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THE RELEVANCE AND OPPORTUNITIES OF ESTABLISHING ISLAMIC BANKS IN CENTRAL ASIA

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The article highlights theoretical and practical differences between traditional and Islamic banks in Central Asia, as well as the significance of the banking system in the existing countries located in the area, and their potential possibilities for the development of Islamic banks. Furthermore, proposals for the establishment of Islamic banks have been developed.
Keywords: *Uzbekistan, Central bank, Islamic bank, commercial bank, bank interest, musharakah, murabahah.*

Introduction

In 2008, the world 's financial and economic crisis began in the form of a severe decline in major economic indicators in most advanced economies, which subsequently turned into a global recession (slowdown). Accordingly, not only countries with advanced economies have suffered from this, but less developed countries have also been affected along the chain. This encouraged the countries of Central Asia to cooperate closely with the Islamic Development Bank (IDB), and led to the development and creation of new forms in the banking sector, more precisely the establishment of Islamic banks. Islamic banking is different from the conventional banking as it is interest free. Islamic banking operates under different principles and they have different risk profiles. The Islamic banks have regulations of two types; first is the government and the central bank that govern the conventional banks as well and the other is the Shariah Supervisory Board that approves the products of the Islamic banks and keeps a check over the implementation of the rules defined by the board[1].

It is essential to emphasize that the Islamic financial products are not religious ones, and they are also as profit-oriented as in traditional financial relations, but according to Sharia rules. Hence, in recent years, Islamic banking model is being successfully implemented by many Muslim and secular organizations in various states of the world.

Literature review

Islamic banks attract customers with their ethical norms combined with profit-risk-sharing principles. These principles allowed Islamic banks to resist during the global financial crisis of 2008-2011 and serve as an example of the highest efficiency [2]. At the beginning of the financial crisis, Central Asian countries showed a willingness to join affordable flows of Islamic investment capital. But their commitment to adapting to Islamic financing came to naught when the internal political situation in these countries began to aggravate, causing a rapid and sudden

shuffling of reform priorities [3].As the scientists such as R. V. Shelgunov [4], R.I Beckin [5], A.Y. Zhuravlev [6], Zhdanov N.V. [7] emphasized, liberalization and globalization of banking services, especially after the application of the international trade agreement shows a great demand for the introduction of Islamic banking products. In addition, even the technological gap and weak development of the Islamic financial industry compared to the traditional financial industry, as this is a new direction in the economy and requires appropriate development measures, according to the statistics of last for 2019, it was observed that Islamic banks in the world have much larger capital in 2019 (1.7 trillion dollars) than traditional banks, specifically, it was transformed at the expense of securities "sukuk".
The market of Islamic financial services developed at a rapid pace: from 2011 to 2016, the average annual growth of global Islamic financial assets amounted to 18.82% . The global financial crisis has cast doubt on the benefits of the western financial system. Nevertheless, traditional financial institutions and instruments continue to prevail. It is noteworthy that even in the financial markets of Muslim countries the share of Islamic banks on average is relatively small (less than 20% of the banking assets of Muslim countries and about 1% of the global banking assets) [8].

Analysis and results

To date, commercial organizations are institutions that carry out operations related to the movement of loan capital, its mobilization and distribution. The income of bankers is bank profit, or interest. Traditional banking is unrelated to religious dogmas and is governed solely by national legislation, a number of international conventions, uniform rules of the International Chamber and IMF statutes. The Islamic Financial Services System is a system whose operating principles and activities are based on Islamic law. The institutional structure of the Islamic financial services system is demonstrated in figure 1. Islamic banking sector holds the leading position in the market of Islamic financial services (almost 72%).

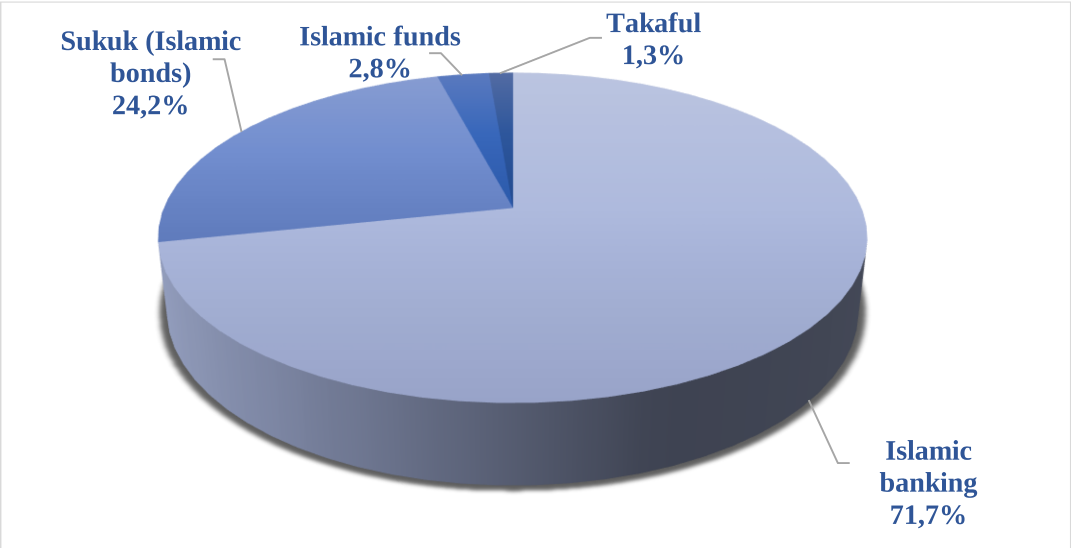

Figure 1. Sectoral Composition of the Global Islamic Financial System Industry [9]

Region	Banking Assets	Sukuk Outstanding	Islamic Funds Assets	Takaful Contributions	Total	Share (%)
GCC	**704.80**	**187.90**	**22.70**	**11.70**	**927.1**	**42.3%**
Asia	**266.10**	**323.20**	**24.20**	**4.10**	**617.6**	**28.2%**
MENA (exc-GCC)	**540.20**	**0.30**	**0.10**	**10.30**	**550.9**	**25.1%**
Africa(exc-North)	**13.20**	**2.50**	**1.50**	**0.01**	**17.20**	**0.8%**
Others	**47.10**	**16.50**	**13.10**	**0**	**76.70**	**3.5%**
Total	**1,571.30**	**530.40**	**61.50**	**27.70**	**2,190**	**100%**

Table 1: Global Islamic Finance Service Industry by Sector and Region (US$ Billion) [10]

But there is another type of banking model based on the religious principles of Islam. Since the advent of Islamic civilization, there have been operations such as currency exchange, money transfers and the use of cheques. As a result of colonial expansion, Muslim countries assimilated the western banking model, and Islamic banking, which emerged during the early period of Islam 's development, ceased to exist. On the one hand, the traditional western banking model failed to gain the full trust of Muslim entrepreneurs and citizens. On the other hand, saving was impossible not only because of the low incomes of the majority of the population, but was also assessed negatively by the general rules of islamic ethics. Still, the "a rainy day" reserves that even the poorest are trying to spare, by some estimates, numbered hundreds of billions of dollars. In an attempt to involve these funds in economic turnover, Islamic scholars and economists have proposed the creation of a new financial system that complies with Islamic standards.

What is the difference between traditional and islamic banks? First, Islamic banks are meant to prohibit loan interest, while traditional banks cannot present a loan without interest. The basic principles of the Islamic finance system include the prohibition of riba, gharar, maisir and haram. According to the sharia, a riba, a pre-determined interest rate on investments or an increase expressed in other quantities, not related to returns and not involving labor costs, is prohibited [11] (Litau, 2016). As this mentioned in Quran: “Those who devour ‘*Riba’* interest (usury) will not stand (on the Day of Resurrection) except like the standing of a person beaten by *‘Shaitan’* Satan leading him to insanity. That is because they say: “Trading is only like *‘Riba’*,” whereas Allah has permitted trading and forbidden *‘Riba’*. So who-so-ever receives an admonition from his Lord and stops eating *Riba*, shall not be punished for the past; his case is for Allah (to judge); but whoever returns (to *Riba*), such are the dwellers of the Fire-they will abide forever therein [12]. The ban on riba is related to the fact that usurious activities do not lead to the creation of a product and the growth of the welfare of society.

Also, according to Sharia, there is the term *Gharar* ("uncertainty") - a ban on intentional risk that goes beyond what is necessary, and uncertainty in the contract, fraught with big losses. These are derivative financial instruments such as forwards, futures, swaps and classic insurance. Gharar is the result of an information asymmetry in relation to one of the parties to the contract, and

Muslim law condemns the acquisition of unilateral advantages by a more informed side to the contract at the expense of the other. There is no specific evidence from the Quran which connotes gharar, however, Allah mentions: “Eat not your property among yourselves unjustly by falsehood and deception, except it be a trade amongst you by mutual consent” [13]. In addition to that tradition of our beloved Prophet Mohammed on many occasions forbade many transactions which included gharar. For example, the Prophet Mohammed has forbidden the purchase of the unborn animal in the mother’s womb, the sale of the milk in the udder without measurement, the purchase of spoils of war prior to distribution, the purchase of charities prior to their receipt, and the purchase of the catch of a diver.

Actually, gharar occurs in all types of transactions when the subject matter, the price, or both are not defined or fixed in advance. Speculative activities in capital market, derivative instruments and short-selling contracts are prime examples of gharar in modern finance. Furthermore, gharar in practice potentially address the issues such as pricing, delivery, quantity and quality of assets that are transaction-based and would affect the degree or quality of consent of the parties to the contract. For example, an "option" cannot be bought at a certain price to be entitled to purchase underlying shares owned by it, because an "option" is not ascertainable and is therefore uncertain. An option is just a right and it is not an asset whose specifications are clear and obtainable In conventional insurance, the premium paid by policyholders and the indemnity provided by the insurer upon a claim are equally uncertain, thus making conventional insurance non-compliant from an Islamic legal perspective [14].
Another forbidden element of sharia is *maisir* (Arabic "azart") - a ban on speculation, the use of any circumstances in the way of anyone 's difficulties in own interests: gambling, betting deals, classic insurance, therefore, participation in lotteries and other similar operations are prohibited in practice of Islamic banks. The essence of maisir is that in the case of any financial contract, the benefit of one party is achieved by the loss of the other party or vice versa. An overview of the elements forbidden by the Sharia shows that excessive gharar in any financial agreement can lead to the emergence of maisir element. Accordingly, the absence of the gharar leads to the opinion that the contract doesn’t include any maisir elements as well.

Finally, a last but not least important requirement of Sharia is that the islamic banking and finance industry should be channeled to *halal* industry to ensure the comprehensiveness of the compliance. Halal is a ban on investment in the production and consumption of goods that Islam defines as unclean (haram): pork, alcohol, tobacco, weapons, as well as a ban on financing openly criminal business: prostitution, witchcraft, distribution of drugs, pornography, and etc. [15].
Being home to several countries with a high share of Muslim population, the Central Asian region is emerging as a region of opportunity for the development of the Islamic finance industry, underpinned by low banking penetration and increased demand for financing. While progress has been slow for the most part, the region is now catching up and recognizing its vast potential. The region has witnessed an

increase in Islamic finance activity in the past decade, although it remains largely fragmented. Nevertheless, the interest is there. Even in countries without formal Islamic finance regulations, there have been cases where Sharia compliant instruments and transactions were issued and executed while remaining applicable within the current legislative framework. In this respect, the Islamic Development Bank (IDB), along with its private sector arm, the Islamic Corporation for the Development of the Private Sector (ICD), has played an instrumental role in leading Islamic finance initiatives in the region. Since 2011, ICD heads its countries' operations from the IDB Group Regional Office located in Almaty, Kazakhstan[16]. As a continuation of the region's important legislative framework, in 2017, the Islamic Development Bank (IDB), with the assistance of the Government of Azerbaijan, developed the "Special Program for Central Asia", which also covers Kazakhstan, Kyrgyzstan, Turkmenistan, Uzbekistan and Tajikistan. It was emphasized that one of the key tasks of IDB is to expand cooperation between the member countries of the bank, which can only be done through regional, integration programs and regional cooperation. The aim of this program is to expand regional cooperation not only in the issue of financing energy and transport corridors, trade, agriculture, but also in the matter of reducing the costs of regional trade, transport and investment, which was planned for the period from 2016 to 2020 [11]. However, despite the growing tendencies of Islamic banking in the world and the fact that its assets are valued at more than $ 2 trillion, the majority part of the post-Soviet Central Asian countries are not participating actively in this new picture of global Islamic financial flows. In fact, Islamic investment in most countries of the region has grown only marginally. In spite of repeated statements by the authorities about their intention to develop Islamic banking, the results so far are disappointing. Out of five republics, only in Kyrgyzstan, the National Bank of the Kyrgyz Republic issued a license to a local institution to open the first Islamic bank- EcoIslamic Bank, on 31st December, 2010. At the current time, the bank is achieving the trust of many resident by supporting the Islamic position of financing and provides a comprehensive range of financial services to customers across Kyrgyzstan over 120 branches and the Bank's core business is commercial banking, including corporate banking, personal banking and financial markets services. Low tariff plans make it possible to pay utility bills and other receipts through the network using the cashier's office. In Islamic banks the main source of inefficiency is securities followed by NPLs and fixed assets, respectively[17].

"EcoIslamicBank" CJSC works according to international accounting and reporting standards and its financial results are steadily profitable. The bank holds consistently high places in the annual ratings conducted by the Agency "Aki-Press" in the nomination "Best Bank of Kyrgyzstan." Thus, according to the financial results of 2005, the bank took the 2nd place among all commercial banks, and according to the results of 2006, it was recognized as the best bank in the financial market of

Kyrgyzstan. The long history of EcoIslamicBank addresses will be a great example for many other young financial institutions in Central Asia, which are at the initial stage of their successful development.

In 2012, a special plan was adopted in Kazakhstan, which lists the necessary steps to achieve this goal. And although legislative changes occurred rather quickly, the establishment of indeed functioning Islamic finance institutions in Kazakhstan was slowed down. Advisers and lobbying groups such as Fattah Finance, the brokerage companies for Islamic investment and securities, and the Islamic Finance Development Association (IFDA) appeared soon after the initial discussions. In addition, only Kazakhstan provided an actual Islamic bank - Al Hilal Bank, which until recently was the only Islamic banking institution. Al Hilal was founded in 2009 on the basis of an agreement between the governments of the Republic of Kazakhstan and the United Arab Emirates, and is completely owned by the UAE authorities. In Kazakhstan, Islamic banking is relatively young, in particular, Al Hilal Bank began working with individuals in August, 2017. Nevertheless, according to annual rating statistics of commercial banks in Kazakhstan, the growth of deposits of individuals placed with Islamic banks, only in the first quarter of 2019 amounted to 11% or 1.3 billion tenge[18], accordingly, by widening the range of financial products and services, the bank has gone up from 28th to 23rd position between 2018 and 2019 [19]. Another member of IFDA and a newcomer to the Islamic financial market in Kazakhstan is insurance company “Takaful”, founded in 2010. The company aims to develop Takaful insurance, where policyholders insure each other by sharing losses and profits. To clarify, Takaful is a form of insurance based on principles of mutuality and co-operation, encompassing the elements of shared responsibility, joint indemnity, common interest and solidarity. One of the continuing major innovations in the market was the issuance of “Sukuk al-Murabaha” securities, islamic bonds, in the amount of $ 75 million by the Development Bank of Kazakhstan (DBK) in cooperation with the Malaysian Central Bank in mid-2012.

Other CIS countries either do not dare, or retard attempts to introduce the necessary legislative changes, or they rely on external initiatives and funding. Given the rich Muslim heritage of the region, the active restoration of bonds with the global mind and the executive powers of decision makers in Central Asian counries, not to mention the urgent need to attract new capital, the rapid implementation of the basic principles of Islamic banking in the region would be logical.

In Tajikistan, the introduction of Islamic banking began to be discussed as early as 2010. In the summer of 2014, the “Islamic Banking Act” was passed, and Qatar soon expressed its intention to participate in the establishment of the first Islamic bank in the republic. However, due to the financial crisis that began in the republic in 2015, the projects were frozen. Then the banking system suffered from problematic loans, the total volume of which at that time was about $520 million. As the representatives of Sohibkorbank stated in 2018, the introduction of Islamic banking will "restore the confidence of the residents of Tajikistan in the banking system."

Conclusion and proposals

To summarize, in recent years, Islamic banking model is being successfully implemented by many Muslim and secular organizations in various states of the world. Islamic banks attract customers with their ethical norms combined with profit-risk-sharing principles. These principles allowed Islamic banks to resist during the global financial crisis of 2008-2011 and serve as an example of the highest efficiency.

The Islamic financial model is interesting not only because it represents an alternative method of conducting banking activities, but also because it is in demand outside the Muslim world. Western financial institutions want to strengthen their position in the face of global financial crises via diversifying their products and services. Some European and American banks open special branches, so-called Islamic windows, which provide financial services in line with Sharia standards. It should be emphasized that whereas in Muslim countries the Islamic banking system is being established with the support of the government, in non-Muslim countries the emergence of Islamic economic institutions is dictated by the needs of the market. At the same time, Islamic banking services are specifically little-studied products, and therefore, it is becoming crucial to understand the essence of working processes of Islamic financial institutions. At the background of the ideas of Islamophobia, which are widespread in modern society and especially aggravated after the terrorist attacks on September 11, 2001 in the United States, opinions are expressed about the relationship between the activities of Islamic banks and terrorist organizations.

What is stopping other CIS countries? As the main reasons, it can be pointed out that in the countries of Central Asia, the traditional banking system is at the development stage, as well as other areas of the economy, and also the lack of experience in introducing new innovative banking products. Nevertheless, the initial steps to introduce Islamic banks in Uzbekistan were taken by few private joint-stock commercial banks such as “Capital Bank” and “Trust Bank” and the state-stock commercial bank “Asia Alliance Bank”. Special programs were created for the population with the assistance of loans from the Islamic Development Bank. In Turkmenistan, just as in Uzbekistan, there is no significant experience with Islamic finance, apart from cooperation with the Islamic Development Bank at the state level.

As a result of the analysis, it should be emphasized that Islamic finance to gain an institutional position in CIS region, following actions need to be as completely as possible taken into account:

the system must be acknowledged and supported at the legislative level

an awareness campaign among people to promote the perception of Islamic finance and Islamic banking as interest-free alternatives to conventional banking and financial services must be started.

amendments would also be required to the Civil Code, the Tax Code and the major banking and investment laws to address this matter systemically.

commercial banks should be allowed to open Islamic windows or Islamic banking institutes to set up independently from conventional banking

to introduce Islamic banking and Islamic finance instruments, new rules must be formulated or amendments in existing ones should be done to accept the Islamic laws and procedures with assistance of the countries with stable implementation on the system

some Islamic Finance training courses should be introduced at national level to increase the basic and practical knowledge of people in order to adopt this new change.

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