

Problems of Development of Islamic Financing in Kazakhstan: Financial and Legal Aspects

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Abstract

Objectives: In terms of the development of financial system of Kazakhstan the issues of implementation of principles and basic institutes of Islamic financing in the financial and legal systems are of much importance. **Methods/ Statistical Analysis:** In order to define the features of Islamic financial institutes in terms of economic and legal situation of Kazakhstan the basic principles and normative legal acts at different levels and of different areas are analyzed. **Findings:** Basic institutes and principles of Islamic financing and the possibility of their implementation in the Republic of Kazakhstan are established. The Republic of Kazakhstan is in the process of alteration of acting legislation in order to comply with the requirements of Islamic financing. The main features of adaptation of Islamic financing institutes and principles within the economic and legal system of Kazakhstan are defined. Main directions of development of financial and legal systems of Kazakhstan are determined on the basis of studying the results of research. **Application / Improvements:** The results shown in this paper can be used to improve the current financial system and acting legislation regulating process of implementation of Islamic financing in the Republic of Kazakhstan.

Keywords: Banks, Finances, Islamic Financing, Legislation, Principles

1. Introduction

As it is known, the maximum profit is the engine of monopoly capitalism. This is happening everywhere; the largest transnational corporations control almost all economies of the world. Throughout the history of capitalism, its development was accompanied by the ups and downs, causing the most severe crises, the output of which, as a rule, have been global and regional wars. At present, the world has again come to a point. One of the main causes of these crises is the existing financial system, based on usurious credit interest. With free capital, the bankers are not producing the goods and not having the means of production, engaged in a sale of the money, while money itself actually represent the equivalent of commodities and are the only means of exchange of goods between people. Therefore, moneylenders actually

involved in the robbery of their fellow citizens, this leads to the impoverishment of the people, which in turn causes a drop in demand for manufactured goods and services, stopping the development of national economy. Acute liquidity crisis, originating in the Western world, showed the inferiority of the financial system. Therefore, therefore globally there is a primary task of creating a liquid resource allocation system that addresses urgent issues of poverty alleviation and improvement in important socio-economic aspects of life, such as health and education, to ensure a safe and secure future for young people, etc. All this is possible only through an efficient and equitable distribution of resources for productive capacity and jobs.

Such financial system, steadily growing in the context of the global economic crisis, is the model of Islamic banking based on ethical business principles. These principles protecting private property, guarantee freedom, fairness

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and transparency of market forces. Ensuring compliance of financial services these guidelines enable us to provide the appropriate services are not only Muslims, but also to all other interested fellow citizens, as it happens, for example, in Malaysia or the United Kingdom.

During world financial crisis Islamic banks showed their stability and strength, while classic banking system was the main sufferer of that crisis. Thus, the Islamic banks are getting more popular.

2. Materials and Methods

Islamic practice of creating specialized financial companies dates back to the 60s of the last century. The central concept in Islamic financial transactions is justice, which is achieved mainly due to the distribution of risk. It is assumed that the parties involved have to share profits and losses. Accordingly, the calculation of interest is prohibited. While conventional intermediation is usually based on debt and allows for a lender to minimize the risks, the ethical mediation based on real assets and risk-sharing. This means that the investment is based on equity participation, or the actual purchase and sale of an asset, hence, Islamic banks are an integral part of the real economy compared to conventional banks, which have already cut off from her, receiving income from a purely financial transaction in principle¹.

Islamic finance is alternative financial system that is consistent with the principles of sharia (Islamic law).

Islamic finance differs from classic system by five main principles:

- no interest rate (*riba*);
- no place for speculative operations; especially financing operations with tobacco, alcohol, guns, entertainment, pork etc.;
- casino, financing speculative operations (*maisir, zulm*);
- financing operations with tobacco, alcohol, guns, entertainment, pork and etc. (*haram*);
- no limits for transparency (*gharar*);
- Profit and risk are equal for all participants.

So, one of the important features of Islamic finance describes operations without interest rate, because sharia laws prohibit it. Another feature is that operations based on assets. According to Islamic financiers, the main prin-

ciple of Islamic finance is its relation with real sector of economy, also its economic efficiency and strong risk-management, which includes analyzing of client's activity. There are many possibilities of financing and keeping business principles via participation in share capital. Unlike Western system the main feature of this finance is that bank participates as business-partner, so bank doesn't affect negative to development of entrepreneurship.

Implementation of Islamic finance relates to three groups of its tools:

- 1) general:
 - financing without interest rates (financing direct cost with discount) (*card al hasan*);
 - raising funds via emission of sukuk certificates;
 - non-banking operations (investment fund, Wakf, Hajj, pension fund, microfinance);
 - Takaful (mutual insurance)
- 2) On the basis of partnership:
 - Mudarabah (rabb al mal – investor);
 - Musharakah (partnership);
 - Wakala (agent).
- 3) On the basis of trade:
 - Murabahah (short-term financing of trade);
 - Ijarah (selling equipment for long periods);
 - Istisna (financing of infrastructure after request);
 - Salam (advance financing of agriculture).

The features of Islamic financial products are described in the following features:

In accordance with the acting norms of financial and legal system in Kazakhstan there are following strengths and weaknesses are found out.

For financing of trading activities as intermediary via commercial lending as a strength we can consider the fact that the client knows about payments². The weak point is absence of any loans with cash form; Islamic bank buys asset for client with additional value and long-term form.

Financing of industrial and trading activities of legal entities via participation to authorized capital on the partnership basis is characterized by the positive fact that Islamic bank and client participate as partners. Both sides are stakeholders, who need profit from project. Profit divides among participants as they arranged before. Losses are equal to volume of participants' bankroll. But at the same time both sides participate in project³.

The next product is investment activities on the leasing basis (rent). Its strength is that the client knows about leasing payments beforehand. The weakness is that leasing property must meet requirements of Islamic finance.

In Islamic rental certificates – right of profit in appliance with rental contract (financial leasing) there are two strengths: 1. Possibilities of getting real estate, land, equipment. 2. Certificates are secured by assets. The weakness is that assets must meet requirements of Islamic finance.

Islamic certificates of participants – purpose of emission is spending borrowed funds for new and current investment projects are also the possible products. For such an institute the strength is that it gives possibilities to finance infrastructural, industrial, agricultural projects. However, property must meet requirements of Islamic finance.

Finally, shares and participatory interest of Islamic investment funds – company, which activity complies with Islamic finance principles, and also it transfers project investments to securities. Its strength is in investments are secured by assets. The weak side is that due to lack of Islamic tools Islamic mutual funds are not popular in Kazakhstan.

3. Discussion and Results

Nowadays Islamic finance institutions work via more than 400 banks in 80 countries including USA and Western Europe. Islamic Development Bank forecasts that at the end of 2015 the volume of Islamic financial assets will be 2.8 trillion US dollars, because it's been growing average 10-15% per year. According to Standard & Poor's rating agency, it is possible that growth can be 4 trillion US dollars, so it means 7-time growth⁴.

World market share of Islamic finance, which based on sharia principles, grew 3 times last decade, at the mid of 90's it was 150 billion US dollars and in 2010 it was 663 billion. According to many experts of the world, it is a big future of Islamic finance in the countries of Central Asia, North Africa and South-east Asia. At this time there are many developed countries, where Islamic finance functions well⁵.

Among post-soviet countries the Republic of Kazakhstan was the first state that created the legal basis of Islamic finance. In 12.02.2009 the Republic of Kazakhstan adopted the Law on "Functioning and organization of Islamic banks and amendment to separate law acts of the Republic of Kazakhstan".

One of the main reasons, which motivated to do that was stability after world financial crisis. The basic precondition of Islamic finance formation in our country is attraction of long-term foreign investments for regional industrial development.

The second reason – reducing risks of classic financing and motivating investment flow. The third reason – sustainable economic development by regulating the source of financial system. Due to these reasons there are many arrangements within Road map of Islamic finance until 2020, which adopted by the Government of the Republic of Kazakhstan. After adoption and amend the laws on "Bank and banking", "Securities market" and etc., where main amendments were about Islamic finance, in our country was created additional possibilities for Islamic finance. The first Islamic bank in Kazakhstan JSC "Al-Hilal" Islamic Bank" (United Arab Emirates) was opened in 2010, which has branches in Almaty, Astana and Shymkent. Nowadays this bank with support from the state and via adopted laws is financing 15 corporate clients of oil, gas, railway and other sectors. According to official information from this bank, "Al-Hilal" is going to invest 200 million dollars in Kazakhstani business⁶.

The role of Islamic banks in this process is extremely important due to the universality of the very nature of banking services. Currently, the only "Al-Hilal" Islamic Bank participates only in selective financing of large state-owned companies, yet it is small in terms of capitalization. In the meantime, the bank plans to have no desire to offer services for SMEs, and to go to the retail market, so access to Islamic financial services to the population is still closed. However, it is recognized that the bank is experiencing problems of legislative and operational nature, namely the improvement and adoption of preferential tax treatment for a range of banking products (Commodity Murabaha, Ijara, Wakala, etc.), support for short-term liquidity, and the absence in the information space of the country, extreme passivity and lack of autonomy in decision-making.

Given this situation, in Kazakhstan it is necessary to create several Islamic banks, serving the interests of the corporate sector and the general population. Moreover, it is important to create the appropriate legal framework⁷.

After merger of "Association of Islamic finance development" and the first Islamic insurance company "Takaful" the first Islamic broker company "Fattah Finance" and companies, which provide consulting services related to Islamic finance, have been registered.

Moreover, in association with ICD in Kazakhstan has been registered Islamic leasing company JSC “Kazakhstan Ijara Company”.

In opinion, which is head of bank’s Islamic finance department, Kazakhstan can be the regional Islamic financial center, because the state is considered as the strongest country in that region⁸.

To date, the average growth of Islamic insurance in the world is about 25%, higher than the growth rate of conventional insurance companies. It is estimated Ernst & Young, one of the largest auditing firms in the world, if this growth continues in the future, by 2012, the takaful market will reach 7.7 billion. US dollars. The number of takaful operators, represented in more than 38 countries around the world, exceeded 180⁸.

Islamic trade and finance companies and micro-credit organizations in their activities use the most common tools - Murabaha. These companies will help finance SMEs, especially in rural areas and to involve the active population in the creation of jobs and production activities. One of the most promising and fastest growing industries for SMEs is the production of halal products (food products, perfumes, clothing and footwear, furniture, books, film industry, the production of goods for children, educational activities, etc.). These products are in demand all over the Eurasian economic space and can be exported to other countries. There is a project of creating Halal Hub in Kazakhstan with the participation of the Malaysian side. This project will help to attract investment in the development of agriculture, not only Kazakhstan, but also the entire region of the Customs Union.

In Kazakhstan it is currently set up and operates an Islamic foundation “Hajj Fund of Kazakhstan” with the participation of the Malaysian state-owned company AmanahRaya like Malaysian Haj fund Tabung Haji. Assets Open 49 years ago, Tabung Haji account for more than 9 billion. USD. The fund will allow Muslims to gradually save enough money to cover the Hajj or Umrah costs and also allows investors Fund using their savings to take an active part in investment, especially in infrastructure projects, as well as the development of the halal industry in the Republic of Kazakhstan and the countries of the Eurasian Union. This Fund could solve the problems of our pilgrims, to raise the authority of the Republic of Kazakhstan in the Islamic world and become one of the main niches for retail business. Currently, the IDB and Tabung Haji forces set up a separate company TaHa Alam (Malaysia), the purpose of which the entry into the share capital Haj Fund in all countries of the OIC, as well as providing services for

pilgrims. Therefore, the shareholders of the Fund will be Kazakhstan’s Hajj is respected around the world as the company IDB, Tabung Haji and AmanahRaya. The presence of these partners serve as an impetus for the development of Islamic financial services industry.

It is also worth noting that Islamic finance has a bright social component. This so-called Wakuf (legacy) service when the company transferred the property for these types of services to management or other tangible assets to be used for the benefit of people with a charitable purpose. This also applies to services such as Zakat and Sadaqa. These funds are used exclusively for the benefit of the poor, eliminating social tensions and to successfully fight poverty. Noting that one of the services the company has AmanahRaya management legacy, it is possible to extend its successful experience in the Republic of Kazakhstan and the countries of the Eurasian Union.

4. Conclusion

Although the legal basis was created, there are some problems in Islamic finance, which prevent the full development. Firstly, Islamic finance is a new and young sector. The first Islamic Bank got license only 30 years ago. Secondly, every country has different rules and structure. Thus, there isn’t any technical, legal regulation for classic and Islamic banks. Thirdly, the legal framework, which based on the principles of sharia, has some disadvantages in terms of liquidity. Fourthly, in post-soviet countries, especially in Kazakhstan people are uninformed about Islamic finance and also there is deficit of practice. Moreover, this sector of finance has deficit of specialists.

Further development of Islamic banking is largely dependent on how quickly upgraded national legislation and as soon as the amendments are approved by Parliament. The main thing is that now in Kazakhstan there is an understanding of the need for Islamic finance and to create the necessary critical mass for successful penetration and expansion based on the principles of sharia banking in the domestic financial sector.

In general, nowadays, when Almaty is being considered as the center of Islamic finance, we can expect the bright future of Islamic finance in Kazakhstan.

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