Islamic Finance and the State in Central Asia

Accepted version of an article published in *Central Asian Affairs*:
Wolters, Alexander. " Islamic Finance and the State in Central Asia", *Central Asian Affairs* 3, 4 (2016): 360-384.

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Abstract

Islamic finance is a rather recent phenomenon in Central Asia. Only with the beginning of the financial crisis in 2007 did the cooperation between the states and the Islamic Development Bank result in domestic initiatives to establish forms of Islamic banking. The case studies in this article indicate a correlation between the subsequent development of such initiatives and the unfolding political crises. The states in Central Asia were eager to connect to available streams of Islamic investment capital in the early stages of the financial crisis. Their commitment to further adapt, however, declined when they entered periods of political crisis that brought about quick and sudden reshuffles of reform priorities.

Keywords

Islamic Banking – Kazakhstan – Kyrgyzstan – Tajikistan – state – economics – finance

Introduction

Islamic finance and banking has been developing steadily since the early 1970s. This growth has been concentrated in the Arab states and in Muslim

1 I would like to thank two anonymous reviewers for their suggestions and comments as well as the *KomPost Research Network* (sub-project D2), sponsored by the German Federal Minis- try of Education and Research, for providing the funding for field research. Material for this article includes data gathered during two field trips to the region in September/October 2012 and February/March 2013. An earlier version of this article appeared in the Research Paper Series of the PFH Private Hochschule Göttingen, see Alexander Wolters, "Islamic Finance in the States of Central Asia: Strategies, Institutions, First Experiences," *Research Paper Series* (2013): no. 1.

doi 10.1163/22142290-00304003

southeast Asia, particularly in Malaysia. Global financial centers like London proved exceptional to this rule and serve as organizational hubs to channel and direct Islamic financial resources.2 Since the dawn of the global financial crisis, however, interest in Islamic financial products has risen because they have performed much better than conventional products. Islamic banking is duly making its way into non-traditional markets and may now exceed US$2 trillion in assets.3

The states of post-Soviet Central Asia have been left out of this emerging picture of global Islamic financial flows. In fact, most countries in the region have experienced only meager growth in Islamic investment in their respective capital markets. And despite repeated proclamations to begin introducing Islamic banks and to benefit from this vibrant economy, the results are disillusioning. Out of five republics, only the National Bank in Kyrgyzstan has issued a license to a local institute to open an Islamic bank, the *EkoIslamikBank*. The other states have been hesitant or delayed in their attempts to provide for the necessary legal changes, or they rely on external initiative and funding.

This state of affairs is perplexing. Considering their much-referenced Muslim heritage, the increasing re-engagement with all parts of the global Ummah, and the assumed executive powers of decision-makers in the countries of Central Asia, not to mention the acute needs for fresh capital, the swift introduction of basic principles of Islamic banking across the region seems logical, but that has not happened. What explains this irritating outcome?

To investigate the possible reasons behind such low performance, this article focuses on the dynamic relation between political crisis and Islamic finance in the Central Asian republics. When facing global financial shocks, states open up to new and unconventional investment opportunities; in times of political crisis, however, concerns for state security and the need for what is perceived as *social tranquility*4 quickly undermine such efforts. In their move against

2 Ricardo Baba "Islamic Financial Centers," in M.K. Hassan, and M.K. Lewis (eds.), *Handbook of Islamic Banking* (Cheltenham, UK: Edward Elgar, 2007): 384–400. Offshore financial marketplaces are gaining momentum, see "Offshore Financial Centers. Attractive for Islamic Finance," *MIFC Insight Report*, August 13, 2015, http://www.mifc.com/index.php?ch=28&pg=72&ac=138&bb=uploadpdf (accessed January 29, 2016).

3 See "Islamic Finance: Developments in Non-traditional Markets," *MIFC Insight Report*, January 15, 2016, http://www.mifc.com/index.php?ch=28&pg=72&ac=160&bb=uploadpdf (accessed January 29, 2016); for a discussion of recent estimates, see "The Size of the Islamic Finance Market," *IslamicFinance.com*, December 27, 2014, https://www.islamicfinance.com/ 2014/12/size-islamic-finance-market-vs-conventional-finance/ (accessed January 29, 2016).

4 For the use of the term see, for example, "Doverie k vlasti snizhaetsya – Gul'mira Ileuova," *Radio Tochka*, November 28, 2015, https://radiotochka.kz/18833-doverie-k-vlasti-snizhaetsya-gulmira-ileuova.html (accessed January 29, 2016).

possible sources of instability, the states in Central Asia seem to repress all kinds of irritating social innovation. Kazakhstan and Tajikistan were eager to connect with available streams of Islamic investment capital in the early stages of the financial crisis in 2007 or 2008; yet they found it difficult to continue when the political regimes came under threat a few years later. In addition to detailing the nascent evolution of Islamic banking and finance in the region, the article thus aims to contribute to an emerging body of literature about the potentials and limitations of Islamic economics in Central Asia.

After a short review of the literature, the text uses case studies that contrast the respective initiatives to introduce Islamic banking in the Central Asian republics with political developments in the region since 2007. Ratings from Freedom House's *Nations in Transit* reports are used to evaluate overall political performance of the Central Asian states throughout the period.

The State and Islamic Finance in Central Asia

In comparison with the many debates about the fate of the state in Central Asia and its relation to economic transformation and development, the role of Islamic finance has been scarcely examined. This can be partly explained with the lack of proper material. There were simply not many stories that could have been told about Islamic finance in Central Asia until quite recently.5 Since 2011 more attention has been paid to the first pioneering projects. Most of this work attempts to examine state capacity to facilitate the establishment of Islamic financial institutes in the respective countries and discusses policy propositions.6 More recent studies examine the chances of implementing the Islamic leasing instrument *Ijarah* in Uzbekistan or discuss the prospects of

5 A first short article by G.F. Gresh is the exception, see "The Rise of Islamic Banking and Finance in Central Asia," *The Fletcher School Online Journal for Issues Related to Southwest Asia and Islamic Civilization* (2007).

6 See, for example, B. De Cordier, "The development space(s) of Non-OECD aid donors in Southern Eurasia: A look at the Islamic Development Bank," *Central Asia Economic Paper No. 3* (2012); F. Aliyev, "The Politics of Islamic Finance in Central Asia and South Caucasus," *Voices From Central Asia*, *2* (2012); Alexander Wolters, "Zwischen Scharia und der Suche nach frischem Kapital. Über die Einführung des islamischen Bankwesens in Kasachstan und Kirgistan," *Zentralasienanalysen*, 63 (2013): 2–5; Khaki and Malik's study on Islamic finance in Central Asia borrows in large part – and in unauthorized form – from my own research paper, published in 2013, compare G.N. Khaki and Ah. Malik, "Islamic Banking and Finance in Post-Soviet Central Asia with Special Reference to Kazakhstan," *Journal of Islamic Banking and Finance*, 1, no. 1 (2013): 11–22, and Wolters, "Islamic Finance."

Halal banking in the wider region.7 Such contributions reiterate stereotypical images about the prospective markets in Central Asia in order to promote Islamic banking. The line of argument followed here usually includes classifying titular nations as Muslims and therefore potential consumers in Central Asia,8 as well as identifying impediments in form of the legacy of Soviet secularism among the population, and hence the need to further promote principles of Islamic banking.9 Instead of questioning the common sense assumptions about the legacy of Soviet secularism or the dynamics of Islamic "re-awakening," these studies tend to use them as explanations.

One exception to this argument is Hoggarth's suggestion that Islamic banking has been used as an instrument for post-colonial nation-branding.10 She argues that Islamic finance serves Central Asian states, particularly Kazakh- stan, in their attempts to formulate an independent foreign economic policy. As such they strive to become part of what she labels a "form of post-colonial capitalism."11 Kazakhstan is leading this process and intends to utilize Islamic finance to build an alternative to Western, Russian, and Chinese developmentmodels.

Studies of the Islamic revival in Central Asia have largely ignored the arrival of Islamic finance. Botoeva's comparison of the establishment of Islamic finance principles in Kyrgyzstan and Kazakhstan offers a first insight into the complex processes of adoption and rejection, of adaptation and contestation of the accompanying norms and values.12 The advent of Islamic finance, she argues, is neither determined by pure economic rationality, nor can it be reduced to the rising piety among Central Asian Muslims. Botoevas study thus

7 Alam Asadov and Khurshid Gazikhanov, "Ijarah's Prospects in Central Asia: An Example of Uzbekistan," *Journal of Islamic Economics, Banking and Finance*, 11, no. 2, (2015): 63–85; B.A. Malik, "Halal Banking in post-Soviet Central Asia: Antecedents and consequences", *Marketing and Branding Research*, 2 (2015): 28–43; G.N. Khaki and Ah. Malik, "Emergence of pls Industry in Post-Soviet Central Asia: An Empirical Study of Kazakhstan," *Journal of Islamic Economics, Banking, and Finance*, 11 no. 1 (2015): 140–156.

8 Asadov and Gazikhanov, "Ijarah's Prospects in Central Asia," 65; Malik, "Halal Banking," 36.

9 Asadov and Gazikhanov, "Ijarah's Prospects in Central Asia," 73, 80; Malik, "Halal Banking," 33, 36–37.

10 Davinia Hoggarth, "The rise of Islamic finance: post-colonial market-building in central Asia and Russia," *International Affairs*, 92, no. 1 (2016): 115–136.

11 Ibid, 135.

12 Aisalkyn Botoeva, "Let's Bank the Muslim Way? Explaining the Establishment of Islamic Banks in the Peripheral Economies of Kazakhstan and Kyrgyzstan", paper presented at *sase Mini-Conference on Rethinking Islamic Finance: Markets, Firms and Institutions*, University of Milan (June 29, 2013).

questions both the ready-made assumptions about the natural affinity of Muslim Central Asia for Islamic finance, as well as the quick reference to market logic to explain its development in the region. Her argument adds to Hoggarth's critique about the assumption of Islamic finance as an elite strategy to pacify an Islamized population. In fact, both argue that the development and success of Islamic finance in Central Asia depends on complex adaptation strategies, whether for individual businesses (Botoeva) or national politics (Hoggarth).

The following case studies provide evidence to support this line of critique and also to move beyond it in some respect. Efforts to establish Islamic finance principles are conditioned by the experience of political crisis in the states of Central Asia. The first initiatives to promote Islamic banking, for example in Kazakhstan and Kyrgyzstan, followed a widely accepted belief about the economic nature of the global financial meltdown. Subsequent attempts to deepen the engagement, however, had to maneuver between economic rationalities and changing perceptions of the unfolding political crisis. Thus, individual or national strategies to adopt Islamic finance principles, either out of personal needs or for ideological projects, are limited by the crisis management strategies of the political regimes.

Islamic Principles for Business and Finance

Debates about the normative foundations of Islamic finance have become more intense and diversified following the impressive growth rates of this industry. The more Islamic finance enters new markets, and designs and offers new products, the more religious experts and practitioners question the sharia compliance of the business and subject it to their critical inquiry.13 Scholars like Choudhury seek to build up theological grounds for a Quranic-based world order to eventually realize a financial system fully rooted in the real economy.14

13 See, for example, M. Asutay, "Conceptualisation of the second best solution in overcoming the social failure of Islamic banking and finance: Examining the overpowering of homoislamicus by homoeconomicus," *iium Journal of Economics and Management*, 15 no. 2 (2007): 167–195; Ulrich Derigs and Shehab Marzban, "Review and analysis of current Shariah- compliant equity screening practices," *International Journal of Islamic and Middle Eastern Finance and Management*, 1, no. 4, 285–303; for a discussion from a practitioner's point of view, see John Foster, "How Sharia-compliant is Islamic banking?" *BBC News*, December 11, 2009, http://news.bbc.co.uk/2/hi/business/8401421.stm (accessed January 29, 2016).

14 M.A. Choudhury, "Development of Islamic economic and social thought," in M.K. Hassan and M.K. Lewis (eds.), *Handbook of Islamic Banking* (Cheltenham, UK: Edward Elgar, 2007): 21–37.

This contrasts with practitioners such as Yerlan Baidaulet, the head of the Association of Islamic Bankers in Kazakhstan, who envision the establishment of Islamic finance as a further branch of modern ethical banking.15

Aside from such disputes, the principles of Islamic finance are rather clear. They rest upon a systemic body of rules for economic engagement in compliance with the sharia, and they aim to help develop *asabiyya*, or social cohesion, in society.16 For example, *zakat*, one of the five pillars of Islam, functions as a special tax on wealth to provide for the poor. More specific conditions for Islamic finance are the exclusion of excessive risk or uncertainty and related speculative action, usually referred to as *gharar*, and, most famously, the exclusion of interest.17 *Riba* or *usury* leads to excess compensation without due consideration and must be forbidden in accordance with sharia law. To counter the negative effects of financial arrangements, Islamic economics instead proposes to balance out the risk to loose and the chance to profit in doing business (Profit-Loss-Sharing). Further principles resemble the criteria developed in conventional ethical banking, for example the ban on investments into gambling or pornography, as well as other activities that are *haram*, i.e., sinful and therefore prohibited.18

There are many instruments to allow for the sharing of profits and losses in Islamic finance, and many more are being designed and tested every year, leading to the above-mentioned debates about sharia compliance.19 A *mudarabah*, for example, is a profit- and loss-sharing agreement in which the bank provides financial capital and the partner provides knowledge and skills. The *murabaha*, which comprises more than two-thirds of the market, 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 transactions Islamic

15 Interview with Yerlan Baidaulet, Astana, Kazakhstan, October 2012.

16 Muhammar U. Chapra, *Morality and Justice in Islamic Economics and Finance* (Cheltenham, UK: Edward Elgar, 2014).

17 See S.R. Hakim, "Islamic Money Market Instruments," in Hassan and Lewis, *Handbook of Islamic Banking*, 161–171; a narrow definition uses the term *usury* as specific financial interest to designate the prohibition of interest, whereas *riba* more generally refers to addition or excess.

18 For an introduction into the principles of Islamic finance and banking, see Tarek S. Saher, M. Kabir Hassan, "A Comparative Literature Survey of Islamic Finance and Banking," *Financial Markets, Institutions, and Instruments*, 10 no. 4 (2001): 155–199.

19 For introductions, see Saher and Hassan, "A Comparative Literature Survey of Islamic Finance and Banking"; Hakim, "Islamic Money Market Instruments"; and *Glossary of Financial Terms*, Institute of Islamic Banking and Insurance, http://www.islamic-banking.com/glossary_of_key_terms.aspx (accessed January 29, 2016).

law demands that all information about costs in the transaction be honestly declared and that it be rooted in real commodity trade, not only financial transactions. The bank does actually buy the good, for example a house, and sells it further to the buyer with the added margin. Other commonly known instruments of Islamic finance are *musharakah*, a joint venture in which parties agree in advance on profit sharing, based on shares of investment; the Islamic bond *sukuk*; the above-mentioned Islamic lease arrangement called *ijarah*; and *bai salam*, a financing instrument for a deferred commodity ex- change.20 In general, all instruments in Islamic finance and banking aim to compensate for the time value of money in transactions without resorting to interest, as well as to guarantee that any transaction be rooted in the real economy.21

Any effort to establish Islamic banking in Central Asia must master the challenge of adhering to Islamic principles in financial investments. Even if Kazakhstan and its neighbors are considered fertile ground for future successful Islamic business, the institutionalization of corresponding norms and supervisory practices, for example the establishment of sharia councils, must be resolved before such initiatives can bear fruit. At the same time, a broader debate about Islamic economics and the underlying philosophical system still has yet to take off in the region.

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

Based on the number of international conferences and forums dedicated to Islamic finance and business that it has hosted, Kazakhstan has indisputably become the regional leader in promoting Islamic ideas of banking and doing business in the region. The Seventh World Islamic Economic Forum, held in June 2011, the Second Islamic Finance Forum in September 2011, or the Fourth

20 It is such sale- and buy-back instruments or deferred sales that are often criticized for non-compliance with sharia law, since many experts believe they disguise a transaction that basically runs on interest.

21 Choudhury explicates: "[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 ex- change 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, "Development of Islamic eco- nomic and social thought," 2007: 34).

Kazakhstan Islamic Finance Conference in September 2014, as well as such specialized events like the Kazakhstan International Halal Expo 2012, held in October 2012, and the 12th Islamic Financial Services Board Summit, held in May 2015 in Almaty, underline Kazakhstan's leading role in regional efforts to introduce Islamic finance and banking. Officially the Kazakhstani government has declared its ambition to develop the country into a regional center for Islamic finance in the former Soviet Union. To this end a special roadmap was adopted in 2012 that lists the steps necessary to reach this goal.22 Financial planners like Baidaulet or Zhaslan Madiyev, the deputy head of the Development Bank of Kazakhstan (DBK), confirm Kazakhstan's potential and have lobbied for the development of Islamic financing in the republic.23 Before the roadmap was adopted, Ernst & Young favorably assessed the Kazakhstani market opportunities:

> The Government's commitment to make Kazakhstan an Islamic finance centre, coupled with the country's current leadership in the [Commonwealth of Independent States] 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.24

Kazakhstan began to put more efforts into the development of Islamic finance with the onset of the global financial crisis in 2007. Before then, initiatives were limited to two smaller projects in the 1990s. While still a 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.25 Al'baraka Kazakhstan Bank opened on January 1,

22 The roadmap lists eight chapters with specific tasks to realize the goal to become the major hub for Islamic finance by 2020, see *Dorozhnaya karta razvitiya islamskogo fi- nansirovaniya do 2020 goda* (Respublika Kazakhstan, 2012), http://adilet.zan.kz/rus/docs/ P1200000371#z9 (accessed January 29, 2016).

23 See, for example, "Kazakhstan nachal vnedryat' islamskiy banking," *Deutsche Welle*, May 4, 2012, http://www.dw.com/ru/kazaxstan-nachal-vnedryat'-islamskij-banking/a-15925120 (accessed January 29, 2016).

24 "Challenges and opportunities for Islamic finance in Kazakhstan," *Ernst & Young* (2011), http://documents.mx/documents/islamic-finance-in-kazakhstan-ey.html (accessed January 30, 2013).

25 "Postanovlenie Soveta Ministrov Kazakhskoy SSR," *rgp Respublikanskiy tsentr pravovoy informaytsii Ministerstva yustitsii Respubliki Kazakhstan*, no. 472, November 30, 1990.

1991, and survived the difficult years of the dismantling of the Soviet economy only to be renamed Kaspi Bank and restructured into a conventional commercial financial institute in 1997. A similar fate, according to one observer, was suffered by an initiative from *Lariba*, a riba-free US-based bank that tried to enter the Kazakhstan market in the 1990s.26

The Islamic Development Bank (IDB) provided invaluable advice and support for the first Islamic finance initiatives in Kazakhstan. The country had joined the international agency in 1995, and in 1997 Almaty was selected to host one of the bank's four regional offices. Since operations commenced, the IDB has spent more than $1.2 billion in the republic, which puts it ahead of its Central Asian neighbors in terms of received funding.27 The IDB observes the standards set for all international development banks, in particular close cooperation with state structures, which has resulted in a predominance of funding and loans to state-organized infrastructural projects.28 Despite its focus on development aid projects, the IDB emerged as a promoter for Islamic banking when it supported the first attempts to launch legislative reforms.

Several respondents cited the years 2007 and 2008 as a critical period for Islamic finance in Kazakhstan.29 The global economic crisis caused four major banking institutes in the republic to run into default by 2010.30 The core of the crisis was made up of accumulated debts of Western states and nonperforming loans in banks in the Western hemisphere. For Islamic finance strategists in the republic, this moment provided an opening to propose ideas to diversify

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26 Interview with representative of *Kazakhstan Development Bank*, Astana, Kazakhstan, October 2012.

27 De Cordier, "The development space(s) of Non-OECD aid donors in Southern Eurasia"; also see "IDB investments to Kazakhstan stand at $500 million," *Tengrinews*, January 16, 2014, http://en.tengrinews.kz/finance/IDB-investments-to-Kazakhstan-stand-at-500-million-25314/ (accessed January 29, 2016).

28 IDB assets stem from member states contributions of the IDB group. In its activities the IDB follows Islamic principles, yet it also collaborates with non-Islamic financial institutions to implement projects, see "About IDB," *Islamic Development Bank*, 2015, http://www.isdb.org/irj/portal/anonymous?NavigationTarget=navurl://24de0d5f10da906da85e96ac356b7af0 (accessed January 29, 2016).

29 Interview with representative of ATF Bank, October 2012; and interview with representative of Amanie Advisors cis, October 2012.

30 See, for example, "Kazakhstan Turns to Sukuk After Eurobond Offering Dropped: Islamic Finance," *Bloomberg*, July 29, 2010, http://www.bloomberg.com/news/2010–07–29/kazakhstan-turns-to-sukuk-after-eurobond-offering-dropped-islamic-finance.html (accessed January 29, 2016).

accesses to global capital flows. With advice from the IDB and support from the department for Islamic banking in the commercial Kazakh BTA bank, specialists formed discussion groups to design a project to establish Islamic finance institutes in Kazakhstan.31 The state lent support as well, with a working group for Islamic finance formed within the presidential administration. Additional advice was also sought from external experts, attracting international business consultants like Ernst & Young Bahrain. These early efforts resulted in a first conference of interested parties in May 2007 in Almaty. Funded by the Abu Dhabi Islamic Bank, representatives of the Ministry of Industry and Trade of Kazakhstan joined with lobby organizations and consultancies in Islamic finance under the auspices of BTA Bank and the Islamic Development Bank, with further participants from various countries in the Muslim World.32 The agenda for the conference reveals the early conditions for reforms: inquiries about the general nature of Islamic finance abounded, followed by questions about possibilities to adjust legislation and allow Islamic businesses to enter the republic's market.33

These first initiatives were successful and resulted in a further 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.34 Since 2009, Kazakhstan has continued to prepare the legal framework for Islamic financial operations in the country. In resolutions both the National Bank of Kazakhstan

31 Interview with representative of Amanie Advisors cis, October 2012.

32 "Financial Market Participants Will Discuss Islamic Banking Prospects," *BTA Bank* 2007, http://bta.kz/en/press/news/2007/05/07/238/ (accessed January 29, 2016).

33 Ibid.

34 "O vnesenii izmeneniy i dopolneniy v nekotory'e zakonodatel'nye akty Respubliki Kazakhstan po voprosam organizatsii i deyatel'nosti islamskikh bankov i organizatsiy islam- skogo finansirovaniya," *Respublika Kazakhstan*, no. 133–4, February 12, 2009; the law itself contains changes and amendments to a number of laws, for example the Civil Code or the Tax Code. It does not introduce terms of Islamic finance instruments like *mudarabah* or *ijarah*, but it tries to distinguish conventional from Islamic banking. An Islamic bank must fulfill special terms to conform with sharia 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, but any Islamic institute must be independent from conventional banking, see "Introduction of Islamic Finance in Kazakhstan," *Banking and Finance–Legal Alert*, Baker & McKenzie, May 29, 2009, http://www.legal500.com/assets/images/stories/legal_alert_islamic_banking_090609_fin_eng.pdf (accessed January 29, 2016).

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and the Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Market and Financial Organizations have formulated new rules for Islamic bookkeeping procedures and for issuing Islamic financial securities, the latter providing legal ground for Islamic social finance companies. The new laws further specified regulations and supported the launch of Islamic financial products, in particular by equalizing the taxation of Islamic with conventional financial products.35 The roadmap mentioned above served to pool the efforts for further reforms. Adopted in 2012, the roadmap recalls the original stimulus, the economic crisis in 2007, when it stipulates the need for the "Completion of earmarked negotiations and meetings with banks, funds, and companies in countries of Southeast Asia and the Middle East with the goal to attract investments to Kazakhstan (funding of investment projects, finalizing of contracts)."36

While legislative developments came rather quickly, the establishment of actual operating Islamic finance institutes in Kazakhstan has been much slower. Consultants and lobby groups like Fattah Finance, a financial broker for Islamic investment and securities, and the Association for the Development of Islamic Finances (ARIF) appeared soon after the first discussion rounds were held. But out of the seven members that ARIF listed in 2012, only one was an actual Islamic bank, the Islamic Bank Al-Hilal, which until recently had been the only Islamic banking institute operating in Kazakhstan. Al-Hilal 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, the mother Al-Hilal Bank in Abu Dhabi owns 100 percent of the JSC Islamic Bank Al Hilal headquartered in Almaty, with branches in Astana and Shymkent. Al-Hilal Bank in Abu Dhabi, in turn, is fully owned by the UAE government. It has turned into a major player in the UAE financial market, with only 3 percent of its assets in corporate financing and 97 percent of its activities in the retail market, where it is known for its innovative approach to private customers. In contrast, Islamic Bank Al-Hilal in Kazakhstan operates solely in corporate financing, servicing state holdings and investing in infrastructure projects. Furthermore, with assets slightly more than 13 billion tenge (us$ 70 million) in

35 For an overview over legislative efforts, see "Islamic Finance in Kazakhstan: New Amendments," *Islamic Finance Almaty – Legal Alert*, Baker & McKenzie, May 12, 2015, http://www.bakermckenzie.com/files/Publication/09c10614–0267–40a4-bb58-e8599622299e/Presentation/PublicationAttachment/5e8972d1-b9b4–474f-986a-efa70e702740/al_almaty_newamendments_may15.pdf (accessed January 29, 2016).

36 *Dorozhnaya karta razvitiya islamskogo finansirovaniya do 2020 goda.*

2014 the bank plays an insignificant role in the financial market in the republic, ranked only 31st out of 35 Kazakh banks in 2015 in terms of total assets.37

Another member of ARIF and newcomer to the Islamic finance market in Kazakhstan is the insurance company Takaful. Established in 2010 Takaful aims to develop *takaful*, the Islamic principle of community insurance, where policyholders insure each other by sharing losses and profits. Following the lead of Al-Hilal, Takaful established a Supervisory Board for Principles of Islamic Finances.38 Other players in the Islamic finance sector in Kazakhstan, like Istisnaa Corporation Inc. or Fattah Education Inc., are lobby groups that do not offer any actual financial services. The last big innovation in the market has been the launch of the *sukuk* commodity *murabahah*, an Islamic bond, with a value of $75 million by the Development Bank of Kazakhstan (DBK) in mid- 2012, in cooperation with the Malaysian Central Bank.39

Since 2012 the Islamic financial market has been dormant. Despite promises of new legislation, new initiatives, and new financial institutions, the results have been meager, at best. As of mid-2016 Al-Hilal Bank still had not opened its retail business, while promises for a second Islamic Bank, Zaman Bank, have not materialized.40 Takaful had not been able to launch products on the

37 Assets decreased from 16 to 13 billion tenge in 2014, see "Financial Statements for the year ended 31 December 2014," *'Al Hilal' Islamic Bank' JSC*, March 16, 2015, http://www.alhilalbank.kz/upload/iblock/a64/a64b5f77bd084ef10a499b551d7a6bd4.pdf (accessed January 29, 2016); for ranking in 2015, see "Renking bankov Kazakhstana 2015," *Forbes Kazakhstan*, December 3, 2015, http://forbes.kz/leader/renking_bankov_kazahstana_2015_2016 (accessed January 29, 2016). 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 yearly issues a fatwa on the bank's performances, see "Islamic Finance Principles Board Report – Al Hilal Islamic Bank. For the Financial Year Ended on 31 December 2011," *'Al Hilal' Islamic Bank' JSC*, May 16, 2012, http://www.alhilalbank.kz/upload/fatwa%20of%20Shariah%20board%20fs.pdf (accessed November 20, 2012).

38 See "ovs Khalalnoe Strakhovanie takaful," http://www.takaful.kz/ (accessed January29, 2016)

39 For detailed information about the circumstances of the *sukuk*, including the partnershipwith Malysian investors and Malaysian jurisdiction, see Wolters, "Islamic finance."

40 For Al-Hilal Bank, see Al Hilal Bank Awaits New Legislation for Islamic Finance," *The Astana Times*, September 26, 2014, http://astanatimes.com/2014/09/al-hilal-bank-awaits-new-legislation-islamic-finance/ (accessed January 29, 2016); for plans to establish Islamic Bank Zaman Bank see "The Islamic Corporation for the Development of the Private Sector goes into a strategic alliance with Zaman Bank of Kazakhstan," *Zaman Bank*, May 23, 2013, http://zamanbank.kz/en/islamskaya-korporatsiya-po-razvitiyu-chastnogo-sektora-vstupaet-v-strategicheskij-soyuz-s-kazahstanskim-zaman-bankom/

market, while lobby groups like Istisnaa Corp. seem to have stopped their activities altogether.41 A November 2015 conference to create an Islamic microfinance body merely continues the series of workshops and working groups that try to promote but not achieve the development of Islamic finance in the republic.42 DBK needs support of the Malaysian government before it can is- sue further sukuk bonds, while no sovereign sukuk bond still has been released anywhere in Central Asia.

A closer look at the time line of promises and early initiatives reveals the year 2011 as the turning point. For politics in Kazakhstan, 2011 proved to be difficult and loaded with crises, starting with early elections for the presidency—which incumbent Nursultan Nazarbaev won with 95.5 percent of the vote—and finishing with the Zhanaozen events in December, in which labor protests were dispersed violently and 15 workers shot dead. Freedom House, in fact, increased the democracy scores from 6.45 to 6.54 (1 = full democracy), highlighting deteriorating trends for the Civil Society and Local Democratic Governance categories.43 Furthermore, the emergence and alleged attacks of a hitherto unknown group of Islamic radicals, *Jund al-Kilafah*, in 2011 gave rise to further restrictions on the media sphere, particularly for online media.44 Overall, the political crisis that unfolded in 2011 seems to have reshuffled governance priorities and diverted attention from innovative economic and financial practices.45 Still, plans formulated in 2011 were carried

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(accessed January 29, 2016);"Kazakhstanand Central Asia. Accelerated Rise," *IFN Analysis* 12, no. 35, IFN Islamic Finance News, September 1, 2015; http://www.islamicfinancenews .com/ifn-country-analysis-kazakhstan (accessed January 29, 2016); as of January 2016 no Islamic financial operations are being offered by Zaman Bank.

41 For a comparison of a list of activities by Istinaa Corporation, see "O nas," http://www .istisna.kz/rus/?page_id=2 (accessed January 29, 2016); the last activity reported took place in 2012.

42 See conference agenda, "Islamic Social Financing: Micro-Finance and Micro-Takaful," http://www.adfimi.org/userfiles/files/kazakhstan_flyer_03.pdf (accessed January 29, 2016).

43 See "Kazakhstan" in *Nations in Transit 2012* (New York: Freedom House, 2012), https:// freedomhouse.org/report/nations-transit/2012/kazakhstan (accessed January 29, 2016). Freedom House uses a rating scale of 1 to 7, with 1 representing the highest level of democratic progress and 7 the lowest.

44 Ibid.; the drop in ratings for the year 2009 is for the most part connected to the scandalous trial of human rights activist Evgeniy Zhovtis, see "Kazakhstan" in *Nations in Transit 2010* (New York: Freedom House, 2010), https://freedomhouse.org/report/nations -transit/2010/kazakhstan (accessed January 29, 2016).

45 In interviews with the author, members of *Amani Advisors cis* mentioned the lack of support for their initial plans to spread ideas about Islamic economics in Kazakhstan for the mentioned period, Astana/Almaty, Kazakhstan, October 2012. See also for an assessment of rising political sensitivities, "Islamic finance treads fine political line in

out in 2012, most noticeably the adoption of the roadmap, but no further steps were undertaken.46 Since then, experts have cast doubt on the prospects of Islamic banking in the republic.47 Summarizing the first cycle of economic and political crisis, expert Mingisheva shares her irritation:

> The government of the Republic of Kazakhstan began to attract Islamic finance in the period of the early financial crisis with the expansion of the investment base and the orientation towards the countries of the Organization of Islamic States. A faster growth of Islamic finance is still possible in Kazakhstan, but in recent times we can observe a certain deceleration concerning the development of Islamic banking in the country.48

Periodical announcements of early elections, for example to the parliament in Kazakhstan, announced in January 2016, add to the gloomy picture of further delay in necessary reforms. Legislation still is not ready to allow for retail businesses in the financial sphere, and project initiatives put on hold once again. In general, Islamic finance tends to suffer from its secondary position among policy priorities in Kazakhstan; it quickly falls victim to abrupt changes or, even worse, is increasingly met with suspicion as the mounting discourse of danger alerts against expressions of Islamic piety.

Kyrgyzstan: Ever-Emerging Market for Islamic Retail Banking

Over the last two decades, Kyrgyzstan has pursued a different development path than its neighbors. The often-chaotic events—including two violent

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Kazakhstan," *NBC News*, July 2, 2012, http://www.msnbc.msn.com/id/48040915/ns/world_news-mideast_n_africa/t/islamic-finance-treads-fine-political-line-kazakhstan/ #.umct7flyhRg (accessed January 29, 2016).

46 See *IFN Analysis 12*, no. 35, September 1, 2015. The exception is the launch of the sukuk in 2015 by the DBK.

47 See, for example, "Kazakhstan poka ne ochen' uspeshen v razvitii islamskogo finansirovaniya," *Liter*, November 17, 2015, http://liter.kz/mobile/ru/articles/show/14121-kazahstan_poka_ne_ochen_uspeshen_v_razvitii_islamskogo_finansirovaniya (accessed January 29, 2016).

48 See "Formirovanie islamskogo bankinga v Kazakhstane: nekotory'e aspekty' i perspektivy' (chast' 2)," *nmingisheva.ru*, August 5, 2015, http://nmingisheva.ru/islamskii-financy/ 136-formirovanie-islamskogo-bankinga-v-kazakhstane-nekotorye-aspekty-i-perspektivy-chast-2.html (accessed January 29, 2016).

overthrows of government in six years, swift changes from open to closed political regimes, and endless demonstrations and strikes—affected many spheres of economic activity in the republic, including Islamic finance.49

Kyrgyzstan's introduction to Islamic finance occurred in 1993, when it became the first Central Asian state to join the IDB, following the liberal agenda of then-president Askar Akaev.50 The IDB invested very little in the country, and in mid-2012 Kyrgyzstan ranked lowest among the Central Asian states in terms of IDB funding, with only us$159 million.51 However, IDB engagement began to grow after the change of government from Akaev to Kurmanbek Baki- ev in 2006, with most funding going into infrastructural projects, especially transportation. That year the IDB signed a memorandum with the Kyrgyz government to establish an Islamic bank in the republic. Then-head of the IDB branch in Kyrgyzstan, Shamil Murtazaliev, laid out several steps for transforming Bishkek into an Islamic financial hub in Central Asia. The first initiative aimed at transforming EkoBank, a commercial bank owned by Murtazaliev, into the first Islamic bank on Kyrgyz soil. More importantly, the memorandum paved the way for new legislation that created one of the most advanced legal systems for regulating Islamic financing business in the region.52

Following the memorandum, President Bakiev 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 (NBK) to move forward with formulating new rules for Islamic financial institutes. Al- ready in October 2006 the NBK adopted a statute for Islamic finance principles, stating in detail conditions for Islamic banking instruments like *mudarabah*, *ijara*, *murabaha*, and others. Finally, in December 2006 the NBK was autho- rized to issue licenses to Islamic financial institutes operating in Kyrgyzstan. The NBK's leading role was further consolidated with two laws adopted by parliament in March 2009, which made changes to the law "On the National Bank of the Kyrgyz Republic" and to the law "On Banks and Bank Operations in the Kyrgyz Republic."53 Now the NBK was empowered to supervise financial

49 For regime dynamics in Kyrgyzstan, see Alexander Wolters, *Die Politik der Periphery: Protest und Öffentlichkeit in der Republik Kyrgyzstan* (Bielefeld: transcript, 2015).

50 Gresh, "The Rise of Islamic Banking and Finance in Central Asia."

51 DeCordier, "The development space(s) of Non-OECD aid donors in Southern Eurasia."

52 Aliyev, "The Politics of Islamic Finance in Central Asia and South Caucasus"; "Informatsiya po islamskim principam finansirovaniya i bankovskogo dela," *National Bank of Kyrgyzstan* (2012); "Kyrgyzstan: Islamic Banking Offers Alternative to the 'European System'," *Eurasianet*, June 14, 2011, http://www.eurasianet.org/node/63675 (accessed January 29, 2016).

53 "Zakon Ky'rgy'zskoy Respubliki O Natsional'nom banke Ky'rgy'zskoy Respubliki," National Bank Law, no. 59, July 29, 1997; "Zakon Ky'rgy'zskoy Respubliki O bankakh i bankovskoy deyatel'nosti v Ky'rgy'zskoy Respublik," Law On Banks, no. 60, July 29, 1997.

operations in line with the principles for Islamic banking. In addition, the bank had been authorized to formulate normative regulations to further organize the market for Islamic finance in the republic. In September 2009 the government began to prepare the market for the introduction of Islamic securities in the form of *sukuk* and *takaful*.54 Such groundbreaking work showed its effects, when the government concluded talks with IDB consultants and investors from Malaysia to set up an Islamic insurance company in Kyrgyzstan in 2012.55 To open up Islamic finance for the fast growing micro-finance sector in the republic, the NBK adopted further resolutions to allow agencies to offer micro-credit lines in form of *mudarabah*, *ijara*, and others.

The EkoBank pilot project was very successful, with branches established in all major cities across the country and gaining market shares. In July 2010 the bank was renamed EkoIslamikBank. In May 2015, the yearly audit revealed as- sets of more than 3.3 billion som (appr. $54 million), yet also reported a net loss of almost 10 million som (appr. $164,000).56 Such annual loss notwithstanding, EkoIslamikBank's development is a success story. The bank managed to retain its many depositors who had been clients of the branch of the Russian institute that formed the base for the future EkoIslamikBank. At the same time, it expanded its client base, and in 2010 alone it registered 2,274 new customers. Based on deposits, EkoIslamikBank ranked eighth, out of 24 institutions, with a 4 percent market share in 2014.57

EkoIslamikBank not only engages into Islamic banking operations, it also spreads knowledge about Islamic finance. Its Barakat educational center trains future staff and facilitates cooperation among institutions. In December 2009, for example, representatives from financial institutions and supervisory bodies in Tajikistan visited Barakat to receive training in principles of Islamic

54 "Pravitel'stvo Ky'rgy'zstana utverdilo polozheniya ob organizatsii islamskogo strakhovaniya i cenny'kh bumagakh, vy'puskaemy'kh po islamskim principam finansirovaniya," *East- time*, September 16, 2009, www.easttime.ru/news/1/4/1626.html (accessed January 29, 2016).

55 "Novosti islamskikh finansov (30.03.2012 g. – 30.04.2012 g.)," *Korporaciya 'Istisna'a Corporation'*, April 30, 2012; "V Ky'rgy'zstane aktivno razvivaetsya sektor islamskogo bankinga," *Info Islam*, April 7, 2012, http://www.infoislam.ru/publ/novosti/mir/v_kyrgyzstane_aktivno_razvivaetsja_sektor_islamskogo_bankinga/3–1-0–15382 (accessed January 29, 2016).

56 See audit report of EkoIslamikBank, "Ochet po finansovom sostoyanii po bukhgalterskomu balansu na 31 maya 2015 goda (vklyuchitel'no)," http://ecoislamicbank.kg/uploads/files/fin_otchot/fr-ecoislamicbank31052015.pdf (accessed January 29, 2016).

57 "Re'nkingbankovKy'rgy'zstanapodepozitnojbazeza2014god,"*Vecherny'jBishkek*,March23, 2015, http://www.vb.kg/doc/307128_renking_bankov_kyrgyzstana_po_depozitnoy_baze_za_2014_god.html (accessed January 29, 2016).

finance.58 In addition to EkoIslamikBank, a small corporate investment firm, called Muslim, started operating in March 2012 in Bishkek, and two micro- credit institutions in Kyrgyzstan announced plans to introduce products in compliance with sharia law, Kompanion invest and Kausar, targeting the south and the north of the country, respectively.59 More firms entered the market in2011.60

Kyrgyzstan has proven to be a promising market for Islamic financial products, with a 5 percent market share in the retail sector in 2012. Predictions that market share would reach 10–12 percent in 2015 did not materialize, however, despite further external assistance such as the agreement between IDB and the Kyrgyz government to support the "further development of Islamic financial services in the country."61 Initiatives to further adapt the legal framework came to a halt in the aftermath of the government collapse in April 2010, while most Islamic-finance businesses experienced stagnation by the year 2015.62 Of the three micro-financing institutes that offered sharia-compliant products, Ijarah Leasing and Ak-Karzhy started operating only in 2014, while Kompanion Invest seems to be the only company that actually grew in 2015.63 The Barakat center appears to have run out of interested clients, EkoIslamikBank is experiencing losses, and no other Islamic banking institute is interested in entering therepublic.

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58 "Ky'rgy'zstan prevrashhaetsya v pionera obrazovatel'ny'kh tekhnologiy v islamskom bankinge," *Business Akipress*, December 21, 2009, http://www.barakat.kg/novosti-centra/kyrgyzstan-prevrashhaetsja-v-pionera-obrazovatelnyh-tehnologij-v-islamskom-bankinge.html (accessed January 29, 2016).

59 "Kyrgyzstan: Islamic Banking Offers Alternative to the 'European System'"; Interview with representative of National Bank of Kyrgyzstan, Bishkek, Kyrgyzstan, October 2012.

60 "Natsional'ny'y bank Ky'rgy'zstana prinyal normativno-pravovoy akt v otnoshenii islamskikh mikrofinansovy'kh organizatsiy," *Muslimeco*, December 26, 2011, http://www.muslimeco.ru/onews/405/ (accessed January 29, 2016).

61 "Islamic Development Bank to provide technical assistance worth $193,000 to Kyrgyzstan in introduction of Islamic banking," *Akipress*, July 4, 2012, http://www.akipress.com/_en_news.php?id=125671 (accessed January 29, 2016).

62 Interview with representative of National Bank of Kyrgyzstan, Bishkek, Kyrgyzstan, October 2012.

63 "Islamskoe mikrofinansirovanie v Ky'rgy'zstane na primere uspeshnoj kompanii," *Muslimeco*, January 2, 2016, http://muslimeco.ru/opubl/462/ (accessed January 29, 2016); "IJARA company Kyrgyzstan predlagaet uslugi finansovogo lizinga po islamskim principam," *Torgovo-promy'shlennaya palata Ky'rgy'zskoy Respubliki*, http://www.cci.kg/kommercheskie-predlozhenija/kommercheskie-predlozhenija-chlenov-tpp-kr/ijara-company-kyrgyzstan-predlagaet-uslugi-finansovogo-lizinga-po-islamskim-principam.html (accessed January 29, 2016).

Kyrgyzstan is the undisputed regional leader in terms of experience in actual Islamic retail banking, servicing private customers and thus moving beyond corporate funding and state orchestrated investments. However, political crises, including the April 2010 revolution, ethnic violence that summer in Osh, elections in December 2010 and October 2015, as well as the counter- terrorist operation in Bishkek in July 2015, and the hunt for the Islamic extremists who broke out of prison in fall 2015 slowed down initiatives to stimulate the growth of Islamic finance in the republic.64 Respondents blamed the 2010 slowdown on the dismantling of government structures and legal initiatives, therefore the rising discourse of danger accompanying the events around Islamic extremists in 2015 likely contributed to the further discrediting of Islamic economic practices.65

Tajikistan: A Market Failing on its Promises for Islamic Finance

Tajikistan seems an attractive place for Islamic finance, considering the significant role Islam occupies in the society. A short summary of macro indicators substantiates this claim: In contrast to Kazakhstan or Kyrgyzstan, only a small percentage of non-Muslim minorities live in the country; until it was banned in August 2015 the Islamic Renaissance Party (IRP) was the only Islamic party legally operating in Central Asia, granting Islam political relevance in public discourse. Furthermore, Tajikistan has strong linguistic connections to Iran and seeks to broaden its relations with Pakistan. Islamic finance principles officially occupy a central place in the doctrines of both states.66

However, despite such favorable circumstances, Islamic finance has been very poorly developed in Tajikistan. The republic joined the IDB in 1996, after the civil war, and has received financial support to invest in infrastructural

64 See for anti-terror operation, "Kyrgyzstan: Authorities Present Their Case for Claimed is Cell," *Eurasianet*, July 21, 2015, http://www.eurasianet.org/node/74326 (accessed January 29, 2016); and for prison hunt, "Kyrgyzstan: Prison Break Culminates in Bloody Show- down," *Eurasianet*, October 22, 2015, http://www.eurasianet.org/node/75676 (accessed January 29, 2016). It must be added here that the contrast with Freedom House scores does not yield much results. The dismantling of the Bakiyev regime widened the freedoms in many spheres, from *Electoral Processes* to *Civil Society* and *Independent Media*, decreasing scores from 6.21 for the year 2009 to 6.11 for 2010 and 6.00 for 2011.

65 Interview with representative of National Bank of Kyrgyzstan, Bishkek, Kyrgyzstan, October 2012.

66 Iran possesses the largest Islamic finance assets in the world, estimated at appr. us$250 billion; in Pakistan Islamic finance has been fixed as a state policy in the constitution.

projects, especially power generation and transportation.67 The cooperation between Tajikistan and the IDB increased in November 2011, when both sides signed an agreement on technical assistance, which foresaw the introduction of Islamic banking in the republic. The aim was to open the first institution by 2013.68 By 2012 discussions to change legislation accordingly had led to the formation of a working group, consisting of specialists from the National Bank of Tajikistan (NBT) and representatives of Zaid Ibrahim & Co., a Malaysian consulting company and the biggest law firm in the Kingdom.69 With Tajikistan's political leadership expressing its sincere interest in establishing Islamic finance in the republic, observers expected the first Islamic bank to emerge the following year, mostly like as a branch of an established bank in Tajikistan.70

Other players launched efforts to spread Islamic finance instruments as well. The German Society for International Cooperation (GIZ), a prominent development agency, organized special trainings and seminars with interested parties, including staff from the NBT, members of the Association of Micro-Finance Institutes of Tajikistan, and representatives from governmental bodies.71 According to specialists in the field, some selected forms of Islamic finance were being practiced in Tajikistan as early as 2012. For example, depositing with micro-crediting institutes has been tested in Tajikistan since 2011.72 Investing into micro-financing seemed plausible, considering the high number of micro-financing agencies operating in the republic. A report from

67 According to some figures, us$212 million were allocated to projects in the republic by 2012; other estimates add up to us$500 million, see De Cordier, "The development space(s) of Non-OECD aid donors in Southern Eurasia"; "IDB, Tajikistan sign agreement on Islamic banking," *Trend*, November 17, 2011, http://en.trend.az/regions/casia/tajikistan/1958198.html (accessed January 29, 2016).

68 "IDB, Tajikistan sign agreement on Islamic banking," ibid.

69 "Zaid Ibrahim & Co podgotovit dlya Tadzhikistana zakonodatel'stvo ob islamskom bankinge," *News.tj*, November 1, 2012, http://news.tj/ru/news/zaid-ibrahim-co-podgotovit-dlya-tadzhikistana-zakonodatelstvo-ob-islamskom-bankinge (accessed January 29, 2016).

70 "Tadzhikistan gotovitsya k islamskomu bankingu," *Deutsche Welle*, November 13, 2012, http://www.dw.de/tadzhikistan-gotovitsya-k-islamskomu-bankingu/a-16375122 (accessed January 29, 2016).

71 "mfo rt realizuet Islamskie finansovy'e produkty',"*Khovar*, October 13, 2010, http://khovar.tj/rus/archive/24818-mfo-rt-realizuet-islamskie-finansovye-produkty.html (accessed January 29, 2013); "Razvitie islamskikh printsipov finansirovaniya v Tadzhiki- stan," *Khovar*, June 5, 2012, http://khovar.tj/rus/economic/33244-razvitie-islamskih-principov-finansirovaniya-v-tadzhikistane.html (accessed January 29, 2013).

72 Interview with representative of Tajik branch of development agency, Dushanbe, Tajikistan, March 2013.

2010 counts 116 such agencies, dealing with deposits, loan organizing, and loan funding.73

Yet by late 2015, no single plan to introduce Islamic finance into Tajikistan had actually materialized. The years 2012 and 2013 turned out to be times of stagnation,74 and while initiatives resumed in 2014, no concrete projects have emerged. Still in May 2014 the Tajik parliament finally adopted a "Law on Islamic Banking Activities" in Tajikistan. Investors from Katar, the holding Izdon, promised to fund the opening of an Islamic financial institute, while one of the leading conventional financial institutions in the country, Tojiksodirokbonk, announced plans to transform one of its subsidiaries, the Bonki Rushdi Tojikiston (BRT), into an Islamic bank by mid-2015. Neither the Katar plans nor the transformation of BRT have led to any tangible results.75

Correlating these developments with Freedom House scores reveals a sudden deterioration in 2011. Before then, Tajikistan had scored 6.14 for three consecutive years, suggesting a degree of political stability. In 2011 however, its score rose to 6.18, not least due to tightening control over alleged Islamic extremism, and since then the situation in Tajikistan, according to Freedom House *Nations in Transit* reports, has worsened every year.76 Developments in 2015, such as banning the Islamic Renaissance Party, new restrictions on religious practices, as well as parliamentary elections, have all brought efforts to promote Islamic finance principles in the republic to a standstill.77

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73 "Dawn in Tajikistan," *IslamicFinanceNews – Country Report*, March 17, 2010, http://www.islamicfinancenews.com/authors/muath-mubarak-0 (accessed January 29, 2016).

74 A project by the IDB and the *Agroinvestbank* in Tajikistan in 2011 to start operating Islamic banking instruments did not materialize, see "Pochemu v Tadzhikistane ne razvivaetsya islamskiy banking?," *Asia Plus*, July 14, 201, http://news.tj/ru/newspaper/article/pochemu-v-tadzhikistane-ne-razvivaetsya-islamskii-banking (accessed January 29, 2016).

75 "Katar sozdast v Tadzhikistane pervy'y islamskiy bank," *Radio Ozodi*, September 22, 2014, http://rus.ozodi.org/content/article/26599500.html (accessed January 29, 2016); "'Tochiksodirotbonk' vnedryaet islamskiy banking," *Radio Ozodi*, December 23, 2014, http://rus.ozodi.org/content/article/26757999.html (accessed January 29, 2016); and still in May 2015 plans were designed, see "V Tadzhikistane poyavitsya pervy'y islamskiy bank," *Slon*, May 20, 2015, https://slon.ru/posts/51732 (accessed January 29, 2016).

76 See "Tajikistan," in *Nations in Transit, 2012* (New York: Freedom House, 2012), https://freedomhouse.org/report/nations-transit/2012/tajikistan (accessed January 29, 2016); the score for the year 2015 is 6.54.

77 For a critical assessment of the role of the "discourse of danger" and its public instrumentalization, see John Heathershaw and Sophie Roche, "A Recipe for Radicalisation: The Campaign against Islam in Tajikistan," *Open Democracy*, January 17, 2011, http://www.opendemocracy.net/print/57613 (accessed January 29, 2016); for the ban see, "Tajikistan Bans Islamic Opposition Party," *Eurasianet*, August 28, 2015, http://www.eurasianet.org/

Uzbekistan and Turkmenistan: Closed Politics and Fear

Neither Uzbekistan nor Turkmenistan has substantial experience with Islamic finance. The authoritarian nature of the political regimes, with long-serving Islam Karimov as president in Uzbekistan and Gurbanguly Berdymukhammedov in Turkmenistan, make any independent business operation, including Islamic banking, a challenging endeavor.78 Furthermore, in the case of Uzbekistan, anything carrying the term "Islamic" is subject to special state scrutiny, especially after the bloody events of Andijan in May 2005.79 This context has led to a situation, where, as one observer notes, the most promising market in Central Asia for Islamic finance has seen the lowest level of activism for the establishment of Islamic institutes and financial agencies.80

Like their Central Asian neighbors, both Uzbekistan and Turkmenistan were introduced to Islamic finance via the IDB. The bank 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 institution in 2003. To both countries the IDB has channeled funds worth more than us$1 billion.81 For the most part, such funding went into the transportation sector and energy. In the case of Uzbekistan, projects worth us$655 million were being planned for the period 2011–2013, and by mid-2015, Tashkent had received more than us$1.2 billion of funding.82 Typical examples of this cooperation are the financing for the

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node/74856 (accessed January 29, 2016); for new restrictions, "As Tajikistan Limits Islam, Does It Risk Destabilization?," *Radio Free Europe*, December 1, 2015, http://www.rferl .org/content/tajikistan-islam-destabilization-rahmon-secular-/27400692.html (accessed January 29, 2016); and for elections, "Tajikistan's Ruling Party Wins Election Decried As 'Farce'," *Radio Free Europe*, March 2, 2015, http://www.rferl.org/content/tajik-elections -rahmon-party-victory/26877105.html (accessed January 29, 2016).

78 In Freedom House's *Nations in Transit* ratings both Uzbekistan and Turkmenistan are atthe bottom of the list, with scores as high as 6.93 since 2010 and 2008, respectively.

79 Tim Epkenhans, "'Islam' in the Security Discourse of the Post-Soviet Republics of Central Asia," *OSCE Yearbook 2010* (2011).

80 Aliyev, "The Politics of Islamic Finance in Central Asia and South Caucasus."

81 To compare data, see DeCordier, "The development space(s) of Non-OECD aid donors in Southern Eurasia" and data from the MFA of Uzbekistan, "Islamskiy bank razvitiya (IBR)," http://www.mfer.uz/ru/international-cooperation/international-organizations/949/ (accessed January 29, 2016).

82 "Islamskiy bank razvitiya dal Uzbekistanu $57 mln na modernizaciyu kanalizatsii," *Regnum*, March 14, 2015, http://regnum.ru/news/economy/1905209.html (accessed January 29, 2016).

construction of the major canals in the Khorezm region or further investments into the modernization of hydroelectric power stations.83

The IDB's cooperation with Uzbekistan also entails investments into the small and medium business sector. To this end, the IDB, via its Islamic Corporation for Development of the Private Sector, signed a memorandum of understanding with Uzbekistan on the further support to small and medium- sized enterprises in the republic.84 The IDB regularly lends funds on the base of Islamic principles and does so alongside donors that operate with conventional financial instruments. The IDB has been channeling money into small and medium businesses through agencies such as Taiba Leasing, Ipak Yuli Bank, and Uzbek Leasing International while still complying with sharia law.85 Further plans to establish a domestic Islamic financial institution have never been formulated and, with the exception of Taiba Leasing, none of the crediting institutions mentioned above has sustained its activities.86 Starting in 2013, the IDB's activities in Uzbekistan have been re-oriented toward funding state-supervised development projects.

There is almost no foundation for Islamic financial practices in Turkmenistan. No legal reform was pursued, nor did the annual meeting of the IDB group in Ashgabat in 2009 translate into more than a single investment project.87 The IDB agreed to fund the construction of the railway line from Bereket (Turkmenistan) to Gorgan (Iran), as part of the wider North–South transport corridor that aims to connect the Russian railway system with the railway network of the Persian Gulf states.88 Further development projects, however, largely failed to materialize. There was one loan of us$121 million to reconstruct the

83 See mfa data, ibid.

84 "Islamskiy kapital dlya uzbekskogo chastnogo sektora," *Gazeta.uz*, Novvember 6, 2008, http://www.gazeta.uz/2008/11/06/nbu/ (accessed January 29, 2016).

85 See Alieyev (2012); "Islamic Corporation for Development of Private Sector provides $11 mln to Uzbek banks," *Trend*, April 6, 2012, http://en.trend.az/capital/business/2011143 .html (accessed January 29, 2016); Asadov and Gazikhanov, "Ijarah's Prospects in Central Asia."

86 At least at the beginning of 2016, neither *Ipak Yuli Bank* nor *Uzbek Leasing International* or *Uzpromstroybank*, another IDB partner, use Islamic financial instruments for their operations according to their websites.

87 "V Ashkhabade otkry'vaetsya 34-e zasedanie Soveta Islamskogo banka razvitiya," *Turkmeninform*, June 2, 2009, http://halalpages.ru/rcief/files/print.php?id=859 (accessed January 29, 2016)

88 "Islamskiy bank razvitiya profinansiruet stroitel'stvo zheleznoj dorogi Turkmeniya-Iran," *Bibo.kz*, June 5, 2009, http://internet.bibo.kz/288292-islamskijj-bank-razvitija-profinansiruet.html (accessed January 29, 2016).

water supply system in the Balkan region in the West of Turkmenistan.89 For the future, the IDB plans major investments into eight selected infrastructural projects.90

It is difficult to compare the developments in Uzbekistan and Turkmenistan with the dynamics in the neighboring countries. A slight similarity to the development dynamics in Kazakhstan or Tajikistan appears in Uzbekistan's commitment to Islamic finance. Early initiatives to involve more lines of Islamic crediting and leasing ran out by 2013, and since then only state-sponsored development projects are allowed to receive funding from the IDB. In Turkmenistan all efforts fall victim to the single-market structure of the economy in combination with the purely ceremonial status of political decision-making under President Berdymukhammedov.

The Dynamics of Islamic Finance Development in Central Asia

The evolution of Islamic finance in Central Asia shows a slight convergence of early efforts around the time of the global financial crisis in 2007, at least in the cases of Kazakhstan, Kyrgyzstan, and, partly, Tajikistan. Further developments stopped or slowed down markedly in periods of political crisis: in Kazakhstan and Tajikistan in the year 2011 and in Kyrgyzstan in 2010 and 2015. Uzbekistan and Turkmenistan, for the most part, only superficially attempted to introduce Islamic finance and banking in their respective domestic markets. One could further speculate about whether the repercussions of the Arab Spring influenced the simultaneous reshuffling of policy priorities in Kazakhstan and Tajikistan, for example, yet evidence to substantiate such a claim is scarce.91

89 "Sotrudnichestvo s Turkmenistanom yavlyaetsya dlya ibr prioretetom – glava banka," Trend.az, September 1, 2012, http://www.trend.az/business/economy/2060961.html (accessed January 29, 2016).

90 "Turkmenistan i Islamskiy bank razvitiya podgotovyat programmu sotrudnichestva na 2016–2018 gody'," *Turkmenistan.ru*, June 20, 2015, http://www.turkmenistan.ru/ru/articles/40898.html (accessed January 29, 2016).

91 For a first assessment of the influence of the Arab Spring on the Central Asian security discourse, see Andrea Schmitz and Alexander Wolters, "Political Protest in Central Asia: Potentials and Dynamics," *SWP Research Paper 7* (April 2012). On the impact of the rise of ISIS in Syria on security discourses in Central Asia, see, "Shadow Boxing With the Islamic State in Central Asia," *Foreign Policy*, February 6, 2015, http://foreignpolicy.com/2015/02/06/ shadow-boxing-with-the-islamic-state-in-central-asia-isis-terrorism/ (accessed January 29, 2016); and "Central Asia and the ISIS Phantom," *The Diplomat*, October 2, 2015, http://thediplomat.com/2015/10/central-asia-and-the-isis-phantom/ (accessed January 29, 2016).

As of mid-2016, the Central Asian countries have yet to grant Islamic finance the importance and corresponding institutional settings that exist in the Muslim nations of the Arab peninsula, Iran, Pakistan, or Malaysia. Still, subtle differences exist between the states and their respective attitudes toward Islamic finance and banking. In Kazakhstan much—if not all—depends on state coordination of efforts to advance Islamic finance. The young history of Islamic finance in Kazakhstan consists of lobbyists, who concentrate their work on legislative reform and who reach out to political decision-makers, and of private banks that wait for approval from the presidential administration. The state, in turn, invites experts from abroad and supervises pilot projects that carry the label Islamic, thereby fully controlling the development of Islamic banking. The result is a stark contrast between the number of state organs involved in the process of establishing Islamic finance and the complete absence of a developed retail market for Islamic finance.

In Kyrgyzstan the central state has taken an attitude of benevolent—yet negligible—support. Outsourcing coordination and supervision to the NBK, Kyrgyzstan has used its fragmented political and administrative system to its own benefit, at least regarding the development of Islamic finance. Constant government changes as well as the menace of Islamic extremism, however, pose challenges to any major initiative that would rest on sustainedstate support.

Tajikistan has taken yet another approach toward Islamic finance. Against supposedly advantageous conditions for Islamic banking, neither the state nor corporate interests have led the initiative. In fact, the few legislative changes and pilot projects that have occurred have been largely due to the efforts of the IDB and development agencies. With a rather centralized political system not unlike the one in Kazakhstan, yet without the economic power, the state in Tajikistan seems hesitant to allow for more experiments. And such hesitation apparently turns into strong suspicion with every new initiative to restrict religious practices in all possible forms.

Uzbekistan and Turkmenistan have taken a different track. Both countries have allowed high-level contacts between state and the IDB. Such contacts show the respective states' commitment to international cooperation, in general, and the intention to benefit from new relations with Islamic investors, in particular. Taking the considerable resources at the disposal of both states into consideration, the continued lack of lasting reforms and of a favorable institutional setting with supervisory bodies leaves the impression that rigid authoritarianism inhibits any meaningful change. What is permissible are top- level decisions regarding investment into the development of state-owned infrastructure.

Conclusion

The case studies examined here reveal a correlation between the phases of development of Islamic finance in Central Asia, and political crises in these countries. They thus support claims made by Hoggarth and Botoeva, for example, that Islamic finance and its introduction to Central Asia depend neither on economic rationale nor on a naturally given cultural predisposition alone.92 Quite contrary to the beliefs of many practitioners and lobbyists, the success of Islamic finance is conditioned by a situational context that limits the political scope for reforms and the social space for economic initiative. And where Hog- garth examines the post-colonial direction of Kazakhstani efforts to loosen its dependence on Western, Russian, and Chinese capital, and where Botoeva investigates local contexts for the incorporation of Islamic values in business practices, this study also puts their conclusions into a new perspective. It is not long-term strategies to shake off the yoke of alien capitalism, but the level of irritability of the political regime and an ensuing crisis that determine the frame for initiatives to introduce innovative finance and banking principles into the respective domestic markets. The same holds true for individual attempts to adopt and appropriate principles of sharia in financial transactions. That is, when a political crisis translates into new rounds of restrictions and repressions, it limits the room to maneuver and experiment with the dynamically developing global market of Islamic finance.

92 Hoggarth, "The rise of Islamic finance"; Botoeva, "Let's Bank the Muslim Way?"