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# Islamic Finance in the States of Central Asia: Strategies, Institutions, First Experiences

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# Islamic Finance in the States of Central Asia: Strategies, Institutions, First Experiences

by

Alexander Wolters

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*Introduction*

Islamic finance has been developing steadily in the last decades since the 1970s, yet for most parts its growth was concentrated in the Arab states and in several south-east Asian parts of the world with a Muslim majority (Malaysia in particular). Perhaps the only exceptions to that were global financial centers like London or New York that serve as organizational hubs to channel and direct Islamic financial resources (Baba 2007). In comparison with that, in Central Asia Islamic finance appeared only in recent years.[1] Triggered not least by the global financial crisis, political decision makers and financial entrepreneurs in the region were eager to develop new sources for capital. The Middle East and the Arabic states, less touched by the meltdown of Western banks, were welcoming partners for fresh capital a part of which now was labeled "Islamic". Before, Central Asia had experienced almost no developments in Islamic finance. Only the "Islamic Development Bank" (IDB), a major development-aid institution that sometimes applies Islamic principles of loan-giving and investment, had been launching projects in the republics since the end of the 1990s. After the financial crisis, however, the double effect of a real-economy need for new and fresh cash-flows and the rising discourse of and the search for alternative forms of banking has opened a new chapter for Islamic finance in the region of Central Asia. The following text looks at first developments and concentrates on the emerging relations between the different states and its institutions on the one hand and Islamic finance and its practices on the other.

*Research on Islamic Finance in Central Asia*

Not much scholarly investigation of Islamic finance in Central Asia has been conducted. Neither scholars of Islamic finance nor experts on Central Asian economics have paid special attention towards the nascent evolution of religiously inspired forms of doing business in the region[2]. I begin with a first body of questions that relates to the states' efforts to ease or hinder the entrance of Islamic finance into the economy. As much as the financial crisis might have stressed the need for alternative funding, several conditions should be considered for a full analysis of the development of Islamic finance in Central Asia. *First*, a Soviet heritage of

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1 Material for this article was gathered from online-sources, secondary literature and two field-trips to the region, conducted in September/October 2012 and February/March 2013.

2 Among recent works in this disciplines see for instance the collections by Hassan & Lewis 2007 on Islamic finance that provides no chapter on Central Asia, and the collection by Ahrens & Hoen (2012) on politico-economic challenges in Central Asia that features no contribution on the developments of Islamic finance or relations of Central Asia to the Arab world.

secularism for most of these states dominates their approach to religion and religious practices. This tradition of secularism today is, *secondly*, expanded by the employment of a discourse that warns against the dangers of Islamic extremism in light of a rising Taliban force in Afghanistan and recent experiences with radical groups on Central Asian soil. *Thirdly*, to some degree most states in the region feature a set of state institutions that are authoritarian in the political dimension and that favor a rational plan for development in the economic dimension.[3] These factors kept in mind, one can ask, how the states in Central Asia react on the institutional level on the introduction of Islamic finance against the background of a secularist legal tradition; how politically new Islamic practices are being dealt with, when the danger of Islamic extremism puts all new religious activities under a general suspicion; how both institutionally and politically the states react to new economic trends and how they experiment with new forms of financing. From the point of view of Islamic banks and businesses another set of questions is directed at the economic and social conditions to use Islamic principles for financial operations in Central Asia. *First*, from an ethical perspective one can ask to what extend the predominant Muslim populations in Central Asia favor the promise of Quran based banking operations over conventional methods to lend money. How do faith-based principles of banking and investment perform in societies that are Muslim on the surface, but, according to some observers, rather unorthodox in their practice of religion? *Second*, Islamic finance rests on the idea to counter the averse effects of an interest-based economy and as such to contribute to a more just society. Is this notion of solidarity reason enough to believe in a natural alliance of Islamic banking institutions and a population in Central Asia that lives in precarious livelihood conditions while a selected few enrich themselves (Schmitz & Wolters 2012)? *Third*, what are the chances for Islamic banking and its moral claim towards transparency and accountability in economic orders that favor the shadows and rely on the undisclosed nature of transactions for successful business?

The further aim pursued here is to learn more about the conditions of social transformation in the countries in Central Asia. Islamic finance serves as a phenomenon that is well suited to inform us about the relation between religion and economy, and state and religion in the region. The approach proposed here then follows the promise of Islamic finance to connect in a unique form questions of solidarity and social security, of state control and religious awakening, of free market development and the global financial crisis. These matters gain

[3] See for a discussion of the "developmental state" in Central Asia Stark & Ahrens 2012.

further complexity if we take into consideration that Islamic finance enters the markets in the Central Asian republics and by doing so changes the very conditions for its own operations. Islamic finance in Central Asia is very much a work in progress in itself and it can be expected that it is a factor *for* change as much as it is used as an indicator *of* change and transition.

The following sections contain short summaries of the history of Islamic finance in the Central Asian republics with a focus on institutional development. Short overviews on selected projects of Islamic finance, like the "Islamic Bank Al-Hilal" in Kazakhstan or the "EcoIslamikBank" in Kyrgyzstan, add selected examples of Islamic finance activities on the ground. I begin with a short introduction into some founding principles of Islamic finance in general.

*Principles of Islamic Finance*

The discussion about the foundation of Islamic finance and its mode of operation is open and further developing. Some scholars claim the need for a Qur'anic based world-order to fully develop the idea of a purely real-economy grounded financial system (Choudhury 2007). To the contrary, practitioners like the head of the Association of Islamic Bankers in Kazakhstan, Yerlan Baitaulet, envision the establishment of Islamic finance as a further branch of modern ethical banking (Interview #6, 2012). Such disputes notwithstanding, a number of principles for the practice of doing Islamic finance have been confirmed over time. They are based on ideas of Islamic economics, a rather systemic body of rules for economic engagement in compliance with the Shari'a, and they all aim to contribute to the development of "asabiyya" (social cohesion) in society. Next to "zakat", a tax on wealth to provide for the needs of the poor and one of the five pillars of Islam, basic concepts in Islamic finance include the exclusion of "gharam", an excessive risk or uncertainty and related speculative action, and "riba", literally translated with "excess", "addition" or "interest" (Hakim 2007). In Islamic finance riba stands for the prohibition of interest on loans. Riba, or more correct "usury" – as the term for specific financial interest – leads to "excess compensation without due consideration" (Wikipedia, 14.11.2012) and must be forbidden according to Shari'a law. Instead Islamic economics propose to counter the negative effects of such arrangements by balancing out losses and profits in business activities. This sharing of risks, called "mudarabah", is expected to contribute to a more just economy. Further principles resemble the criteria developed in several branches of ethical banking, like the ban on investments into gambling or pornography or any other activity that must be considered “haraam” (sinful and prohibited).

Of more importance are special forms of contracts that have been developed under Islamic finance and that today are used by Islamic banks and other Islamic financial institutions to circumvent the very strong economic incentive that interest plays in conventional banking (Hakim 2007). Following the general principle outlined above, as a contract form “mudarabah” is a profit- and loss-sharing agreement in which the bank provides financial capital and the partner provides knowledge and skills. “Murabaha” is a form of a fiduciary sale, where the bank obtains a certain good and sells it to the buyer, the bank's client, with a profit. In such transaction the Islamic law demands that all information of costs in the transaction are being honestly declared and that it be rooted in real commodity trade, not only financial. The bank must actually buy the good, for example a house, and sell it further to the buyer with the added margin. Another form of an Islamic financial operation is “musharakah”, a joint venture in which parties agree in advance on profit sharing and where potential losses are divided according to the shares of contribution made by each participant.

Many more financial instruments have been developed for Islamic banking (El-Ghamal 2006), for example “sukuk” as a special Shari'a conform bond, the Islamic lease “ijarah”, or “bai salam”, a form of financing for a deferred commodity exchange. In general all financial instruments in Islamic banking aim to master the challenge to compensate for the time value of money in financial transactions without resorting to interest and yet guarantee the rooting of any transaction in the real economy. As Choudhury states:

> “[In Islam] in the endogenous interrelationships between money and the real economy, the quantity of money is determined and valued in terms of the value of spending in shari'a goods and services in exchange. Money cannot have an exchange value of its own, which otherwise would result in a price for money as the rate of interest. Money does not have a market and hence no conceptions of demand and supply linked to such endogenous money in Islam.” (Choudhury 2007:34)

This ideal perception of an Islamic economic order in fact forms the background for a heated discussion in which Islamic financial products are constantly questioned for their Shari'a conformity (Asutay 2007). For example, sale and buy-back instruments or deferred sales are often criticized, since to many scholars they are simply a disguise for a transaction with an

Islamic name that basically runs on interest. Such discussions, as much as they are conducted among practitioners, scholars and theologians, nevertheless matter for the expansion of Islamic finance and the development of Islamic banking practices in the countries of Central Asia. Kazakhstan and its neighbors are considered fertile ground for future successful Islamic business, yet they also demand new debates and efforts, like the establishment of Shari'a councils for instance, to define appropriate understandings of Islamic practices within their own societal contexts. For the most part, such considerations seem to be only in their initiation phase in all countries today, where first institutional developments have been set off only in the last years.

*Kazakhstan: The Future Hub for Islamic Finance in the Former Soviet Union*

Taken alone by the numbers of international conferences and forums dedicated to Islamic finance and business, Kazakhstan has indisputably become the regional leader in promoting Islamic ideas of banking and doing business in the region. Among others the “Seventh World Islamic Economic Forum” was held in June 2011, the “Second Islamic Finance Forum” took place in September 2011, the “Kazakhstan International Halal Expo '2012” and the “Third Kazakhstan Islamic Finance Conference” were both organized in October 2012. These events underline Kazakhstan's declared goal to develop the country into the regional center for Islamic finance in the former Soviet Union. This has also been stipulated during many occasions by leading Kazakhstani Islamic finance strategists, like Baidaulet or Zhaslan Madiyev, the deputy head of the Kazakhstan Development Bank. The goal is set against the background of opportunities and challenges that are summarized in an evaluation of the accounting firm Ernst & Young:

> “The Government's commitment to make Kazakhstan an Islamic finance centre, 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.” (Ernst & Young 2011)

Kazakhstan's efforts to develop Islamic finance have a rather short history and are closely intertwined with the effects of the global financial crisis starting in 2007. First initiatives for Islamic banking, however, were undertaken as early as 1990 in the republic. Still part of the Soviet Union the Council of Ministers of the Kazakh SSR passed a resolution to found the

“Al'baraka Kazakhstan Bank” as an international project in cooperation with Saudi-Arabian partners (Sovet Ministrov KSSR, 30.11.1990). Al'baraka Kazakhstan Bank opened on January 1, 1991 and survived the difficult years of the dismantling of the Soviet economy only to be renamed “Kaspi Bank” and re-structured into a conventional commercial finance institute in 1997. A similar fate, according to one observer, was suffered by an initiative from “Lariba”, a riba-free operating US-based Bank that tried to enter the Kazakhstan market in the 1990s (Interview #5, 2012).

Serious relations with the Muslim financial world were established by Kazakhstan only later via membership in the Islamic Development Bank group. The country joined the international agency in 1995 and in 1997 it was selected to host one out of four regional offices of the bank in Almaty, Kazakhstan's economic center. Since operations began the IDB has spent almost 700 Mill. US-Dollar in Kazakhstan, which puts the republic ahead of its Central Asian neighbors in terms of received funding (De Cordier 2012). As a player in the development aid market in Central Asia, the IDB follows the standards of operation provided for in this particular game. For its investments in Kazakhstan such standards demand a close cooperation with the state structures as the point of entrance to the market and it results in a predominance of funding and loans to state organized infrastructural projects. The money used for such activities stems from contributions generated in the member states of the IDB group. Only by the point of origin of the money invested can the IDB in Kazakhstan be considered an Islamic finance institute. In the majority its activities in the republic do not strictly follow Islamic principles as discussed above. For most of its engagement the bank employs conventional instruments, even if Shari'a 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.

*The Global Financial Crisis as a Critical Development Juncture for Islamic Finance Institution Building in Kazakhstan*

In Interviews with the author several respondents highlighted the critical period in 2007 and 2008 for Islamic finance in Kazakhstan (Interview #2, 2012; Interview #3, 2012). Most observers agree that Kazakhstan's banking sector was hard hit by the crisis that resulted in four major banking institutes in the republic to run into default by 2010 (Bloomberg, 29.07.2010). Since the epicenter of the crisis was made up of accumulated debts of Western states and nonperforming loans in banks in the Western hemisphere, a door opened for Islamic finance strategists in the republic to propose ideas for a diversification of accesses to global flows of capital. At times with advice from the IDB and with the support of the department for Islamic banking in the commercial Kazakh “BTA” bank, specialists formed discussion circles to project the establishment of Islamic finance institutes in Kazakhstan (Interview #3, 2012). Support also came from the state, with the presidential administration forming a group that was tasked to develop Islamic banking and business. In addition, advice for projects was sought from outside the country, attracting international business consultants like “Ernst & Young Bahrain” that supervised development processes. These resulted, among others, in a first conference of interested parties in May 2007 in Almaty. Funded by the “Abu Dhabi Islamic Bank”, Kazakh government agencies like the “Ministry of Industry and Trade” joined with lobby organizations and consultancies in Islamic finance under the auspices of BTA bank and the Islamic Development Bank, with participants from various countries in the Muslim World (BTA Bank, 2007). The list of topics for discussion informs about the conditions for Islamic finance development in those times in Kazakhstan. At the top of the agenda rank questions about the general nature of Islamic finance and the possibility to open up Kazakh legislation and allow Islamic businesses to enter the republic's market.

The initiatives were successful and resulted in a push for new legislation. In 2008 a draft law was discussed in parliament and in February 2009 the law “On Making Changes and Amendments to Certain Legal Acts of the Republic of Kazakhstan Concerning Organization and Activity of Islamic Banks and Organization of Islamic Financing” was adopted (Kazakh Islamic Finance Law, 12.02.2009).

The law itself contains changes and amendments to a number of other laws, for example the Civil Code, the Tax Code, and laws on banking and investment. It does not introduce terms of Islamic finance instruments like mudarabah or ijarah, but it tries to distinguish conventional banking operations from Islamic ones. An Islamic bank must fulfill special obligations in terms of conformity with Shari'a law and establish an “Islamic Bank Council”; it also must have the words “Islamic Bank” in its name; furthermore a commercial bank is not allowed to open an Islamic branch or window, but the Islamic bank institute must be independent from conventional banking institutes (Banking and Finance, 29.05.2009).

In terms of legislative reforms Kazakhstan has been moving on since 2009 preparing the legal ground for Islamic financial operations. In resolutions both, the “National Bank of Kazakhstan” and the “Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Market and Financial Organizations”, have formulated new rules for Islamic book-keeping procedures or Islamic securities issuances, the latter providing legal ground for Islamic social finance companies.[4] In general new amendments have helped to further specify regulations for running an Islamic finance institute in the republic and supporting the launch of Islamic finance products, in particular by equalizing the taxation of Islamic with conventional financial products. To continue these reforms a “Road Map” was adopted by the Kazakh government in March 2012. This Road Map lists in eight chapters several tasks that various state and public organs and agencies are set to fulfill and it schedules project periods up until 2020. Next to legislative reforms, the expansion of Islamic finance infrastructure, the establishment of more Islamic finance services including new banks, more educational and scientific work, a closer cooperation with foreign partners and the development of state organs form part in this Road Map. The last point, the work with investors, receives considerably large coverage and includes, among others, closer cooperation with the different agencies of the Islamic Development Bank group and several other multinational finance organizations. At least in the first section of this point, however, the original, crisis-driven incentive of Islamic finance development in Kazakhstan reappears: “Completion of earmarked negotiations and meetings with banks, fonds, and companies in countries of South-East Asia and the Middle East with the goal to attract investments to Kazakhstan (funding of investment projects, finalizing of contracts)” (Road Map 2012).

*The Islamic Finance Sector in Kazakhstan since 2007*

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

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4 In Banking and Finance, 29.05.2009, Baker&McKenzie explain: “Under the Securities Market Law (as amended by the Islamic Finance Law), Islamic securities are emission securities, which are issued in accordance with principles of Islamic finance and which certify common shared ownership rights of the holders in tangible assets and/or the right of disposal of assets and income received from an investment project. The Securities Market Law provides for the following types of Islamic securities: a) stocks and shares in Islamic investment funds; b) Islamic rent certificates; c) Islamic participation certificates; and d) other securities recognized as Islamic securities according to Kazakhstani legislation. Islamic rent certificates and Islamic participation certificates are particularly novel to Kazakhstan’s securities market.”

investment and securities. Fattah Finance and its staff was behind the establishment of the "Association for the Development of Islamic Finances" (ARIF) in 2009. A clear lobby group, ARIF tries to develop contacts with state institutions in Kazakhstan to ease the reform of legislation and work on behalf of its members' interests. In 2012 seven members join ARIF, among them the only Islamic bank operating in the republic to this day, the Islamic Bank Al-Hilal. 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. 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, with assets slightly more than 10 Bill. tenge the bank plays an insignificant role in the financial market in the republic (Al Hilal Audit Report, 26.3.2012), ranked 33 out of 39 Kazakh banks in 2011.[5] In terms of Islamic finance instruments the bank employs ijara leasing and commodity murabaha agreements. It is supervised in its activities by the Islamic Finance Principles Board which consists of three members that are specialists in Shari'a law and that yearly issue a fatwa on the bank's performances.[6]

Another member of ARIF and also newcomer on the market for Islamic finance in Kazakhstan is the insurance company"Takaful". Established in 2010 Takaful aims to develop "takaful", the Islamic principle of a community insurance, where policyholders form a group and insure each other by sharing losses and profits. For that purpose, similar to the supervisory practices in Al Hilal, Takaful has established a Supervisory Board for Principles of Islamic Finances. Other institutes on the nascent Islamic finance market in the Kazakh Republic are "Istisna'a Corporation Inc.", "PWC Inc." and "fattah education Inc.". All this companies work on Islamic finances as consultancy firms.

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[5] Al Hilal has 90 Mill. US$ invested in mid-2012 in Kazakhstan, including a "wakala" contract worth 10 Mill. US$ with the Kazakh Post (NBCNews, 2.7.2012).

[6] In its fatwa in 2011 the Board recommends to the bank to pay a Zakat on those investments that were made into corporate businesses. However, as such the bank is not subject to Zakat, since it is wholly owned by the state (Al Hilal Bank, 16.5.2012).

*Engaging the Market: The Sukuk Commodity Murabahah of the Development Bank of Kazakhstan*

On 3 August 2012 the Development Bank Of Kazakhstan, a government owned financial investment institute with assets worth more than 6 Bill. US$, issued a sukuk, an Islamic bond in the size of 75 Mill US$. This was the first time an Islamic bond was issued in the former Soviet Union. To shed light on some of the conditions for this operation allows to better follow the debut of Islamic finance products on the Kazakh and, for that matter, entire Central Asian market. To begin with, the issuer, the Development Bank of Kazakhstan (DBK), was operating under uncertain legal conditions. The sukuk was issued as a commodity murabahah, yet laws in Kazakhstan specified only sukuk of the ijara and musharakah type. In addition, according to representatives from the DBK, neither issuance procedures for Islamic bonds nor their listing procedures were clearly regulated (Interview #7, 2012). The launching of this bond was a test for all parties involved to examine the reaction of the market. To smooth the process, the sukuk was issued in Malaysian riggit, using the Malaysian law and corresponding supervisory capacities in the Kingdom, namely approval from the Malaysian Central Bank and the Shari'a Advisory Council of the Securities Commission of Malaysia for Shari'a conformity. Listed at the Kazakh stock exchange and with a profit rate of 5,5% p.a. the sukuk was aimed at investors from Malaysia to whom 62% of the bond were allocated, the remaining 38 to investors in Kazakhstan. In conversations with the author and in presentations the DBK clarified that this sukuk issuance was meant to pave the way for other issuers and investors (DBK, October 2012). Against problems of "[l]ittle awareness about Islamic products among general investor community in Kazakhstan and state bodies" and an "Islamic investor community unfamiliar with the credit and Islamic finance initiatives of Kazakhstan (Malaysia, Middle East)" (DBK, October 2012), the DBK made use of its standard ratings with global rating agencies to set a benchmark for second-tier financial institutes (Interview #5, 2012).[7] In general the program size of this issuance mounted to more than 1.5 Bill. Malaysian riggit (488 Mill. US$) and further issuances were planned by the DBK. The goals and concerns for further launches yet have remained the same.

*Kyrgyzstan: Emerging Market for Islamic Retail Banking and Islamic Micro-Financing*

Kyrgyzstan has been in the news and a subject for extended debates in political sciences for

[7] DBK ratings in times of sukuk issuance: S&P – BBB+/stable; Fitch – BBB-/positive; Moody's – Baa3/stable.

its unconventional developments in the last two decades. The often chaotic events, with two revolutions in six years, swift changes from open to closed political regimes, and endless demonstrations and strikes (Wolters 2012; Wolters 2013), almost inevitably had their impact on the emergence of Islamic finance in the republic. Yet, parallel to the developments in Kazakhstan, attempts to set up Islamic finance got a boost in the years 2008 and 2009.

The history of Islamic finance in Kyrgyzstan is strongly connected with the Islamic Development Bank. The republic was the first country in Central Asia to join the IDB in 1993, following the liberal agenda of then president Askar Akaev (Gresh 2007). However, despite this early engagement, investments by the Bank in Kyrgyzstan have been the lowest among the Central Asian countries, amounting to only 159 Mill. US$ until mid-2012 (DeCordier 2012). For a comparison, Kyrgyzstan is ranked third in EBRD investments; and holds the reputation to be a rather open country to foreign aid. The question for the reserved approach of the IDB notwithstanding, investments in recent years, since 2006, have been increasing. Most of the funding went into infrastructural projects, especially transportation, yet increasingly the support of a new system of Islamic banking was given priority. In June 2012 the IDB and the Kyrgyz government signed an agreement for technical assistance worth 193.000 US$ for "further development of Islamic financial services in the country." (Akipress, 04.07.2012). This new engagement into the facilitation of Islamic financing in the Kyrgyz Republic can be traced back to a memorandum, signed by the Kyrgyz government, the IDB, and the "EkoBank", a commercial bank operating in Kyrgyzstan in May 2006. This agreement that owned much to the personal initiative of the head of the IDB in Kyrgyzstan back then, Shamil Murtazaliev, laid out four steps for transforming Bishkek into an Islamic financial hub in Central Asia. It also opened 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 (Osmonalieva 2012; Aliyev 2012; Eurasianet, 14.06.2011).

Following the memorandum president Bakiev, who had come to power after the ouster of Askar Akaev during the Tulip Revolution, signed a decree in July 2006 "On the Pilot Project of Introduction of Islamic Financing Principles in the Kyrgyz Republic". This decree enabled the National Bank of Kyrgyzstan to move forward establishing new rules for Islamic finance institutes. Already in October 2006 the National Bank adopted a statute for Islamic financing principles, stating in detail conditions for Islamic banking instruments like mudarabah, ijara, murabaha, "sharika" (musharakah), or "istisna'a" (deferred production sale). Finally 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” (National Bank law, 29.07.1997) and to the law “On banks and bank operations in the Kyrgyz Republic” (Law on banks, 29.07.1997). 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. In September 2009 the government took the decision to prepare the market for the introduction of Islamic securities in form of sukuk and takaful (Easttime, 16.09.2009). Such groundbreaking work had its effects, when government representatives in Kyrgyzstan concluded talks with consultants from the IDB and investors from Malaysia to set up a Islamic insurance company in the republic (Novosti Islamskikh Financov, 30.4.2012; Info Islam, 07.04.2012). 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, ijara and others.

The establishment of Islamic financial institutes in Kyrgyzstan was closely related to the stipulations of the memorandum in 2006. Not only was Murtazaliev head of the IDB; before he had acquired the former Kyrgyz branch of Russian Credit Bank in 1997 and had it renamed EkoBank. Based on the memorandum, EkoBank became the first pilot-project for Islamic banking in the republic and was eventually renamed EkoIslamikBank in July 2010. EkoIslamikBank provides a good case study for examining the opportunities and challenges to Islamic financing in the Kyrgyz Republic. Since 2007 the bank has been prospering, opening branches in all major cities across the country and gaining market shares. For 2011 the yearly audit revealed assets of more than 2,3 Bill. som (48 Mill. US$) and reported a net profit of more than 60 Mill. som (1,2 Mill. US$) (Marka Audit Bishkek 2012). Most of deposit holders in EkoIslamikBank are former clients of the branch of the Russian institute, yet the bank management was able not only to keep this mostly non-Muslim clientèle but to expand its base of customers. In 2010 the bank managed to sign 2.274 agreements with customers, in total worth 867 Mill. som (19 mill. US$). EkoIslamikBank 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 a training in principles of Islamic financing (Business Akipress, 21.12.2009). Furthermore and independent of EkoIslamikBank, a small corporate investment firm, called “Muslim” (Eurasianet 2011), started operating in March 2012 in Bishkek and two micro-credit institutes in Kyrgyzstan are handing out loans in compliance with Shari'a law. In interviews with the author, representatives of the National Bank also confirmed that micro-credit companies are testing the new regulations, with two firms, “Kompanion invest” and “Kausar” covering the South and the North of the country respectively (Interview #8). More firms were entering the market in 2011 (Muslimeco, 16.12.2011).Kyrgyzstan 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.

*Tajikistan: A Market with Promises for Islamic Finance*

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. A short summary of macro indicators provides evidence to this claim: contrary to Kazakhstan or Kyrgyzstan, only a small percentage of non-Muslim minorities live in the country, making Tajikistan for most parts a Muslim society[8]; the Islamic Renaissance Party is the only Islamic party legally operating in Central Asia as of today, which makes Islam politically relevant in public life (Heathershaw & Roche 2011); Tajikistan has strong connections to linguistically close Iran and seeks to broaden its relations to Pakistan, both nations with Islamic finance principles officially occupying a central place in the states' doctrines.[9] Irrespective of such favorable indications, Islamic financing has been very poorly developed in Tajikistan. Like the other states in Central Asia, Tajikistan joined the Islamic Development Bank Group after independence, even if 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 some figures, 212 Mill. US$ were allocated to

8 According to collected data on Wikipedia, over 90% of the population adhere to Islam (Wikipedia Islam in Tajikistan 2012)

9 Iran possesses the largest Islamic finance assets in the world, estimated at 235,3bn US$ and six out of the ten biggest Islamic banks are Iranian; in Pakistan Islamic financing has been fixed as a state policy in the constitution.

projects in the republic, other estimates count up to 500 Mill. US$ in funding for Tajikistan (DeCordier 2012; Trend, 17.11.2011). Further support was delivered by Islamic relief organizations from abroad to ease the burden of the civil war. The Saudi-Arabian “Saudi Al-Igatha” and the Iranian “Imdad” both engaged into charitable activities and, according to De Cordier (2012), are still running projects in Tajikistan. The cooperation between Tajikistan and the IDB further developed in November 2011, when both sides signed an agreement on Technical Assistance. This agreement foresaw the introduction of Islamic banking in the republic and pursued the goal to have a first institute operating by 2013.

As of 2012 no registered Islamic finance institute was offering its services in Tajikistan. The legal framework had 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 consulter and the biggest law firm in the Kingdom, to assist in drafting a law “On Islamic banking in the Republic of Tajikistan” (News.tj, 1.11.2012). With the political leadership expressing its interest in establishing Islamic finance institutes in the republic, some observers expected the first Islamic bank to emerge in 2013. Most likely this bank would be a “window” of an already established bank in Tajikistan, since the market itself still is carrying too many risks for investors abroad (Deutsche Welle, 13.11.2012).

Efforts to spread Islamic finance instruments have been undertaken already for quite some time in Tajikistan. One driving force behind such initiatives so far has been the GIZ, the leading German development agency. In trainings and seminars with interested parties, among others staff from the National Bank, members of the “Association of Micro-Finance Institutes of Tajikistan”, or representatives from governmental bodies, the GIZ was informing about Islamic principles of doing business and financing (HIAT, 05.06.2012; HIAT, 13.10.2010). In a conversation with the author, one expert told about some selected forms of Islamic financing already being practiced in Tajikistan (Interview #8). Especially depositing with micro-crediting institutes was an instrument being tested in Tajikistan since 2011. This market entry for Islamic finance principles is reasonable considering the high number of micro-financing agencies operating in the republic. A report from 2010 counts 116 such agencies, dealing with depositing, loan-organizing and loan-funding (Mubarak 2010) and having more than 150.000 clients (EkoIslamikBank, 24.06.2011). Therefore, such 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.

*Uzbekistan and Turkmenistan: Closed Politics and the Fear of the Islamist Threat*

As of today, both Uzbekistan and Turkmenistan have had little experience with Islamic financing. It seems that the authoritarian nature of the political regimes, with long-serving Islam Karimov as president in Uzbekistan and Gurbanguly Berdymukhammedov as successor to tyrannic Turkmenbashi in Turkmenistan, makes any independent business operation, and therefore Islamic banking too, a challenging endeavor. What is more, the reform-adverse political environment, where the political will of the elite rarely amounts to more than the idea of a preserved status quo makes changes to current legislation, as a precondition for Islamic finance practices, highly unlikely (Aliyev 2012). A third obstacle, at least in the case of Uzbekistan, seems to be a very sensitive environment for any project that bears the word Islamic in its title. Karimov and his government have been very cautious about any open adherence to Islam. Especially after the events of Andijan in May 2005, an Islamist discourse emerged in the republic where almost strong expression of Islamic belief risk to be subject to a general suspicion of extremist tendencies (Epkenhans 2011). Such development led to a situation, where, as one observer notes, the most promising market in Central Asia for Islamic financing with the Uzbek Ferghana valley as supposedly its most conservative region, has seen the lowest level of activism for the establishment of corresponding institutes and agencies (Aliyev 2012).

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. The donor developed relations with both countries and managed to negotiate and agree on country development programs throughout the last decade. Historically Turkmenistan was the second country in Central Asia to join the IDB group in 1994, whereas Uzbekistan was the last when it entered the institute in 2003. To both countries the IDB has channeled funds worth more than half a billion US$.[10] In most of the cases such funding went into the transportation sector and energy.

Initially, in Uzbekistan the IDB engaged in the 90s with small scale funding for the Spiritual Board of Muslims to help the community restore the madrassa Mir-Arab and Dar-el Khadis in the ancient city of Bukhara and to help rebuild dormitories and hospitals (mfer.uz 2011). Only

[10] To compare data see De Cordier (2012) and mfer.uz (2011).

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 655 Mill. US$ 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) (Islamnews, 7.11.2012; rbc, 18.9.2012). The IDB is a member of the Coordination Group next to the "Saudi Fund for Development", the "Kuwait Fund for Arab Economic Development" and several other Arab donor organizations. 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. The IDB's "Corporation for Development of Private Sector", to which Uzbekistan is a member, signed a memorandum of understanding with Uzbekistan on the further support to businesses in the republic (gazeta.uz, 6.11.2008).

The IDB regularly lends funds on the base of Islamic principles and does so next to donors that operate with conventional financial instruments (Akingump, 2.4.2012). 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 (2012) 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 and additional credit line was granted to "Uzpromstroybank" (Trend, 6.4.2012). However, so far it seems like plans for the further development of such IDB loans into an Islamic financial instrument for the recipient banks, for example the ijarah, do not exist.[11] The development of the Islamic finance sector in Uzbekistan has been limited to proclamations only.

In Turkmenistan conditions for Islamic finance practices to take root in the economy seem to be even less developed. From the point of view of legislation, nothing has been undertaken by the state, no reform has been implemented. Announcements were made in the past that suggested a shift towards a favorable perspective on Islamic banking. In June 2009 Turkmenistan was host to the annual meeting of the IDB group and organized a series of

[11] At least in 2012, neither Ipak Yuli Bank nor Uzbek Leasing International or Uzpromstroybank use Islamic financial instruments for their leasing operations according to information on their websites.

forums and seminars dedicated to Islamic finance (Turkmeninform, 2.6.2009). This engagement did not translate into any real attempt to introduce Islamic banking in the country. However, the meeting resulted in an agreement signed by the Turkmen government and the IDB to fund the construction of the railway line from Bereket (Tukmenistan) 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 (bibo.kz, 5.6.2009). The IDB granted more than 370 Mill. US$ to this project and continued talks with the Turkmen side concerning a variety of projects estimated at a total value of 950 Mill. US$ (Islamicfinance, 28.12.2009). Further developments, however, were faltering: of the few noteworthy agreements one involves a loan of 121 Mill. US$ for the reconstruction of the water supply system in the Western region of Balkan and the other entails the plan to establish an investment holding company to support small and medium enterprises (Islamicfinance, 3.11.2010; EDB, 25.6.2011). Aliyev (2012), however, records no current activity of the investment holding company and additional memorandums of understanding between Turkmenistan and the IDB have been of a proclamatory nature for the time being.

In sum both states are more than hesitant to introduce Islamic banking and to allow alternative forms of financing like murabahah or musharakah to be tested among their populations. In Uzbekistan connections with the IDB seem to be strengthening in recent years with a shift towards Arab investors in form of the Coordination Group as evidence for a diversification of sources of fresh capital. In Turkmenistan such diversification is not visible and for now seems to be falling victim to the monotonous structure of the economy in combination with the purely ceremonial state of political decision-making under president Berdymuchammedow.

*Islamic Finance and the State in Central Asia*

Summarizing on the state of development of Islamic financing in the five Central Asian republics, some conclusions, even if preliminary at this stage of the research, can be drawn. To be clear, in light of the gap in empirical research into informal practices of alms giving and the works of Muslim charity organisations in the region, it is almost impossible to generalize about the relevance of ideas of Islamic finance, its principles like asabiyya or the prohibition of usury, to the population in the region. Also the selected initiatives to establish banking institutes and micro-credit agencies do not add much to our knowledge due to their short existence. As of today, Central Asia is far from affording Islamic finance the importance and corresponding institutional settings similar to those in the Muslim nations of the Persian Gulf, or in Iran, Pakistan or Malaysia. Irrespective of that, the case studies allow to hypothesize about the relation between Islamic business practices and the state in Central Asia and therefore about economic action and state re-action in general in the region. In Kazakhstan the central state is the important actor. Here lies the capacity to boost Islamic finance or to limit it to selected infrastructural projects. In interviews with experts the state is being identified as the key decision maker, yet, as the case studies show, also by means of initiative taking it holds the key position. The young history of Islamic finance in the republic tells of lobbyists, who concentrate their work on sound new legislation and who try to reach out for political decision makers, and of private banks to wait for approval from the presidential administration. The central state in Kazakhstan makes the initiative to form commissions, to invite experts from abroad and also to supervise investment projects that carry the label Islamic. In sum the central state distinguishes itself in Kazakhstan by its ability to control for the development of Islamic banking. The absence of a developed retail market for Islamic finance, for example with Al-Hilal Bank, as well as the non-existence of micro credit agencies in this sector stays in contrast to the number of state organs involved in the process of Islamic finance evolution in Kazakhstan. The National Bank, the Financial Market Supervision Agency, the presidential administration, the Development Bank of Kazakhstan and several ministries in last years in various degrees participated in the preparation of new legislation as well as guiding and controlling the introduction of Islamic finance mechanisms into the market. Taking Islamic finance as an indicator, the central state's actions in Kazakhstan fit well into descriptions of a typical developmental state. In Kyrgyzstan the central state less so than in Kazakhstan can take the attitude of obstruction but it is the condition for progressive developments in Islamic finance. Here the question of particular interest for the future is, to what extend the positive impulse can be sustained in the context of constant political changes. The challenge to Islamic finance expansion is to master changing political alliances and insecure state institutional settings. What was initiated due to personal relations between president Bakiev and banker Murtazaliev in 2006, and resulted in the National Bank becoming the driving regulatory force behind Islamic banking, so far has been only half-heartedly supported since the April revolution in 2010.[12] Constant government dismissals

[12] In an interview I was informed that a Leading Committee set up to promote the goals of the Memorandum towards state officials and interested parties has halted all operations in Spring 2010 and not resumed its work ever since

represent the generally weak state in Kyrgyzstan and they carry the risk of a sudden change in personnel and the marginalization of supporting networks. However, Islamic finance seems not to rely solely on state support for its development in the republic. Initiatives mostly come from actors from non-goverment sectors. Banker Murtazaliev stands for a type of entrepreneur who calculates the risks of unstable state support against the open liberal economic context. In that sense EkoIslamikBank as the first example of privately organized Islamic banking in Central Asia and its followers are indicative of a favorable socio-economic context for doing Islamic business in Kyrgyzstan, against the background of a weak state and a chaotic institutional setting. Tajikistan seems to be in a position similar to that of Kyrgyzstan, yet some trends in Islamic finance development make the picture more complex. First, despite the advantageous condition of a Muslim society, the initiative to establish Islamic finance institutes in the republic has been taken by development agencies and less so by entrepreneurs from within Tajik business circles. And second, disregarding the comparable stable context of the political regime in Tajikistan, first steps to reform the corresponding legislation were made only very recently. In sum, in Tajikistan domestic actors seem rather hesitant to introduce Islamic banking. Since the institutional setting with concentrated decision making power, developed relations with other Muslim countries and experiences with micro credit companies must be considered rather supportive, there is reason to believe that this caution is rooted in political considerations. In fact, Tajikistan's struggle against alleged Islamist groups, the competition of Rahmon's regime with the Islamic Renaissance Party and the attempt to attract the big powers' attention feed a discourse that warns of an imminent Islamist threat (Schmitz & Wolters 2012:14). Following this argument Islamic finance in Tajikistan falls victim to the extended employment of a discourse that serves regime stabilization in the first place but casts a general suspicion on any outright expressions of unconventional Islamic practices. Such political considerations certainly play a role in Uzbekistan too, but here a comparison to developments in Kazakhstan reveals considerably more insight. Both Uzbekistan and Turkmenistan created platforms to discuss Islamic finance and showed top-level commitment to international cooperation. This central state action shows the intention to benefit from the new relations with investors from Muslim countries. Yet it also discloses the weak control capacities of the central states in both republics, when such intentions do not translate into lasting reforms, into new market segments being made

(Interview #8, 2012).

accessible and into the development of a favorable institutional setting with supervisory bodies and advocacy groups. Compared with developments in Kazakhstan Uzbekistan and Turkmenistan show the control ambitions typical of the authoritarian political context, yet they do not possess the institutional capacity to guarantee the supervision of economic experiments. Here they certainly depart from the ideal of the more powerful and creative type of the developmental state.

*Central Asian States and the Concern for Stability*

In conclusion two hypotheses can be further developed. A first reflection relates to the discourse of solidarity in the Central Asian societies. If the creation of Islamic finance is being pursued in the five republics, it can be expected that its growth will have implications for the public formation of questions about justice and solidarity. So far corresponding research on this issue is scarce, yet Tajikistan and Kyrgyzstan and the role of retail service and micro crediting already provide first interesting case material for the study of an Islam from below. To what extend are such new activities an impulse for an Islamic based moral economy, in which a newly found religiosity in the villages and provinces connect with new reformist movements like the Tablighi Jaam'at or Hizb ut-Tahrir[13]? What would be the implications for Uzbekistan, where the Andijon massacre in May 2005 had end all experiments with Islamic endowments (waqf) and all engagement with poverty alleviation based on informal zakat for an indefinite period (Karagiannis 2010)? Do such Islamic local welfare systems still exist in the Ferghana valley or do Islamic finance practices play a role for the Uzbek mahallah? It seems no impact can be expected in the case of Kazakhstan, where most experts don't grant the “Muslim faith” factor much potential to develop. However, the recent increase in terrorist activities has opened the public debate for Islam to enter as an issue of political concern. If retail services are being provided by Islamic banks, this might, even if rather subtly, add to the public discussions about the place of Islam in society as much as it will influence and be influenced by the political discourse on the Islamist threat.[14]

A second consideration is concerned with a problem that was raised especially by Tajik experts in light of the first attempts to establish Islamic banking in the republic. They believe

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13 On the Tablighi Jama'at movement see Mostowlansky 2007, on Hizb ut-Tahrir Karagiannis (2010).

14 Even in Kyrgyzstan, such concerns were raised during the establishment of EkoIslamikBank. A cable of the US Embassy, made accessible via Wikileaks, sheds light on fears of Islamic extremists: in it, embassy staff comment on the possible danger of Islamist financial involvement in the bank and discuss the issue with Kyrgyz officials (Wikileaks 2007).

that the condition for full transparency is a barrier that not many entrepreneurs will be willing to agree to (Deutsche Welle, 13.11.2012). The Tajik economy, they contend, for most of its share takes place in the shadows, where corrupt practices in dealing with the state as well as tax evasion have become systemic features. This statement can be applied to most Central Asian economies. Full transparency, the demand to disclose all parties' interests and shares of assets in an economic endeavor, the exclusion of any kind of speculation (ideally), are conditions for business that do not fully align with the principles of the shadow based economies of Central Asia. For the political regimes that seek to boost Islamic finance this condition is tricky, since their public support to Islamic banking as an alternative means for economic and also societal development now carries the risk to questioning the systemic feature that the shadow economy has become as an integral part of the politico-economic nexus that forms the power base of the political elites. In sum, the experience of the financial crisis did influence the debates in Central Asia on economic development, mostly towards questions of alternative sources of capital, but also towards new ways to organize difficult economic and social transformation processes. Islamic financing offers an alternative to both, the search for fresh capital and the debate on social development, yet it also confronts the political regimes as well as the societies in the region with challenges the implications of which for now neither are fully understood nor can be properly measured.

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#2, 5.10.2012, with representative of ATF Bank

#3, 5.10.2012, with representative of Amanie Advisors CIS

#4, 6.10.2012, with representative of Alageum Group

#5, 7.10.2012, with representative of Kazakhstan Development Bank Leasing

#6, 9.10.2012, with Yerlan Baitaulet, head of the Association of Islamic Bankers in Kazakhstan

#7, 9.10.2012, with representative of Development Bank of Kazakhstan

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