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**Islamic finances: the way to diversify the economics of Kazakhstan**

Most countries see Islamic finance as an alternative system to the existing traditional one. Because its stability during the financial crisis showed its reliability. As the Islamic finances required to be invested in the real assets, such socially significant industries as agriculture, infrastructure construction can be developed with the help of the Islamic finances. As for Kazakhstan our government takes serious steps to develop this sphere in our country. In this article we offer agriculture for investment attracting from the Islamic world.

**Key words:** Islamic finance, Islamic banking, Kazakhstan's perspectives in attracting investments, agricultural potential of the Kazakhstan, Ijara, Murabaha.

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**Исламдық қаржы: Қазақстан экономикасын әртараптандырудың жолы ретінде**

Исламдық қаржы жүйесі бүгінгі күні дәстүрлі қаржы жүйесінің баламасы ретінде қарастырылып жүр. Соңғы дағдарысқа қарсы тұра алу тәжірибесі жүйеге деген сенімділікті арттыра түсті. Исламдық қаржыландыру нақты активтерге инвестициялауға шақыратындықтан, әлеуметтік маңызы бар ауылшаруашылығы, құрылыс секілді салаларды исламдық қаржыландырудың көмегімен дамытудың мүмкіндігі бар. Қазақстан үкіметі де осы бағытта маңызды бастамаларды қолға алып отыр. Мақалада ауылшаруашылығын ислам әлемінің инвесторларының көмегімен дамыту ұсынынылады.

**Түйін сөздер:** исламдық қаржы, исламдық банкинг, Қазақстанға инвестиция тарту, Қазақстанның ауылшаруашылық әлеуеті, Иджара, Мурабаха.

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**Исламские финансы как способ диверсификации экономики Казахстана**

Во многих странах исламская финансовая система рассматривается как альтернатива к существующей традиционной системе. Надежность этой системы была еще раз доказана во время последнего кризиса. Так как исламские финансы призывают инвестировать в реальные активы, имеется возможность развивать социально значимые сферы, как сельское хозяйство и строительная индустрия, с помощью исламских финансов. Правительство Казахстана также заинтересовано в развитии исламских финансов в Казахстане. В данной статье предлагается развивать сельское хозяйство путем привлечения инвестиций из стран исламского мира.

**Ключевые слова:** Исламские финансы, исламский банкинг, пути привлечения инвестиций в Казахстан, сельскохозяйственный потенциал Казахстана, Иджара, Мурабаха.

**ISLAMIC FINANCES:  
THE WAY TO DIVERSIFY  
THE ECONOMICS  
OF KAZAKHSTAN**

Nowadays the Islamic financial system is becoming more attractive in the world, particularly after the world economic crisis. Islamic institutions attract the attention of the world due to their sustainability against the crisis. The main reason of this is the prohibition of investing in high-risk assets, mortgages and derivatives according to the Islamic set of rules – *Shariah*. The some of the current assets of the global Islamic financial systems is more than 1.3 trillion USD and the system's reliability increases year by year. Even if the Islamic finance has been developing for 40 years around the world, it is taking its first steps in Kazakhstan. In 2011 during the World Islamic Economic Forum in Astana the president Nazarbayev announced about the arrangements on Islamic financial system development cooperation. Also in that year it was announced that attraction of investment for 10 billion USD in next 5-7 years [1]. The president's speech shared the information about the other countries' experience on using Islamic finances for their countries development. Agency on financial markets and financial institutions regulation and control said about the non-performing half part of the second tier banks' current assets which is equal to 18 trillion KZT, where 30% of it is doubtful loans, and 20% is bad loans. The amount of the current assets in 2013 was as in 2005-2007 [2]. But first Kazakhstani Islamic bank's portfolio does not contain any doubtful loans. We can understand a lot of things from here. Large banks require a real estate as collateral during the crediting process. One of the mistakes of the traditional banks is the next: when a client borrows money from a bank, the bank does not take into consideration the fact whether the collateral makes a profit or not. When the client cannot pay its debt, how can the bank take the house, where the client lives? Banks have given loans without limits under the aegis of demand for mortgage from the people and economics' development. Here is the advantage of the Islamic banks: they finance only those products that make a profit. It means that the bank will invest the client's project if it produces a product and makes a profit.

An Islamic bank is also commercial one. Therefore they must have incomes. Islamic banking is based on religious values and norms system; also they rely on the traditions of the Islamic world. Prohibition of *riba* (interest) exists for 14 centuries, and the principle of today's Islamic banking is to use *Shariah* rules in all financial

operations. According to the basic rules of Islamic banking system, interest rate is prohibited. In other words extra payments for a credit are prohibited. Though, we should not think that commercial loans are given for charity. According to the Islamic law it is not allowed to expect for interest before the real profit estimation. Because, Islamic economists pay attention on the purpose of the lent money. In addition the next industries are not prohibited to be financed: alcohol production, cigarette, pork products, gambling and weapons [3]. Also projects without clarified risks or related to speculation are not allowed to finance. The principle of partnership of bank and a client in financial projects is one of the basic rules in Islamic banking system. For example, in traditional lending process a company must return the amount of borrowed money with a clarified interest rate in any case. But in Islamic banks' case, if a company's project does not success and has losses, then the bank also has losses with the company together [3]. It means that in order to gain an income from the project acts as a member of the project and shares both profit and losses. Once financial operations are conducted through trading, then the bank can make profit from the cost price and added price for the transportation. Traditional banks do not have such risks and they receive only profit. It is unfair and wrong. In Islamic banks the risk, both losses and profit are shared by both sides. The important thing is that other religions also prohibit interest as Islam. It is said that it is *haram* (not allowed) to lend money in order to receive interest on it in most religions. Kazakhstani and foreign researchers say that the reason of such unpleasant results of economic situation in the world is insatiability. Insatiability in the banking system and those who aim to get richer come from voracity.

Islamic finance, firstly, require for equal, honest business relationship between two sides. No matter how many clients come to them, the bank provides equal service to all. For economic growth, stabilization and sustainable development the first required thing is the equal attitude to wealth-sharing. As for the bank policy, it is no secret that traditional banks are more disposed to urban clients. Urban apartments, where live people, will be pledged as a collateral in any case. The bank will not agree to accept a rural house as collateral. But 45% of all population of Kazakhstan lives in rural areas. Here we see that traditional bank treat and provide services of different degree depending on who is a client (from city, or village). But economics must provide services to all people. We have another point of view. As less attention paid to the rural areas and economics of

far villages, we still suffer from this. The conclusion of past and today's economic crises is one. The growth of product production does not always mean the improvement of socio-economic situation in the country. Everything is increasing: products and others increase too. Although the social situation may not improve, even it may get worse. Because all capitalist countries face such a gap in their economics.

It will be more useful to use Islamic finances to invest not short-, but long-term profitable projects. In Kazakhstan's case, this appropriate sphere is agriculture. There are not a lot of countries with high fertility potential territories for agriculture as Kazakhstan. Therefore we need to develop our agriculture for its long-term perspective for our economics. It is necessary to bring modern agricultural technologies to our country. Kazakhstan's oil industry develops by itself and it is not possible to change the situation there. But agriculture cannot develop by itself without government's assistance. It is the same thing for every country. Additionally, we have 'a heritage' from Soviet Union as old machineries and wrongly cultivated lands. We need to divide the land for agriculture as land for pasture, for growing crops and for gardening. There are not a lot fertile, irrigated lands that are impossible for cultivation. Then the obtained product can be sold to countries with large population as Indonesia, Pakistan, and Saudi Arabia. It is profitable also from geographical point of view. We mean those countries that do not have cultivated lands. In order to realize this project we need to make the competent specialists work together purposefully. Further, they will make the work last usefully in future periods. By developing agriculture we can export these products to partners from ICO. By doing this we can attract finances and improve our economic. As land is a real asset, by sharing it with investors, we will receive *halal* products. When food is safe, other things also become safe. Secondly, an Islamic bank as an investor will try to save the ecology, it is studied by scientists. By examining countries with developed agriculture, we need to attract investors of Islamic countries to bring the technologies of those countries. Saying about agriculture, we mean that safe food is safe life. In many foreign countries different chemical supplements are used in order to increase the shelf life of foods. A few technologies are used for 'marble meat', which increases its high cost price. But natural product is always cheap and healthy.

Abdelkader Chachi, researcher and assistant professor of Islamic Research and Teaching Institute, during the workshop organized by by UNNExT on «Trade Facilitation: Paperless Trade Facilitation for

Small and Medium-Sized» Enterprises in Central Asia» in 4-6 May 2015 presented a slide with a theme 'Introduction to Islamic Finance for Agriculture and SME's'. It is said in this presentation that agriculture sector contributes about 40% of worldwide employment and 100% of food production. Also he said that 'despite the discovery of industry, trade and other services that became rival to agriculture, agriculture was and still is the primary source of food security for the world's population. He mentioned that the lack of access to finance is a key impediment to farmers in improving the efficiency of their productions and adopting better technologies. The problems facing agricultural sector that noticed in this presentation as the small size of the cultivated areas in some countries, urban expansion in the countryside, the exodus from the countryside towards the cities, the small size of properties, the fluctuation of agricultural production (depending on the rain from year to year) and prices, the desertification, the lack of financial support for agricultural projects, the lack of encouragement to engage in agriculture and the failure of financial authorities and laws to meet the demand for Islamic finance are the same in Kazakhstan's situation. In order to assist to solve these problems, he gives as an example the next Islamic financial instruments which make us agree:

*Muzara'ah* Contract (between an owner of a land and a farmer who is ready to work in it. They share the yields s agreed 50-50% or 40-60%, for example);

*Mugharasah* Contracts (a landowner gives a farmer a land to plant fruit trees to be partners in the land and trees when they bear fruits);

*Musaqah* Contract (Use someone in watering fruit trees of an existing orchard and share the yields as agreed 50-50% or 40-60%, for example);

*Salam* Contract (the financier advances money to a farmer in order to receive a certain amount of a measured quantity and described quality of a crop) [4].

World Council of Credit Unions' (WOCCU) experience in Afghanistan is also interesting. The organization's program is expanding financial access to small- and medium -size enterprises and farmers through new and existing Shariah-compliant products. WOCCU will design and roll out a hybrid Shariah-complaint loan product to meet the demand for financing for small-scale fixed assets and working capital among the micro-entrepreneurs, small business people and farmers. The financial products such as *Ijara*, *Murabaha* and *Ijara&Murabaha* which can be translated as Financial Leasing, Working Capital Loan and Hybrid Lending consequently.

### *Ijara*

This type of financial lease allows an IIFC to buy and lease equipment to members while maintaining ownership until the member repays the entire purchase price. Under the *ijara* arrangement, the IIFC owns the asset, and the borrower's payments are considered rent. In essence, the borrower pays for the right to use the equipment until its purchase costs are completely repaid, generally within three to four years, at which time title passes to the member.

### *Murabaha*

The classical *murabaha* product provides goods to members on credit with no cash involved. The IIFC purchases the requested good(s) and transfers ownership to the member. Mark-up is calculated based on a declining balance, and no additional mark-up is charged after the loan matures. If members pay off their *murabaha* prior to maturity, they pay the full mark-up for the entire term of financing. Any excess mark-up paid is then deposited into the members' IIFC account as a withdrawable share [5].

### *Ijara & Murabaha*

The hybrid product consists of two interlinked components 1) a lease of a fixed asset (*ijara*) to existing businesses to expand operations or to start a new income-generating activity and 2) a line-of-credit working capital loan (*murabaha*) to support the use of the fixed asset(s). Five IIFCs in Helmand province will test the product with entrepreneurs and farmers who have the potential for expansion but lack reliable financial records or collateral to guarantee a loan. Members will be able to access larger and longer-term loans to invest in their businesses, while the IIFCs' ability to recover and resell leased assets will reduce the institutional risk in lending[5].

WOCCU's experience is also possible to use in Kazakhstan. But we should notice the significance of our economics and cultural differences.

Also Islamic banks offer financial instruments as traditional banks and make a profit too. Therefore it is called financial structure. As for a traditional bank, they rely on interest rate, while an Islamic bank works with trading operations [3]. Because Islam does not forbid trading. An Islamic bank may say: «which car would you like to purchase? Tell us where the car is. Then we will go there, buy and sell it to you'. In simple words, an Islamic bank buys a car for 1000 USD and sells it to client for 1150 USD. The client will pay this amount of money in 36 months. Bank does not credit a client, but they sign a contract of sale to sell the car for 1150 USD. In traditional banks a client receives a profit as 5% interest rate for saving his money

in a bank. In an Islamic bank it is similar to this, although a client does not receive a profit as an interest rate, but his part of the profit. A client saves his money in an Islamic bank. The bank adds the clients money to other financial instruments they have. Then the bank uses it for financing real projects of client, except money, to develop their business. In the end of a year the bank counts his net income and gives client's 5% profit, depending on the proportion noticed in the contract. This part

of net income is accepted as *halal*, fair for the client. One more difference is the way of income sharing. Here we see its similarity to an investment fund. It means that the owner of the money agree to share both profit and losses by investing his money in a project. The experts say that most Islamic banks are willing to invest in fast developing countries with reliable investment climate. In this case Kazakhstan must use this chance to improve the country's economics.

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