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**SOCIAL RESPONSIBILITY AND EFFICIENCY OF ISLAMIC FINANCIAL  
INSTITUTIONS**

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### Abstract

Islamic finance is obtaining attention from the financial industry and academia. The growing of the Islamic financial assets and number of institutions despite the crises and global decline in economics sets the interest to the Shariah-compliant institutions activity and social component impacted on welfare needs of the society. The purpose of the paper is to analyze the social responsibility of Islamic financial institutions, and their advantages by using data from in-depth interviews with managers of the institutions, financial statements, and reports of the institutions. The study's estimations show the high social responsibility of the Islamic financial institutions of Kazakhstan and the growth of the social projects covered by the special accounts for charity and amount of the zakat collection, as a result of increasing the financial assets of that institutions. Furthermore, the social impact of these institutions creates the opportunity for assistance to the needy and socially vulnerable population of the country.

*Keywords:* Islamic finance, social responsibility, assets quality, efficiency.

## SOCIAL RESPONSIBILITY AND EFFICIENCY OF ISLAMIC FINANCIAL INSTITUTIONS

Islamic finance is considered as an ethical and moral-oriented financial relationship between the financial institutions and consumers of financial services, because of its leading principles of prohibition of the interest (Riba) and uncertainty (Garar), profit without liability, and unethical investments (Haram business activity). (Ali *et al.*, 2010) (Billah, 2019) The profit and loss sharing nature of Islamic finance allows distributors of funds and investments to become investors instead of being creditors. The suppliers of financial capital and the second party which uses this investments for real products or services share risks in return for a share of the profits. It must be noted that any Islamic financial contract is based or backed on real assets and leads to the development of the real economy. That is the reason for the growth of Islamic financial institutions number and financial assets based on Shariah globally. (Baidaulet, 2014) (Sagiyeva and Kuanova, 2019a) According to the Global Islamic Economy report, there has been an increase in Islamic finance assets by 13.9% in 2019, from 2.52 trillion US dollars to 2.88 trillion US dollars, with 1462 Islamic financial institutions across the world. (Dinar Standard, 2020) Despite the expected absence of growth in Islamic financial assets in 2020 due to the impact of the Covid-19 crisis, the estimated forecast is optimistic for the next 3 years period till 3.69 trillion US dollars in 2024.

There have been made a lot of studies about the social components of Islamic finance that aim to create and distribute wealth fairly in society. (Mirzoev, 2017) (Tatyana Ignatova and Dobayev, 2017) (Siddiqi, 2008) (Asutay, 2012) (Mirakhor and Iqbal, 2011) The following table, developed by the author of this paper, illustrates main of them:

Table 1

The social components of Islamic finance

	<b>Component</b>	<b>Benefit</b>	<b>First source</b>
1	Equal opportunities	The average standard of living, achieving personal and family needs without difficulties	Quran 4:5
2	Equitable Distribution	Poverty alleviation and avoidance of wealth concentration in once hand	Quran 17:83
3	Social justice	The horizontal equality between individuals	Quran 8:29
4	Development and economic growth	Investment in any economic sector that meets the interests of society, avoidance extra saving	Quran 62:10
5	Wealth creation	Wealth is life- sustaining, which must be used efficiently	Quran 2:188
6	Real asset-based financing	The stable economics without financial baubles, crisis-resistant	Quran 30:39, 4:161, 3:130, 2:275, 2:276, 2:278
7	Prohibition of the interest (riba)	The real economy development, avoidance of disconnection of debt creation from wealth creation	Quran 30:39, 4:161, 3:130, 2:275, 2:276, 2:278

	<b>Component</b>	<b>Benefit</b>	<b>First source</b>
8	Prohibition of a return on nominal transactions	Islamic finance is provided only through real transactions, the real transaction mechanism is transmission money supply to commodity markets directly	Quran 30:39, 4:161
9	Prohibition of profit without liability	Liability should not be separated from benefits or profit from risks. The symmetry between rights and obligations of both parties.	Quran 11:85,
10	Prohibition of the uncertainty and speculation (garar)	Establishment productive economic activity, which is the rationale and real asset-based. In Islamic finance, partners are obligated to fulfill contracts and keep their promises	Quran 5:1, 17:34
11	Profit and loss sharing	The joint nature of the business activity, capital establishes partnerships	Quran 4:29, 4:135
12	Risk sharing and partnership	Justice in all dealings and transactions with both friends and enemies	Quran 2:279, 9:24
13	Prohibition of financing forbidden (haram) business	Prohibition of financing haram businesses (tobacco, alcohol, drug, weapons, adult entertainment, gambling and pork) allows to	Quran 90:91, 2:168

<b>Component</b>	<b>Benefit</b>	<b>First source</b>
	create a morally and physically healthy society	
14 Society-oriented financing	The framework of developmental financing, tools for poverty reduction through zakat, sadaqah and qard-hasan.	Quran 22:41, 9:13, 9:34
15 Special accounts for charity	Regulation for clients of Islamic financial institutions, opportunity to do charity by special accounts	Shariah Resolutions in Islamic Finance, based on hadiths and fiqh

Note – Compiled by the author, source: (*Holy-Quran*, n.d.)

As can be seen from the table, there are many benefits of Islamic finance and economy that are given by the first source of Islamic law (Quran and Sunnah), and create a set of advantages for economics and development: Stability, Efficiency, Economic development, Systematic integrity, Establishing equity, Sustainability, and Revolutionary formula for reforming international monetary and financial reform. (Al-Jarhi, 2017) All listed social and financial benefits and advantages are actual for Kazakhstan as a leading country in Islamic finance in the region with adopted legislative framework, state support and more than ten years of the development history of Islamic finance. Nowadays, the Kazakh Islamic financial industry is represented by two Islamic banks, two Ijara companies, several consulting firms and brokerage companies, although to date there have been no significant public transactions in the securities sector with Islamic securities of the economy. (Shirazi *et al.*, 2021) The further study will consider the role of Islamic

financial institutions of the country in solving the social problems, and their effects on the financial sector.

### **Research data and methodology**

For assessment of the effects of Islamic financial institutions for the financial sector of the country, there has been conducted 8 in-depth interviews with senior executives and responsible representatives of the Islamic finance market players: Al-Hilal Islamic Bank, Zaman Islamic Bank, Kazakhstan Ijara Company, Al-saqr Finance, Astana International Financial Centre, Social Islamic Finance and Zeket fund. The senior executives were selected for their knowledge of Islamic finance and experience in this area. The interview strategy was aimed at understanding the social responsibility of the involved in Islamic finance institutions. The interviews were guided by a set of open-ended questions, which help to make the assessment of the social impact of the Islamic financial institutions. This method helped us to understand Each interview lasted from 40 to 80 minutes, and covered the main 3 blocks of questions, as general information about institutions, social efficiency and effects of the activity of the institutions and experts' view on assessment of social efficiency of Islamic finance. The transcript was recorded in the same language as the interview, then all transcript documentations were translated into English, and rechecked for the content and meaning of the text. There has been used content analysis for identifying the social effects and the perspectives of Islamic social finance. For the Islamic financial 4 institutions, 2 banks and 2 ijara companies have been used annual reports for 2019 and 2020 years available at the websites of the companies. The annual profit reports also have been used for estimation zakat as 2.5% of the annual profit, which must be paid by the company or by shareholders, according to the Shariah rules. Since not only financial indicators are involved in the assessment of the social effects of Islamic finance, the results obtained from interviews will allow to assess it. There have been used following indicators:

- financial statements and results of operations;
- social projects in which were involved institutions;
- social effects of the implemented projects;
- the estimated amount of zakat, formed from the profit of the Islamic financial institutions;
- qard-hasan (loan without interest and profit for the financial institution) transactions;
- the policy of payment delay in the case of hardship;
- employment policy in the crisis;
- prohibition on financing haram businesses.

The study is based on the research on social disclosure from the Islamic point of view. Based on (Kamla and Rammal, 2013) (Zarka and Shirazi, 2017) (Asutay, 2012) this study built the design of themes of Social effects in Islamic finance. (Ali Aribi and Arun, 2015) For estimation of the index, which we called as Islamic social finance index, the score was calculated. The approach of calculating scores is considered in a dichromatic way, for the reported and given indicator the score is 1, for unreported is 0. We have adopted the index of social responsibility studied and Rodoni et.al. to assess the Islamic social finance index (ISFI) for financial institutions of the country. (Rodoni *et al.*, 2018)

$$ISFI_j = \sum_{i=1}^N \frac{x_i}{N} \quad (1)$$

where,

ISFI<sub>j</sub> - social finance index score for Islamic institution j

N = number of items in the index

x<sub>i</sub> = 1 if the item is disclosed

x<sub>i</sub> = 0 if the item is not disclosed.



For assessment of the index of Islamic social financial activity of the Islamic financial institutions, the information obtained from interviews was used. The index is estimated as the score for each theme examined in this study and the overall Islamic Social Finance index for each financial institution. The themes consist of sub-themes and the score of 1 for reported and opened themes divided by the number of sub-themes, for unopened themes (sub-theme) estimation was 0. The following table results were conducted by the study.

Table 2

Themes and sub-themes of Social effects of Islamic Finance in Islamic Financial Institutions

<b>Category/ themes</b>	<b>Sub-themes</b>
Shariah compliance	Compliance with Shariah in all products and services Transactions with non-Shariah compliance products How the financial institution disposes of such revenue
Zakat	Source of Zakat Amount of Zakat Beneficiary
Charity and donation	The nature of charitable social activities The amount spent on these activities The sources of funds Effects of charity activities
Qard-Hasan	Source of funds allocated to Qard al-hasan by bank

<b>Category/ themes</b>	<b>Sub-themes</b>
	The amounts are given to beneficiaries
	The social purpose for which the funds were given
The policy of payment delay in the case of hardship	Assessment of the client's condition Situations for payment delay Penalties and Fines
Employee	The policy on education and training The policy of saving workplaces in the crisis
Prohibition of financing haram businesses	Assessment Effect

Note – Compiled by the author

The theme dedicated to Shariah products and services of Islamic financial institutions and Charity and donation theme (but interviewers warned about the inability to use the information for marketing purposes) took the first place in the rating of the theme disclosure. Table 3 illustrates that the Prohibition of financing haram businesses ranks third in the revealed themes, and the policy in the case of clients' hardship ranks 4. One of the interesting for our study theme zakat, has 2 scores and ranks 5, we estimated the amount of zakat from the annual published statement. We found that only one Islamic financial institution pays zakat on retained earnings through the institution's account, the other two estimate the amount of it for shareholders, and one leaves it for shareholders estimation and payment. As can be seen from the table, there is a lack of information on qard-hasan, despite the fact that this instrument is one of the social in comparison with other Islamic financial instruments, for Kazakhstan there is no practice of using qard-hasan for customers.

Table 3

## Islamic social finance index (ISFI)

Theme	Al-Hilal Bank	Zaman Bank	KIC	Al-Saqr finance	Score/Theme rank
Sariah	1	1	1	1	4/ 1 rank
Zakat	0.66	0.34	0.66	0.34	2 / 5 rank
Charity and donation	1	1	1	1	4/ 1 rank
Qard-Hasan	0	0	0	0	0 / 7 rank
The policy of payment delay in the case of hardship	1	0.33	1	1	3.33 / 4 rank
Employee	0.5	0	0.66	0.5	1.66 / 6 rank
Prohibition of financing haram businesses	1	1	0.5	1	3.5 / 3 rank
Overall index by each institution	0.74	0.52	0.69	0.69	

Note – Compiled by the author

By using the method of assessment Islamic social finance index for Islamic financial institutions we attempted to understand the social effects of institutions by interviews and content analysis. The specific feature of these institutions their social responsibility in their activity and operations, which is one of the main differences from the same convectional institutions. There are pieces of evidence and facts of the voluntary charity transfers and other social activities of the institutions, this assumes a greater voluntary role in social welfare.

### Results and discussion.

#### Islamic Bank Al-Hilal JSC

The following information is provided by the results of interviews of the 2 managers of the Bank. Al-Hilal Islamic Bank is the first Islamic bank in Kazakhstan and the CIS, established in 2010 under the agreement of the Governments of the

Republic of Kazakhstan and the United Arab Emirates. It is a subsidiary of Al-Hilal Bank PJSC – one of the fastest-growing Islamic banks in the UAE with 100% participation of the government of Abu Dhabi. After 7 years of successful work with corporate clients, the Bank launched a retail business line in 2017. And currently provides a wide range of banking products and services that comply with the principles and rules of Shariah, such as accounts, deposits, financing products, cash and settlement services, treasury services, etc. through branches in Almaty, Nur-Sultan and Shymkent. The head Al-Hilal Bank PJSC joined a major banking group, merging with Abu Dhabi Commercial Bank (ADCB) and Union National Bank (UNB) in 2019. The number of employees in the bank is 120 people for all branches in Kazakhstan. Initially, Al-Hilal Bank in Kazakhstan focused on the corporate sector, providing Islamic financial instruments and solutions for large and medium-sized businesses. It offers to the corporate clients murabaha, commodity murabaha, ijara and wakala instruments. Al-Hilal Islamic Bank has started to cooperate with the Damu program, and it impacts on the increasing the share of medium-sized businesses, and certain projects related of microfinance, there is a diversification towards medium-sized businesses, retail and microfinance (from 3000 thousand US dollars). For individual clients bank offers home financing within murabaha contract, wakala and mudaraba instruments, starting sum is 1500 US dollars for individuals. The Bank presented itself as the bank for a targeted client with a stable income, with high requirements for risk management. The Bank provides internet banking for clients, alhilal-online. The formation of a digital structure is an expensive project and needs millions of investments, as a result bank does not have digital solutions for all clients, and there is a work on development own application of the Bank.

Based on the official published annual statement of the Bank there have been estimated the main actual zakat of the bank shareholders, as Islamic financial

institutions are obliged to zakat payment either through the bank, either shareholders pay it their self. In the case of Islamic Bank Al-Hilal the zakat amount is payable through the bank using zakat-fund.

Table 4

Zakat estimation of Islamic Bank Al-Hilal for 2012-2020

Year	2020	2019	2018	2017	2016	2015	2014	2013	2012
<b>Profit in thousand</b>	43189	140193	56359	81680	147907	161187	57755	41990	30356
<b>Zakat* in thousand tenge</b>	6	7	9	4	3	2	2	6	6
	10	35 048	14 090	20 420	36 977	40 297	14 439	10 498	7 589
	797								

Note – Author’s own estimation

The table above illustrates zakat payment of Islamic Bank Al-Hilal for 9 years of taking profit by the bank. The Islamic financial institutions are responsible for payment zakat every year by Shariah, and mostly zakat must be paid in the country where profit was earned.

#### *Islamic Bank Zaman JSC*

Zaman Bank was founded in 1991 and is one of the five oldest banks in Kazakhstan. The bank has 27 years of banking successful activity experience. As the Islamic Bank it was converted in 2017 from the conventional bank with a long way of conversation from the initiation of the conversion procedure in 2013. The major participants of the bank are Tasbolat Abguzhinov, Bekbolat Abguzhinov and Alan Abguzhinov (95%). The Islamic Corporation for Private Sector Development (ICD), a multilateral organization and a member of the Islamic Development Bank (IDB) group, is also a shareholder of the Bank (5%). Furthermore, the Bank is a partner of the Shariah Review Bureau, a member of the Malaysian Commodity

Exchange “Bursa Malaysia”, a member of the Kazakhstan Stock Exchange and has the representative office in the Astana International Financial Center (AIFC). There are 70-80 employees in the bank for all branches in Kazakhstan.

The main target clients of the Bank are small and medium companies and individuals. The list of services provided fully complies with the requirements of the banking legislation of the country. The main instruments of the bank for individuals and companies are Mudaraba and Wakala, the starting financing of which 100 US dollars for individuals and 1500 US dollars for companies. Being Islamic Bank, financial institution tries to be among competitive banks of the country and to offer favorable operating rates. The bank provides an internet banking system for clients, but does not provide the application. As the card system providing is expensive and needs processing center solutions, being the associate member of the Visa or Master Card for the international payment system, the bank does not have own card system, these days.

In contrast with Islamic Bank Al-Hilal, Islamic Bank Zaman informs the shareholders about the payment of zakat after receiving the dividends, and shareholders pay zakat themselves. The following table shows zakat amount paid by shareholders from 2017, from the converting year from conventional to the Islamic bank.

Table 5

Zakat estimation of Islamic Zaman Bank JSC for 2017-2020

<b>Year</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
<b>Profit in thousand tenge</b>	694 473	521 667	211 501	386 847
<b>Zakat* in thousand tenge</b>	17 361.83	13 041.68	5 287.53	9 671.18

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Note – Author’s own estimation

From the analysis of the social activity of Islamic Bank Zaman, it can be concluded that along with the main financial activity of the institution, there are several activities that are not connected with commercial profit. However, these social activities affect society in the form of prohibiting of financing of the haram business, improving the social responsibility of the bank and its clients, direct social assistance to the needy and ill children, as well as supporting educational projects. Payment of zakat is one more tool of redistribution of wealth in the country. It should be noted, that described additional functions of the Islamic financial institutions are not regulated by civil law, but are regulated by Shariah law and institutions adhere to and control them independently.

There are two Ijara companies in the country - Kazakhstan Ijara Company JSC and Al-Saqr Finance JSC, there have been estimated zakat amount from the profit based on the annual report. The estimated data showed that the volume of zakat affects the implementation of social projects and assistance for needy people.

The first ijara company Kazakhstan Ijara Company, has been established in 2013 within the cooperation of the Islamic Private Sector Development Corporation

(ICD) and a group of international and local investors. The company offers two Islamic financial instruments, Ijara and Murabaha, from 50 000 US dollars, and carries out activities by the Shariah law and with the legislation of Kazakhstan. There is a range of specter of the segments of the company's financing: manufacturing sector, transport sector, health services sector, construction, road building, commercial property, mining sector, railway sector, agriculture, renewable energy sources. The targeted clients of the company are corporations, legal entities, peasant farming and private entrepreneurs. The company does not provide leasing services to the companies which receive income from the sale, transportation and storage of alcohol and tobacco products, who are active in the gambling business and others. Kazakhstan Ijara Company is a participant of the Damu fund's program.

For 7 years of successful activity of Ijara company there has been the general growth of assets for 181%, however there has been a decrease to 12.5% in 2017 and 10.8% in 2019.

Table 6

Zakat estimation of Kazakhstan Ijara Company JSC for 2013-2019

<b>Year</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
<b>Profit in thousand tenge</b>	36 725	351 553	993 564	6 956	235 551	710 459	600 290
<b>Zakat* in thousand tenge</b>	918.13	8 788.83	24 839.10	173.90	5 888.78	17 761.48	15 007.25

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Note – Author's own estimation

Islamic leasing company Al-Saqr Finance has more than 20 years of experience in leasing activity. It has been decided for converting from the traditional lasing company to the Islamic in 2016, and in 2017 company transferred its activity



to providing Islamic financial instruments and services to the corporate and retail sectors. The main financial tools that the company offers are Murabaha and Ijara for corporate customers. The company was the first in the country's market, which provides the Islamic (total Shariah compliance) debit card, and recently has started the program for Islamic housing within the Ijara model. Furthermore, the company is one of the initiators of the development of the state Program of the Damu Foundation for the financing of small and medium-sized businesses based on the principles of Islamic finance, and a member of the Damu program.

It must be mentioned, that Al-Saqr Finance JSC is the first financial organization to offer the first Islamic debit cards in Kazakhstan, which in compliance with the principles and norms of Shariah. The features of the card are based on the absence of remuneration, the card balances are not used for generation bank's income, the prohibition of payments in shops distributed haram goods and services, the high amount of cash-back. There is the social specificity of the card, that generated cash-back can be used to the charity.

Table 7

Zakat estimation of Al-Saqr Finance JSC for 2017-2019

<b>Year</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
<b>Profit in thousand tenge</b>	731 655	848 862	141 248
<b>Zakat* in thousand tenge</b>	18 291.4	21 221.6	3 531.2

Note – Author's own estimation

Zakat amount of al-Saqr Finance is more than zakat of Islamic Bank Zaman for 2017 and 2018, but if compare their assets, the assets of Zaman Bank are four

times more than Al-Saqr finance assets. It means that the medium-sized Islamic financial institution can bring financing to the social area of the country.

### **Conclusion.**

The in-depth interviews of the representatives of Islamic financial institutions allow concluding the following findings. First of all, the potential of Islamic finance and perspectives of further development are significant and real for the country. There is a lot of activity from the state and international Islamic financial organizations for improving the area and increase the number of participants of the industry. Secondly, despite the crisis period and economic decline, there is a rise in Islamic financial assets and profit of financial institutions, 48% increase of Islamic banking assets for 2019-2020 in Kazakhstan. ([www.nationalbank.kz](http://www.nationalbank.kz)) Finally, the growth of the profit of Islamic financial organizations leads to the rise of the paid zakat amount in the country by the financial institution itself or by shareholders, depending on the policy of the financial institution. The growth of financial assets of Islamic financial institutions as their number in the country leads to the increase the amount of financing social projects, and effects, in the form of educated poor or parentless children number, or recovered or rehabilitated children number, provided by social assistance large and poor families' number. The social responsibility of the Islamic financial institutions is regulated by Shariah law, and includes social justice, society development, and environment saving. (Sagiyeva and Kuanova, 2019b)

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