Sharia financing to counter the dramatic devaluation of the Ruble?

Vnesheconombank, Russia’s state development bank, as well as many businesses and private banks, have looked to Islamic Finance, or Sharia financing, as an alternative to European and American lenders to counter the effects of the dramatic devaluation of the Ruble brought on by international sanctions over its role in the Ukrainian crisis and the sharp drop of oil prices. The expansion of the Islamic financial industry over the past decade has given Russia a chance to draw fresh capital from the Middle East and Asia. The Central Bank in Moscow will have to develop new standards for Islamic banking in order to allow for a Russian bank to issue the country’s first Islamic bond.

Indeed, Islamic financial assets are growing globally by 17% compared to 2013 and they could reach USD$ 2.7 trillion according to a study by PricewaterhouseCoopers over the next three years such that Russian state banks like Sberbank or VTB, cut out from Western banking and finance circles, could find some relief. But this is about more than just temporary relief; such is Russian banks extent of need, that Islamic finance may actually contribute long term opportunities rather than merely short term sanction busting solutions. Sanctions have led Russia toward a transitional phase, and this is a great opportunity for Islamic finance because Moscow has already been enjoying a good relationship with many financial centers in the Middle East and Asia. Moreover, Russia plans to learn from Islamic finance in order to inspire a unique Russian system, independent of Western institutions to be administered by the Russian Orthodox Church.

The new structure, based on the model of Islamic finance, will ban participating institutions to ban loans based on the payment of interest while discouraging investments into areas that are not compatible with orthodox morality, from gambling to tobacco. Orthodox prelates will form a Supervisory Board. Meanwhile, they say that in order for the project to get underway, it will need some 400 million rubles gathered from a dozen legal or natural persons. The statistics from the Islamic world are encouraging: four years of investment have produced volumes amounting to 2,000 billion dollars. Western finance has been increasingly developing rather esoteric products or instruments (which have performed well, or badly) in spite of the real world. The Islamic world offers a solution based on an ethical and moral vision of finance that is attracting more and more support, even outside the Muslim-majority countries.

Islamic finance is based on the Muslim principle that money does not generates more money for itself. It has no intrinsic value and should only be used as a gauge, precluding the involvement of speculative investments ("principle of Maisir") or the taking and receiving of interest ("principle of Riba"). Therefore, Shari'a compliant investments are structured on the exchange of ownership of the goods or tangible services. In fact, Islamic finance has been spreading to cover all sectors of traditional investment banks. There is also the world of mutual funds (Islamic funds), insurance products (Takaful) and even the sovereign bond market has been touched by 'Allah's finance'.

The United Kingdom is where the Islamic banking phenomenon has its deepest European roots and the country has already issued its first Islamic bonds. Islamic finance is also becoming more popular in States with a strong presence of immigrant Muslim communities (France and Germany) and European nations with Muslim majorities as Bosnia-Herzegovina or Kosovo. One of the advantages for participating national and international banking institutions; it is that the presence of a Sharia based financial offerings, makes it easier to attract more capital from the Persian Gulf, as Qatar and Bahrain, which are already investing capital in the European Union – less so in Russia. Moreover, the millions of Muslim migrants who have been living and working permanently in Europe can be the first recipients of products in line with their beliefs. Islamic finance, therefore, can be a useful tool not only to insert massive doses of ethics in a world often marred by financial greed, it can also help boost foreign investment and therefore economic growth in the medium term.Islamic finance emphasized the relationship between debtor and creditor, linking the principle of risk-sharing: the profits or losses. Rather, western finance over the years has been trying to loosen this type of relationship ever more in an effort to eliminate the risk inherent to the debtor-creditor relationship, loading it with derivatives and 'products' marketed wholesale, almost as if to lose track of reality and that credit is risky. In contrast, Islamic financiers consider risk as the cornerstone of their financial instruments.

Debt played a key role in generating the 2007-2008 financial crisis. Islamic finance (and one need not be a Muslim or a follower of any religion to adopt its principles) would inherently push finance toward the real economy, in order to create a sustainable financial climate and set the conditions for a balanced growth. One of the requirements of Islamic finance is that the transaction must support a genuine economic activity. Investors are then remunerated on the basis of profits achieved by the business; alternatively, investors lose when such profits fail to materialize. This principle – stresses – reduces the risk of relying too much on debt financing, avoiding excessive debt and speculation. Contracts between the lender and the entrepreneur in Islamic finance places great emphasis on value creation and the ability to create profit", thereby creating a tight link between finance and economics where the former cannot become more important than the latter.

The principle of risk sharing forces lenders to perform extensive ‘due-diligence’ before agreeing to grant credit, to ensure that profits are commensurate with the risks. All this, say proponents, leads to a more equitable distribution of wealth and a greater availability of credit for small businesses. Meanwhile, the market for Sharia bonds (also known as ‘sukuk’) has grown exponentially in recent years, rising from some USD$ 33 billion in 2006 to USD$ 292 billion in December 2012. The future growth prospects of the Gulf and Asian countries support the continuous growth of the sukuk market, especially because of the growing need for investment in infrastructure.