid Donors in Southern Eurasia: A Look at the Islamic Development," *Central Asia Economic Paper*, no. 3, September 2012.

<sup>7</sup> "Kyrgyzstan: Start na postsovetском prostranstve."

<sup>8</sup> *Ibid.*

<sup>9</sup> J. Stark, *Malaysia and the Developing World: The Asian Tiger on the Cinnamon Road* (New York: Routledge, 2012), 129.

<sup>10</sup> O. Sodirov, "Kazakhstan poka ne ochen' uspeshen v razvitii islamskogo finansirovaniia," *Liter*, November 17, 2015, [http://liter.kz/ru/articles/show/14121-kazakhstan\\_poka\\_ne\\_ochen\\_uspeshen\\_v\\_razvitii\\_islamskogo\\_fansirovaniya](http://liter.kz/ru/articles/show/14121-kazakhstan_poka_ne_ochen_uspeshen_v_razvitii_islamskogo_fansirovaniya).

<sup>11</sup> "Kazakhstan: Spetsifika rynka islamskogo finansirovaniia," *Islamic Finance and Business*, <http://islamic-finance.ru/board/11-1-0-50>.

<sup>12</sup> Y.A. Baidalet, "Kazakhstan. Ambitions for Setting up a Regional Hub for Islamic Finance in CIS," in A. Morgan, A. Tebbutt, eds, *Islamic Finance Handbook: A Practitioner's guide to the Global Markets* (Somerset: Wiley, 2014), 242.

<sup>13</sup> For more information see: "IDB investments to Kazakhstan stand at \$500 million," *Tengrinews*, January 16, 2014,

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- <sup>17</sup> A. Wolters, *Islamic Finance in the States of Central Asia: Strategies, Institutions, First Experiences*, 11.
- <sup>18</sup> "Kazakhstan: Spetsifika rynka islamskogo finansirovaniia."
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