Emergence of PLS Industry in Post-Soviet Central Asia: An Empirical Study of Kazakhstan.

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Abstract

Since the collapse of the Soviet Union in 1991, the Muslim republics of Central Asia have witnessed the arrival of Islamic banking and finance to the region. Each country of the Central Asian region has incorporated Profit-Loss mode of financial intermediation to varying degrees depending on the nature of its political and economic construction. Particularly, the steps taken by the Kazakh authorities promise a good opportunity for the growth and development of industry in the country. To examine the emergence and growth of Islamic banking and finance industry in the region, particularly in Kazakhstan has now become an advanced discourse for financial experts and policy makers. The present research paper would definitely bring some new insights as, much hasn't been written on this subject so far.

Keywords: Islamic banking, Islamic finance, Post-Soviet Central Asia, Emergence, Kazakhstan

1. Introduction

Islamic banking and finance industry, moving out of its niche, has now become an integral part of the global financial market. The industry has not only taken its roots in almost all of the Muslim countries but has also been under discussion and penetration in Western and Far Eastern jurisdictions. Presently, the industry's more than 500 working outlets are found in 75 countries of the world (Martin, Heiko, 2008). In today's depressed financial scenario; investors, retail banking customers and corporations are embracing Islamic banking and financing as a viable alternative in investments, lending and corporate financing (Zetti Aziz, 2008). Although, Islamic financial institutions have existed since the 1960s[1] but the investment in Central Asia was on halt till the end of the communist regime. After independence in 1991, the Muslim republics of Central Asia

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[1] Mit Ghamr bank established in 1963 in Egypt was the first official bank based on interest free mechanism.

and the southern Caucasus witnessed the genesis of Islamic banking and finance to the region (Geoffrey 2007).

In the mid-1990s, most of the Central Asian states joined the Organization of the Islamic Conference (OIC), allowing themselves to tap into the resources of the OIC's largest Shari'ah based banking unit IDB (Islamic Development Bank) and get linked to PLS (Profit-Loss Sharing) financial operations. Moreover, triggered not least by the recent global financial crisis, political decision makers and financial entrepreneurs in the region were eager to develop new sources of capital. The Middle East and the Arab states, less touched by the meltdown of Western banks, were welcoming partners for fresh capital investment in the region. The need for new and fresh cash-flows, the search for an alternative form of banking and the rising discourse about interest free banking has opened a new chapter for Islamic and finance industry in the region (Mahmud 2012). Along with many other; the growth in the range of financial products and services, the increasing significance of the international dimension of Islamic finance, the growing economic and political relations between Central Asian countries and other money rich Arab countries are some of the essential factors which are believed to push-up the industry to become a dynamic and competitive form of financial intermediation in the region.

The purpose of the present research paper is to get an overview of PLS industry in the whole Central Asian region after the collapse of Soviet rule and to examine the actual demand for services and products offered by the industry to the majority Muslim populace of the region in general and Kazakhstan in particular. The paper will also investigate the role of Kazakh government in providing legal provision to the industry.

2. Reality of Islamic Banking and Finance

Islam is not only a religion but a "codification of general standards of behavior that reach far beyond the contents of belief". It prescribes a holistic approach to life and regards economy, polity, social aspects and belief as closely interlinked. Concomitant with the statement of Islamic faith, the individual agrees to observe the rules of Islamic law (Shari'ah) in private and public affairs. This applies also to economic and financial matters. The Islamic economic system differs substantially from the Western conventional, capitalistic one as it is goes beyond the pure financial and economic

sphere. It's most important foundations are the Islamic precepts and the Shari'ah – the Islamic law- providing a religious framework as well as social and ethical boundaries for Islamic finance and banking activities.

Years ago, Islamic finance was considered merely a wishful thinking. However, serious research efforts and development of Islamic products have shown that the Islamic finance is not only feasible but also an efficient and productive way of financial intermediation (Mohammad, Nadiyah, Khalid, Hajar, and Rohaya 2011). Islamic banking and finance is a generally used term to indicate all banking, financial and commercial transactions that are in compliance with Shari'ah (Islamic law). Since its relatively recent appearance, nearly fifty years ago, Islamic banking and finance industry has increasingly become a mainstream banking activity with its major financial centers in Bahrain, Dubai, and Kuala Lumpur. While still considered to be in its infancy as compared to the conventional global financial industry, Islamic finance accounts for assets conservatively valued at over US$750 billion across more than 500 financial institutions based in 75 countries, all operating according to Islamic principles (Ernst & Young 2011). Most of the customers came to know about the industry only after recent global financial crisis. It was not less than a wonder to economists and financial experts that during global financial crisis 2007-2009 no Islamic bank failed or required government recapitalization in contrast to centuries old conventional banking giants. The industry has established its own regulatory authorities and standard-setting bodies. Being based on Shari'ah rulings, Islamic banking has moral principles ingrained in its core and its high level goals aim for social justice and distributional equity. The principles of Interest free banking and finance industry are explicitly mentioned in the text of Quran and hadith and have been further expounded through the Islamic commercial jurisprudence (Fiqh al-Ma'amalat). La-Riba (No-interest), La-Gharar (No-uncertainty), La-Maisir (No-speculation), and La-Haram (No-unlawful) are the significant components of the financial structure propounded and advocated by the scholars associated with interest free banking perspectives. The characteristic features of Islamic banking and finance industry which differentiate it from its conventional counterpart are as:

• Risk and profit is shared between the two parties of a financial transaction.
• Speculation and uncertainty (*gharar*) in transactions is strictly prohibited.

• *Riba*, making money from money (i.e. interest) isn't justifiable at any cost.
• Certain activities like gambling (*maisir*) and game of chance (*qimar*), not beneficial to society, are banned.
• Transactions must be asset-based or asset-backed.
• Prohibition of investment in illegal and void (*haram*) businesses.

3. Emergence of Islamic Banking and Finance in the Post-Soviet Central Asia

In the late 1980s most Central Asians were still deeply secular in outlook, a legacy of 70 years of communist rule. Yet from the bottom up, as well as from the top down, there was an impetus for enhancing the role of Islam in society. The collapse of Soviet Union marked end of the 'Iron-curtain, a period that ascertain limited access to the outer world and beginning of the 'Velvet-curtain' era, letting the regional people to peep in and out. The process of reformation and revival moved on very quickly as Islam always has had deep roots in the region. Moreover, the newly freed region started to become a hub of *dawah* activism as many missionaries and funding agencies started to arrive from the outer mainstream Muslim centers to help the indigenous Muslims in rebuilding the mosques and other religious institutions. Increasingly, as the Central Asian states became integrated into the international community, so their responses to Islam began to resemble those that are found in other parts of the world, particularly in the Middle East.
Since the breakup of the Soviet Union, each of the Central Asian Republics joined the largest Islamic banking institute Islamic Development Bank (IDB): Azerbaijan (1992); Kyrgyzstan (1993); Turkmenistan (1994); Kazakhstan (1995); Tajikistan (1996); and Uzbekistan (2003). By 1997, the IDB established a regional office in Almaty, Kazakhstan, to foster the Bank's efforts enhance the socio-economic development of the Muslim republics of Central Asia. The regional office in Almaty (ROA) has effectively become the hub for IDB group operations in the area. The regional decision makers and private bankers are gradually opening up to Islamic financial products. Responding positively to the growing customer demand, local governments like Kazakhstan, Kyrgyzstan and Azerbaijan have made some significant amendments in their respective state constitutions. Such amendments were also meant to provide some legal space for the industry where it could facilitate its Shari'ah based financial instruments and could

generate a healthy market share. A healthy group of economic experts and financial analysts are of the opinion that the continuity of financial crisis, firstly hitting U.S and now rocking the Euro-Zone has encouraged the demand for some robust and risk-mitigated alternative in the Central Asian republics and there is better option than Islamic banking and finance industry. For example, in spite of the crisis, the Islamic financial market in Kazakhstan grew by 15% last year and in the last two years Kazakhstan's trade turnover with the Arab world reached 500 million dollars per year - more than any other Central Asian state (Oxford Analytica, 2009).

4. A Brief Overview of Banking in Kazakhstan

Since its independence in 1991 Kazakhstan, a transitional economy has been carrying out a lot of reforms and innovatory fiscal trends towards a market-oriented economy and macroeconomic stabilization. The FDI inflow into oil and gas industry was enhanced, public sector was restructured, financial sector was liberalized, Soviet era Kazakhstan Republic's *Gosbank* was transformed to the National Bank of the Republic of Kazakhstan in 1993 and Russian ruble was replaced by Kazakh *Tenge* (KZT), the national currency (OECD report). The two-tier banking system was introduced with the National Bank as its first tier and all other commercial banks as the second one. The National Bank was empowered to fulfill traditional central bank's functions including money issue, currency control, monetary policy and banking regulation and supervision. Among all Central Asian countries, the banking system of Kazakhstan continues to be one of the strongest and comparatively stable since independence. The total banking assets cover around 10% of total GDP, and the National Bank of Kazakhstan commands sufficient resources to support the country's commercial banks. Consolidation in the banking sector continues, with liquidation of insolvent banks, privatization and mergers of others. Currently, NBK oversees 38 commercial banks, including one Islamic bank opened in 2010. NBK facilitated growth by strategies aimed towards international banking and finance standards in terms of accounting and reporting, information technologies and risk management, infrastructure and regulation.

Over the past decade, Kazakhstan's banking industry has experienced a pronounced boom and bust cycle. After several years of rapid expansion in mid-2000s, the banking industry collapsed in 2008, since then the role of the banking sector in the economy

decreased significantly. The total Assets-to-GDP ratio fell down as much as twice to 47% at the end of 2011. Overall, despite economic recovery of the country and structural changes in the banks' balance sheet during last few years, the banking sector is still fragile. Already high NPL (non-paying loans) ratio may be even higher than official number, as indicated by 2012 IMF Kazakhstan banking sector report. At the same time the decreased Assets-to-GDP ratio designates a low penetration of the banking sector, promising a high potential for growth. It also reflects the possibility of new banking approach in contemporary Kazakh economy (Mahdi 2012).

4.1 Kazakhstan: A Growing Market for Interest-Free Banking and Finance Industry

Kazakhstan holds a unique position among the countries that gained sovereignty after the collapse of the USSR. Kazakhstan, the ninth largest state in the world in terms of area, occupies more than 2.7 million square kilometers (over one million square miles). More than 70 percent of the residents of Kazakhstan are Muslims. For centuries, Islam has been the main religion for the whole country. However, during the period of Soviet regime, Kazakhstan faced a vehement wave of modernization and secularization. The country where thousands of Islamic state figures and scientists lived and worked was subjected to violent elimination of religious values and potential abolishment of religious institution and as a result Islam was saved for domestic aspects of life only. Once Kazakhstan has gained sovereignty in the early 1990s after the demise of the Soviet Union, the process of the revival of Islamic values started with a vengeance (Kuralay 2008). Although, Kazakhstan does not have Islam as the state religion and according to Article 1 of the 1995 constitution Kazakhstan is a secular state but still one can witness the rapid increase of religious feelings among the people. The increase in number of Mosques (2.5 thousand compared to 63 during Soviet era), Madrasas, Islamic institutions of higher education, and Islamic publication of Islamic literature come as evidence of reactivation and revitalization of religious life in Kazakhstan (Saniya Edelbay 2012). The demand for Halal food and valid dressing was another sign of growing interest in religious activities. Meeting the public demand, in 2001, the Halal standard was introduced in Kazakhstan, resulting in a growing number of cafes and restaurants

offering Halal food, and stores selling clothes that meet Shari'ah requirements (Saniya Edelbay 2012).

The most fascinating thing to see was the emergence of Shari'ah compliant banking and financial transactions. Kazakhstan, in this regard took some initials soon after independence. Though not to a large extant but Kazakhstan got practically involved with Islamic banking and finance after joining IDB in 1995.The statistical observations reflect that PLS (profit and loss share) industry in Kazakhstan is continuously spreading out to produce a better alternative in terms of policies and services in the near future. Kazakhstan's effort to develop Islamic finance has a short history and is 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. 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 was suffered by an initiative from "La riba", a riba-free operating US-based Bank that tried to enter the Kazakhstan market in the 1990s (Wolters 2013).

Kazakhstan was the first country in Central Asia to experience PLS system of banking and finance when in 1996 IDB opened its representative office in Almaty, then capital of the Russia, which is now covering the whole Central Asia, Azerbaijan and Albania. 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. 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. It is important to mention that for most of its engagement the bank employs conventional instruments, even if Shari'ah conformity is being observed on a case-by-case basis. As an important engine for the further development of Islamic finance in Kazakhstan the IDB has emerged, nonetheless, during the unfolding of the global financial crisis when it supported first

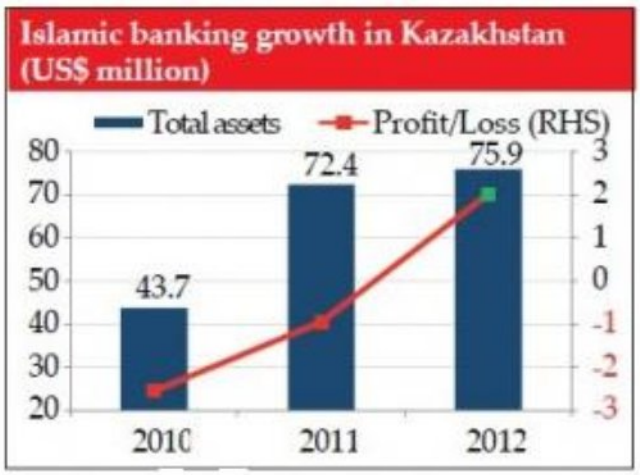
attempts to launch reforms (Wolters 2013). Taking a move forward, Kazakhstan became the only IDB member country in the Central Asia Region which joined the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) in 2002. During the Member Country Partnership Strategy (MCPS) Technical Mission, potential opportunities in the provision of Shari'ah-compliant export credit and investment insurance in Kazakhstan were identified. In order to enhance Islamic banking finance in the country the MCPS Work Program proposed the following programs and capacity development activities:

- Technical Assistance to develop the Enabling Environment (regulatory and supervisory frameworks) for Islamic finance;
- Technical Assistance for developing the Takaful sector;
- Equity investment in an Islamic bank to expand the sector, as well as joint initiatives and programs with key institutions, including the Development Bank of Kazakhstan; and
- Assistance to build capacity of the Zakat Fund (IBD Group 2012).

Kazakhstan banks demonstrated a strong interest in Islamic financial services since early 2000's. In 2003, Kazakhstan's largest bank, BTA, became the first Central Asian financial institution to draw on an Islamic-backed line of credit when it borrowed 250 million dollars from Arab, UK and Malaysian Islamic lenders. Since 2006, other Kazakh banks such as Centre Credit and Alliance have started using Islamic financial practices (Oxford Analytica 2009). In the spring of 2007, BTA Bank signed a memorandum of understanding with Dubai-based Emirates Islamic Bank to promote Shari'ah-compliant banking in Kazakhstan and other CIS states, where BTA has a number of subsidiaries (New Horizon 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 investment and securities. Fattah Finance and its staff were behind the establishment of the "Association for the Development of Islamic Finances" in 2009.

The first full-fledged Islamic bank in Kazakhstan is Al-Hilal Islamic bank. The bank was founded in 2009 based on an agreement between the governments of the Republic of Kazakhstan and the United Arab Emirates. In line with this agreement, Al-Hilal bank from Abu Dhabi owns 100% of the JSC Islamic Bank Al Hilal which has its headquarters in Almaty, with branches in Astana and Shymkent and each branch is

targeting to offer a wide range of products for both retail and corporate customers. Al-Hilal bank in Abu Dhabi in turn is 100% owned by the UAE government. The young bank, founded in 2008, has become a major player on the UAE financial market, with 97% of its activities in retail and only 3% in corporate financing. Quite to the contrary, Islamic Bank Al Hilal in Kazakhstan operates solely in corporate financing, with state holdings being the main recipient of investment and service, and big infrastructure projects as the target market segment for loans. Furthermore, having considered the need of an independent Shari'ah Panel as specified in the Al Hilal Islamic Bank's JSC charter and the Banking Law of RK (Article No. 52-2), the Bank's Shareholder has appointed the Islamic Finance Principles Board of scholarly qualified individuals to issue opinions (Fatwa) according to Shari'ah Principles with specialized and comprehensive knowledge in Islamic Jurisprudence, Finance, Banking and Laws. It has been put at the helm of the bank to ensure all the activities are carried out in strict compliance with Shari'ah rules and principles (Al-Hilal Audit Report 2012).



Source: Al-Hilal Bank, Kazakhstan

The Bank's mission is to raise the profile of Islamic banking in the CIS countries whilst contributing to Kazakhstan's national growth and prosperity and also strives to understand its customers' needs and provide the right Islamic finance solutions to meet these needs. The bank plays an insignificant role in the financial market in the republic ranked 33 out of 39 Kazakh banks in 2011. According to the bank's annual report (Al

Hilal bank, 2012) the main products offered to the corporate clients are commodity *Murabaha (58%)* and *Ijarah (42%)*. The retail banking presents a current account based on *Qard-Hassan* and a deposit based on *Mudarabah* contracts. It is supervised in its activities by the Islamic Finance Principles Board (IFPB) which consists of three members that are specialists in Shari'ah law and that yearly issue a fatwa on the bank's performances (Wolters 2013).

The Government of Kazakhstan plans to develop and promote Almaty as the Central Asia's regional financial center, and mandated the Regional Financial Center Almaty, or RFCA, for achieving this goal. More recently, in November 2011, the National Bank of Kazakhstan was admitted as an Associate Member of the Islamic Financial Services Board, based in Kuala Lumpur, Malaysia. Furthermore, in July 2011, the Kazakh President signed into law, the amendment "On alteration and addition to some legislative acts of the Republic of Kazakhstan on the organization of Islamic finance", paving the way for issuance of *Sukuk* (IDB Group 2012). In July 2012 the Development Bank of Kazakhstan became the first in the region to issue *Sukuk*. In May 2013, the ICD announced its initiative to convert Zaman Bank into Islamic bank with an investment of up to 35% of capital. The local bank will be the second Islamic bank in the country. The ICD along with Zaman Group and other investors established the first *Ijarah* Company in the Republic with an authorized capital of US$36 million. A US$ 76 million debut *Murabaha* program carrying a 5.5% yield will mature in August 2017. Since independence, the government of Kazakhstan has been paying special attention towards the development of Islamic financial services sector but from the past few years, there has been a kind of drift in its policy. The industry is being supported through;

(a) Promulgation of specific legislation,
(b) Development of ambitious strategies,
(c) Setting up of special purpose departments,
(d) Hosting of events to deliberate on core issues in a transparent environment, and
(e) Reaching out to IDB and other institutions and experts for assistance.

4.2 Law of Kazakhstan and Government Road Map: Future Prospects

The economic researches convey that the market of Islamic banking and finance industry is growing 15-20% annually which reflects prospects of the industry in the coming years. Kazakhstan has joined the list of countries that have altered their legislation in order to

facilitate Islamic banking and finance. Modern Islamic banking and finance legislation has originated not bottom up from the Islamic faithful, but top down from multinational businesses seeking a profitable market position (Maggs 2011) The Republic of Kazakhstan became the first country in the Commonwealth of Independent States (CIS) to introduce fundamental legislative amendments after identifying the volume and future prospectus of Islamic finance in the country.

In 2009, after President Nursultan Nazarbayev ordered a bill on Islamic financing, the government revised existing laws on banks and the securities market and several other laws pertinent to Islamic financing. The country's powerful president has issued an edict calling for use of Islamic finance as a measure "for attracting resources for further development" (Maggs 2011). Such amendments were made to a number of Kazakhstan's legislative acts (the Civil Code, the Tax Code, the Law on Banks and Banking Activities, the Law on Financial Markets and others). An amendment to the Kazakhstan Banking Law in 2009 allowed Islamic banking activities, established a separate license for Islamic banks and stipulated the Islamic financing products. However, the law does not recognize Islamic 'window' operations. The main differentiating factor between conventional and Islamic banks is the accounting procedures for Islamic banks (IDB Group 2012). To develop these amendments, a group of specialists was formed that actively cooperated and continues to cooperate with government bodies on issues related to the development of Islamic finance in Kazakhstan. The main principles used in developing the amendments to Kazakhstan's legislation were the following:

- Equalization of the taxation of Islamic financial products with the taxation of conventional financial products
- Expansion of existing concepts to include specific definitions of Islamic financial instruments
- Extension of tax benefits applied to traditional financial products to Islamic financial products
- For tax purposes, Islamic financial products are classified as such only for the purposes of transactions carried out by Islamic banks.

The following main amendments to the Tax Code were also introduced:

- The list of types of income received by residents and non-residents was expanded to include income received from an investment deposit placed in an Islamic bank. Such an amendment allows the taxation of such income to be defined and makes the tax consequences of investing in Kazakhstan, including foreign investments, more transparent.
- The provision of Islamic financial products was generally exempted from value added tax, which is a significant achievement in equalizing the taxation of Islamic and traditional financial products.

The implementation of Islamic finance at the legislative level in Kazakhstan is expected to play an important role in the development of the country's economy and infrastructure. In particular, it extends the range of financial services, which makes Kazakhstan's financial market more competitive, and is a means of attracting investment capital and major players from the worldwide Islamic financial industry to Kazakhstan (Ernst &Young 2011). The Government and NBK continue to demonstrate a political will to support the new industry. The 41-point government road map "Road Map for Development of Islamic Finance by 2020", released on March 2012 (extending up to the year 2020), speaks about the concern of Kazakh government towards expansion of Islamic banking finance industry in the country. The Road-map includes main actions to be taken, responsible parties and time-frame for the following directions (Mahdi 2012):

1. Legislation Improvement;
2. Educating Market;
3. Islamic Finance Infrastructure Development.
4. Public Sector Development.
5. Islamic Financial Services Development;
6. Science and Education;
7. Investors Relations.

4.3 Growth of Sukuk and Takaful Market and Some other Activities

In the medium term and in the context of favorable market conditions, the Government of Kazakhstan is considering the issuance of Sovereign *Sukuk* to finance fiscal deficit of the country and set the benchmark for local issuers. According to the estimates, the

coupon rate of the *Sukuk* will be formed taking into account some risk premium. Overall, expected markup will be comparable to ones with traditional sovereign securities, as one of the key factors of price formation is the credit risk of the issuer. Issuance of *Sukuk* is being promoted by the Government, however, for this to materialize the pricing of the *Sukuk* will need to be competitive with the conventional bonds (Ernst & young 2011). 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. For a market new to Islamic finance, the issuance by the Development Bank is believed to provide a good starting point for opening the market for other *Sukuk* issuers because of the bank's ties with the government of Kazakhstan. To begin with, the issuer, the Development Bank of Kazakhstan (DBK), was operating under uncertain legal conditions. The *Sukuk* was issued as a commodity *Murabaha*, yet laws in Kazakhstan specified only *Sukuk* of the *Ijarah* and *Musharakah* type. In addition, according to representatives from the DBK, neither issuance procedures for Islamic bonds nor their listing procedures were clearly regulated. 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 ringgit, using the Malaysian law and corresponding supervisory capacities in the Kingdom, namely approval from the Malaysian Central Bank and the Shari'ah Advisory Council of the Securities Commission of Malaysia for Shari'ah 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 (Wolters 2013).

The *Takaful* sector shows potential in Kazakhstan. The *Takaful* Association is busy in promoting the sector. Currently, it only offers health and accident coverage for *Hajj* and *Ummrah* travelers. The Financial Services Industry (FSA) has adopted a document which entails acceptance of necessary legislation of *Takaful* by 2012. The Hajj Fund (A 50:50 joint venture of Fattah Finance and Amana Raya) was launched at the WIEF in June 2011. The Ministry of Finance is keen to develop the Islamic microfinance sector, and has allocated funds for developing the microfinance in the country. It is proposing changes to national legislation for microfinance with a focus on rural areas. Kazakhstan's priorities are to strengthen the existing 800-1,000 microfinance institutions.

Applying Islamic financing instruments in Agricultural sector is a new market exposure for the Islamic finance industry in Kazakhstan. The country is among the world's top 10 exporters of wheat which is by far the country's most important agricultural commodity, well- known for its modernization of harvesting techniques. The International Islamic trade Finance Corporation (ITCF), a member of the Islamic development Group, put together an Islamic structured deal of US$40 million for financing exports of wheat in a Shari'ah-compliant manner. The deal in the form of a *Murabaha*- based financing structure serves as a model for future agricultural and supply chain transactions with a substantial reduction of the total pricing charged to the beneficiary and thereby rendering the financing structure more competitive (IRTI 2012).

5. Findings and Practical Implications

Islamic banking and finance industry has a high potential market in all Muslim republics of the Central Asia. Nevertheless, the industry in Kazakhstan has been gradually evolving from its nascent stage in terms of regulation, infrastructure and number of market participants, but still the overview shows that Islamic banking and finance in Kazakhstan is quite far from a full market opportunity. The industry have a prosperous future if could develop a better market realization strategy and customer convincing polices and services. The industry could broaden its outreach by ensuring microfinance schemes for rural population and people dealing with agro-sector. The operational units of Islamic banking and financing industry in Kazakhstan could seek expertise from IDB, the largest Islamic banking unit and can also tap into its financial resources. The awareness programs about Islamic banking and finance industry through workshops, seminars and other means of social media could be helpful to enhance familiarity about the services and policies of the industry.

Based on the findings, the present paper shall have following practical implications:

- Islamic banking and finance industry could be used as a viable alternative to overcome banking and financial irregularities like high rate of interest, bankrupts leaving bankers and customers with nothing, minimum returns and investment in unethical ways faced by the customers.

- The industry could potentially provide the schemes, particularly for Muslim clients of the region to get involved in those financial transactions which are mostly asset-backed and with an inbuilt Shari'ah compliant PLS character.
- The Kazakh authorities could use the industry as a means to strengthen economic ties with rich and wealthy Arab countries.
- The partnership with similar institutions especially Islamic Development Bank could have a significant contribution in the economic and financial development of the whole Central Asian region.

6. Conclusion

Islamic banking and finance is emerging as a viable financial intermediation in the republics of Central Asia. The banking and financial pundits are of the opinion that the chances for Islamic banking are higher in Kazakhstan because of declining customer trust in years old conventional banking industry due to the impact of global financial and debt crisis on the local Kazakh banks. While the majority of Kazakhstan's citizens are Muslim, the country is largely secular, and Nazarbayev's policy has been to build good relations with all religions. However, he has been very much the driving force behind efforts to establish Islamic finance in Kazakhstan. The country of Kazakhstan has a lot to offer for Islamic banking and finance. The banking and business sector of country shows a promising potential for the industry. 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. 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. The government is currently implementing a program of industrial and innovative development and to give this framework a practical shape, it needs foreign investment. The Muslim world, including Malaysia and the countries of the Middle East, has a huge amount of capital ready to flow into Kazakhstan once the right conditions are in place, and that is what the roadmap is for. The roadmap, primarily set out to provide all possibilities of regulating the Islamic banking and finance activities

until 2020, is expected to enhance the market share of Islamic banking and finance industry in the coming years. From the industry side, the industry has to keep the local market requirements into consideration while developing new policies and only those Shari'ah complaint financial instruments which are equally effective in market penetration and customer satisfaction are to be promoted.

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