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Dr. Alaa Abduljabbar Hussein
Lecturer, College of
Administration and
Economics, Tikrit University,
Iraq

The infrastructure of Islamic financial institutions providing a mechanism for attracting investment of Islamic state partners in Russian projects

Dr. Alaa Abduljabbar Hussein

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Abstract

The article explores the use of alternative financial solutions, in particular Islamic financial institutions, for the implementation of various Russian projects in the context of limited access for Russian business structures to Western financial markets. The work defines the prerequisites for the development of Islamic financial institutions in Russian practice, as well as justifies the directions for the development of investment cooperation between Russia and the Islamic countries of the Middle East and Southeast Asia within the framework of the use of the infrastructure of Islamic financial institutions. The methodological toolkit of the study includes an analysis of public facts on the development of Islamic finance, the functioning of Islamic financial institutions in Russia. The study showed that there is currently potential for the development of Islamic finance in Russia, but so far this market has not reached a full-scale deployment in the country due to certain circumstances that impede the development of the infrastructure of Islamic finance. Obviously, the necessary conditions for starting work in new markets for Islamic investors are the presence in the country of a legislative, regulatory, organizational and tax infrastructure of Islamic finance, as well as a system for protecting foreign investors. It is these conditions that Russia will have to create in the near future. In the context of the development of Islamic financing mechanisms, an experiment on testing Islamic finance in Russia, focused on increasing the availability and development of Islamic financing tools for the population and business, as well as attracting international investors who pay increased attention to the ethical and religious aspects of investment, should play a special role.

Keywords: Islamic finance, partnership financing, Islamic investments, Islamic financial model, Islamic financial institutions, Islamic banks, halal industry, Shariah compliance, Islamic financial instruments, bank of Russia, Russian Shariah compliant investment projects

Introduction

Sanctions pressure from Western countries is motivated to revise the existing direction of investment inflow and transformation of the Russian financial sector. The need to turn to alternative financial solutions comes to the fore, one of which may be Islamic finance, called "partnership financing" in Russia, personifying economic relations consistent with the norms of Islamic law (Shariah).

A high level of social responsibility, transparency in the implementation of financial activities, building business relations on the principles of Partnership, leading confessional and ethical, and not exclusively financial considerations, brings Islamic financial approaches closer to ESG principles [Gundogdu:2018:234] ^[6]. In addition, Islamic finance is a valuable tool for the development of trade and economic cooperation between Russia and the countries of the Middle East and Southeast Asia (primarily the countries participating in the Organization of Islamic Cooperation - OIC), with which Russia traditionally maintains friendly relations. At the XIV International Economic Forum "Russia - Islamic World: Kazan Forum 2023" held in May 2023, Minister of Economic Development of the Russian Federation Maxim Reshetnikov noted that over the past six years, Russia's trade with Islamic countries has grown 2 times and last year reached \$153 bln [DKN World News; 2023:3] ^[14]. Cooperation continues in the development of joint investment projects between Russia and the OIC countries. Note that the Islamic model in cross-border financial transactions is more preferable for public and private business structures from Muslim countries.

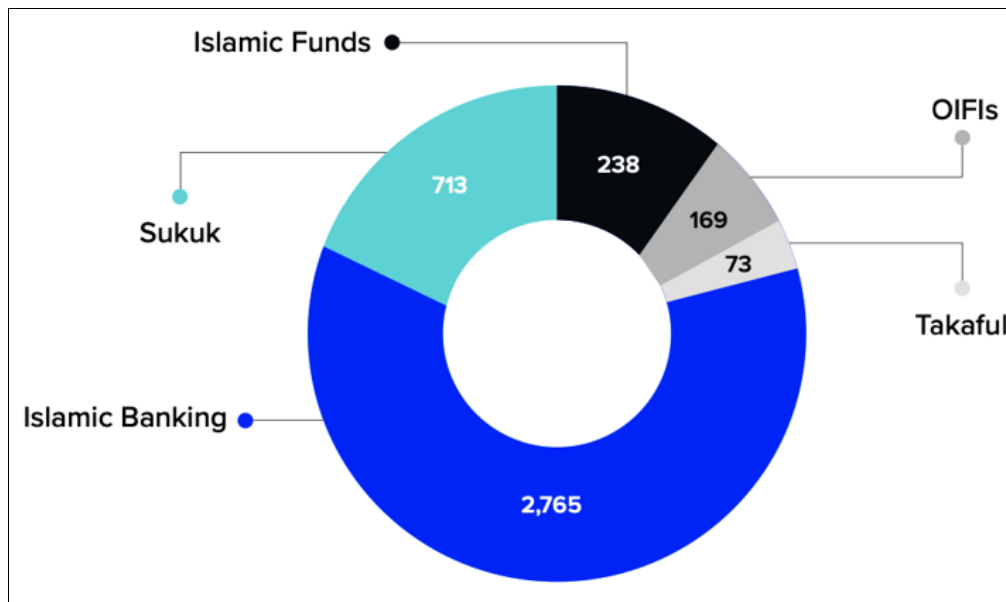
Corresponding Author:
Dr. Alaa Abduljabbar Hussein
Lecturer, College of
Administration and
Economics, Tikrit University,
Iraq

It is expected that in the new geopolitical conditions, cooperation with Islamic countries will continue to grow further, so the development of Islamic finance seems even more relevant.

Thus, for the Russian economy, in the context of limited financial and investment resources, Islamic mechanisms and financing instruments seem to be a real effective alternative to Western capital. Some international experts even talk about such a phenomenon in the world as an "Islamic alternative" [Malashenko; 2006:8] ^[11], which is a specific form of response to the challenge of globalization, the desire of Muslims to determine their own, Islamic niche in world

development, to demonstrate the possibility of an original model of social order, which is built on the principles of Islam.

In this context, it is important to emphasize that, in view of the specifics of their activities based on the principles of Islam, Islamic financial structures have shown better stability and resistance to the financial crisis. In this regard, such financial products for the investment community are no less attractive than their classic counterparts. At the same time, support from the state bodies of Russia and the OIC countries would give a greater impetus to the development of the Russian Islamic financial infrastructure.



Source: ICD https://icd-ps.org/uploads/files/ICD%20Refinitiv%20ifdi-report-20221669878247_1582.pdf.

Fig 1: Islamic financial assets in \$BLN.

We believe that the idea of developing financial institutions based on Islamic principles proclaimed by the state will immediately resonate with Muslims at Russia and abroad and will attract significant funds to the Russian economy, making it possible to compensate for the outflow of capital caused by sanctions.

Research methods

The empirical base of the study is based on facts and data on the development of Islamic finance, the functioning of Islamic financial institutions in Russia, the directions of investment cooperation between Russia and Islamic countries of the Middle East and Southeast Asia, obtained from official information resources, as well as data from information and analytical agencies with open access.

The study relies on general scientific methods: Induction and deduction, collection and generalization of information, systematization, classification, comprehensive and comparative analysis.

What is Islamic finance and why develop it in Russia?

Currently, Islamic finance is a rapidly growing sector of the economy, opening up huge resources that are especially relevant now, when access to Western financial markets for Russian business structures is extremely complicated.

Russia is looking for new economic partners to replace ineffective or closed areas of activity for Russian business. The external situation led to a change in the strategic goals

and vectors of Russia's movement, forcing to revise the foundations of the functioning of the national financial system and its sectors, both instruments for attracting and external investment, and internal savings of the population.

At the same time, one of the most attractive, effective and sufficiently developed models, which should be taken as a basis when introducing alternative financial systems into Russian practice and which, in our opinion, should be provided with preferential opportunities for development, is Islamic finance, i.e. business in compliance with the restrictions imposed by Islamic commercial law created in compliance with the requirements of Shariah.

As priority counterparties and potential investors, it is advisable to consider the states reliable partners since the times of the USSR countries of the Middle East and Southeast Asia, in which excess liquidity is observed and which are increasingly gravitating towards economic principles consistent with Shariah, and recommend that their foreign partners also apply these principles in joint projects. Experts note that most investors in the Middle East and Southeast Asia are willing to invest large resources in the Russian economy. However, the preferred component for the full-scale attraction of investments from the Middle East and Southeast Asia, which will not only replace, but also far exceed the indicators of Western financial investment in the pre-sanction years, is the developed infrastructure represented by the relevant Islamic financial institutions [RTVI; 2022:2] ^[8].

Islamic financial institutions are financial companies that use the Islamic financial model in their activities, which is a set of financing methods, mechanisms and tools that allow them to carry out financial activities without violating the basic principles formulated in Islamic law Shariah [Al-Azzawi; 2021:88] ^[2].

The system of Islamic finance, which began its formation in the 1960s in Egypt, Malaysia, Iran and the UAE, is a financial model built with the restrictions imposed by Islamic law in mind, namely, a ban on a predetermined loan interest; uncertainty; excessive risk and income from socially harmful industries: All traditional finances, production and trade in alcohol, tobacco, pork; the entire spectrum of "adult entertainment" (from casinos to the porn industry). In the Islamic financial model, the separation of risks and revenues is preferable; prohibition of speculation, absence of financial transactions without movement of real goods or provision of services, encouragement of charity.

The Islamic financial system has the following key components: 1) Islamic banks and financial companies; 2) takaful market operators (insurance companies); 3) funds (investment, leasing, trust, commodity funds); 4) operators of the sukuk market (certificates of equity participation, bonds); 5) regulatory authorities.

Instruments based on partnership and principles of profit and loss separation, joint liability for risks, strengthen the business discipline of Muslim entrepreneurs, make them more attentive to risk assessment, verification of counterparties, economic settlements, and contractual relationships. They contribute to an improved business environment, greater trust and fair reallocation of resources. In the course of doing business, special financial instruments were designed and put into practical use. For example, it is:

1. Mudarabah - a type of financing when an investor provides his resources to his Islamic (recipient of funds) on the terms of sharing profits and losses. The profit received from the project is divided on the basis of predetermined proportions, and possible losses relate to each of the parties.
2. Musharakah - a joint venture, when both Islamic invest funds in the project, the powers of each of the Islamic and the procedure for distributing profits are stipulated in advance. The risks are borne by both Islamic.
3. Wakala - agency - granting limited or general powers to an authorized person (agent) for a certain fee [Zaripov; 2016:99] ^[18].

In the trade in Islam, a trade surplus is allowed, and Islamic banks, unlike traditional competitors, have no restrictions on trading activities, so they actively use such an instrument as Murabahah - the purchase and sale of goods with a mark-up for deferred payment for a certain time (or payment in shares). The original price should be announced, the mark-up is justified, the shortcomings of the product are told. Resale is prohibited.

Ijarah resembles a lease agreement, but with slight differences. For example, from the point of view of Islamic law, it is impossible to include both lease and the right to purchase a leased asset by a tenant in the property, and other nuances in one Ijarah contract. In lending, Card Hassan is an interest-free loan agreement that involves, but does not cause, the transfer of a gift (Hibah) to an investor from a borrower for the use of resources. The size of the gift and

even its presence is not prescribed in the contract, and therefore this condition is not mandatory. Some theologians remind of the presence of a charitable element in Card Hassan and do not recommend that the financier insist on debt repayment if the borrower is experiencing financial difficulties. From the Sharia point of view, the investor always carries risks within his investments.

The most common financial instrument in Islamic stock markets is Sukuk a certificate of equity participation, securities backed by assets. It is in significant demand among investors due to the shortage of other halal debt equity securities [RBC: 2024:8].

Islamic Finance in Russia

The first practical operations based on Islamic financial principles in Russia began to be carried out in the mid-1990s, with companies operating in the banking sector, insurance and the stock market. The second wave of practical interest in Islamic finance in Russia began to manifest itself after 2010, some of the Islamic financial institutions created at that time show successful results of activity, exist, develop, set themselves ambitious tasks and solve them [Zaripov: 2016:69] ^[18].

The successful promotion of the Islamic financial model in Russia was facilitated by certain prerequisites, among which the following can be noted:

1. Advantages of Islamic investment solutions that are not in the traditional financial system: High reliability of investment accounts, mutual funds and authorized shares in connection with the prohibition of risky transactions, as well as the presence of a certain ethics of investments funds cannot be invested in industries that do not comply with sharia.
2. A number of non-Muslim investors are ready to diversify their business through the implementation of non-standard financial models and investments in halal products.
3. A significant amount of liquid funds from representatives of the Islamic world look attractive to the banking sectors. To attract these funds, conventional banks have to open the so-called "Islamic windows".
4. A constant increase in the Muslim population in the world as a whole and in Russia, in particular, and, accordingly, the emergence of new clients with special requirements. According to the Pew Research Center's Forum on Religion & Public Life, by 2030 the Muslim population in the world will increase by about 35%, and by 2050 it will become equal to the number of all Christians [Audi; 2015:3].
5. Political reasons in the era of tolerance and with a significant proportion of Muslims, the state authorities cannot ignore issues significant for the Muslim population.

In modern conditions, the Islamic model of doing business is rapidly gaining momentum in Russia. Large players are actively developing in this direction, such as Sberbank and Ak Bars, which have launched a whole line of Islamic financial products for retail and corporate clients (settlement account, debit card, corporate card, mortgage, trade financing, factoring, etc.) [Sberbank; 2023:2]. The Moscow Exchange launched two indices: The Islamic Investment

Index and the Full Yield Islamic Investment Index [Moscow Exchange; 2022:8]. It is the Islamic financial model that is proposed as an investment mechanism for the Russian Federation. The presence of mutual "points of attraction"; significant liquidity and proven instruments among Islamic businesses and a vast domestic market and modern technologies among Russians, make it possible to count on successful long-term cooperation.

Possible areas of cooperation between Russia and Islamic countries may be, in particular, attracting foreign investment in various projects. Numerous experts say that it is necessary to turn to alternative financial solutions for the implementation of various projects, one of which may be Islamic finance. Thus, the head of the Investment Development Agency of the Republic of Tatarstan Talia Minullina stressed that "such a project could be a center of Iranian trade, a logistics complex with production companies from Iran. The project is at the structuring stage; in particular, the initiators plan to build the production of liquid detergents in the industrial park" [Rezvanova; 2022:12] ^[13].

Experts from Plekhanov Russian University for Economics note that it is necessary to find alternative ways to saturate the economy with resources and involve domestic investors in promising projects; it is Islamic investments that have advantages in the form of investments in proven companies of the real sector of the economy, which reduces the risk of losses [Kuznetsov; 2022:5] ^[7].

According to the participants of the Russian Association of Experts on Islamic Financing, "the modern political and economic situation is the most preferable for intensifying efforts to attract Islamic investment in Russia. Islamic investors in the world have at their disposal about \$500 billion of liquid funds, some of which could be attracted to the Russian economy and would completely replace the financial sources of Western countries that are not available due to sanctions". [Zaripov; 2023:16] ^[5].

The development of investment cooperation between Russia and the Islamic countries of the Middle East and Southeast Asia can be built in such areas as:

1. Attracting foreign investment in the Russian economy in halal projects. Most Islamic states have significant liquidity from exports of commodities, primarily petroleum products, and a willingness to invest in projects in other countries. In Russia, the so-called "halal industry" is developing quite quickly, that is, the production of goods and services that comply with Sharia principles. These are, first of all, food (meat, dairy, grain products, etc.), as well as the provision of tourist, health, medical, educational and other services according to Sharia standards. At the same time, a number of goods have serious prospects for export to Islamic states.
2. Attracting Islamic investors to infrastructure projects. In Russia, there are many projects in formally non-halal industries, but not classified as forbidden and therefore suitable as an object for Islamic investment. This is an energy complex (production and distribution of energy, including nuclear and renewable, oil and gas production and processing, production and sale of metals (including precious ones), construction (primarily large infrastructure facilities), transport and the creation of logistics hubs, trade.

3. Creation of the Islamic segment of the stock market in Russia to attract portfolio investors. If a legislative and methodological framework is created in Russia for the functioning of Islamic segments in stock markets that allow transactions with Shariah-selected shares and Islamic debt securities (sukuk), there is a high probability that Islamic portfolio investors will enter the Russian stock market.
4. Interaction with Islamic financial institutions. In Russia, Islamic finance is now at the stage of formation and is represented mainly by microfinance organizations in the form of partnerships on the faith or consumer societies. Takaful companies (insurance according to Sharia standards) are completely absent from insurance. There are only a few funds offering clients to invest in securities according to Islamic standards. There is no legal, regulatory and methodological framework for conducting Islamic financial transactions. It is assumed that it is advisable to attract Islamic financial institutions from friendly Muslim countries to the Russian market, ensuring that they can conduct operations in Russia.
5. Participation of Russian business in projects on the territory of the OIC states. The interest of Russian business structures, including state corporations, in projects in the Middle East and Southeast Asia suggests that there are significant prospects for joint projects of Russian business with OIS entrepreneurs. Not only trade export-import operations with traditional goods should develop, but also projects in the field of transport, the creation of logistics corridors, the construction of large infrastructure projects, the agro-industrial sector, oil refining, tourism, IT, bio-, medical technologies, robotics.

Thus, there is currently potential for the development of Islamic finance in Russia, but so far this market has not reached a full-scale deployment in the country due to certain circumstances that impede the development of the infrastructure of Islamic finance among which it can be noted:

1. The absence of comprehensive legislation and the existence of legal provisions contrary to Islam, for example, the obligation to interest on deposits and loans; lack of accounting and regulatory standards;
2. Double taxation, especially in case of multi-transaction transactions, such as Murabakhah and Sukuk issues, caused not by the economic meaning of the transaction, but by a formal approach to the implementation of fiscal norms.
3. Lack of Islamic financial infrastructure;
4. Financial illiteracy of some citizens, ignorance of the opportunities and differences between Islamic finances and traditional ones, as well as the distrust of the population of banking products and banks as market institutions; insufficient number of professional personnel and specialized educational disciplines and advanced training programs in Russian universities on the subject of the entire range of Islamic finance;
5. Fear and rejection of all Islamic caused by the activities of false Islamic radical terrorist groups, as well as incorrect coverage of issues related to Muslim ethics by the media.

Obviously, the necessary conditions for starting work in new markets for Islamic investors are the presence in the country of a legislative, regulatory, organizational and tax infrastructure of Islamic finance, as well as a system for protecting foreign investors. It is these conditions that Russia will have to create in the near future.

In the context of the development of Islamic financing mechanisms, it should be noted that an experiment was carried out to test Islamic (Islamic) finance, which started on September 1, 2023 in four Russian regions: Tatarstan, Bashkortostan, Dagestan and Chechnya. The experiment is designed for two years and will end on September 1, 2025 [Federal Law of Russia №417-FZ; 2023:14]. With the help of this mechanism, the initiators of the project plan to attract to Russia from 11 to 14 billion dollars of investments from Turkey, Iran and Asian countries adhering to the Islamic religion [Voskoboynik, Imamkulieva; 2023:12] ^[16].

As of March 1, 2024, 11 organizations are members of the Bank of Russia register of participants in the experiment: Ak Bars, Sber, Avtogradbank banks, as well as non-bank institutions - AK Bars Capital Management Company, Domklik LLC, Promsvyazinvest RNKO, United Stock Broker LLC, Consumer Society Amal, Fund for Support of Entrepreneurs of the Republic of Tatarstan, LLC "Amal-Business" and LLC "Flagman-Group", engaged in settlements and investment activities of the 11 participants, 7 represent the Republic of Tatarstan, two are registered in Moscow, 1 in Dagestan and 1 in Chechnya. According to Russian law, not only credit financial institutions, but also legal entities registered in the form of a consumer, business company or partnership, fund or autonomous non-profit organization received the status of "participating financing company" as part of participation in the experiment [Central Bank of the Russian Federation; 2023:15] ^[4].

The main goals of the experiment are to identify problems and further eliminate existing legal barriers, develop an optimal regulatory mechanism for creating favorable legal conditions. This is aimed at increasing the availability and development of Islamic financing tools for the population and business, as well as attracting international investors who pay increased attention to the ethical and religious aspects of investment.

It should be noted that the Republic of Tatarstan is one of the most attractive regions for investment in Russia; it has become a platform for the implementation of innovative projects in Russia. Work in the field of Islamic finance in Tatarstan has been going on for more than 15 years; there is successful experience in the implementation of individual projects. Today, a number of credit and financial institutions in the republic provide services in the field of Islamic finance. They provide the opportunity to receive consumer and business financing, housing financing on an installment plan, leasing in accordance with the requirements of Shariah, investments through investment agreements and mutual funds. Two banks offer a debit card that complies with the principles of Islamic finance. During the work, about 2 thousand enterprises were financed; more than 1 thousand families purchased apartments with the help of Islamic financing, more than 7 thousand bank cards were issued [Interfax Russia; 2023:9] ^[9].

For the successful implementation of the experiment, together with the banking sector, universities, clergy, the expert community, market participants, republican ministries and departments, a detailed action plan for the

development of Islamic finance in Tatarstan for the period of the experiment has been formed.

The action plan has been formed in six key areas:

1. Increasing awareness and financial literacy of the population and business in the field of Islamic finance; training in Islamic finance.
2. Monitoring the implementation of the experiment and preparing proposals for improving this mechanism.
3. Development of the market and financial infrastructure in the field of Islamic finance.
4. Assistance in attracting investments in Tatarstan projects on the principles of Islamic finance.
5. Increased international cooperation on Islamic finance.

The law can be viewed on the positive side as a measure that contributes to the development of the Islamic financial sector in Russia, which is achieved by taking into account the specifics of Islamic financial transactions and the peculiarities of the functioning of institutions providing Islamic financial services. The experiment also allows more participants to be drawn into the Islamic financial sector and to increase the number of clients of institutions providing Islamic financial services.

It should be noted that the experimental legal regime will not directly affect the attraction of significant investments from Muslim countries without a number of other support measures. It will only create conditions for the development of Islamic finance and stimulate demand for Islamic financial services within the country, while foreign investment also requires a political solution, building ties at the interstate level, creating an integrated infrastructure, introducing investor protection mechanisms and ensuring unhindered international cash flow. It seems that only if all these conditions are met should significant inflows of foreign capital from Islamic countries be expected. However, this bill could be a signal to Russia in a "turn to the East," namely the Muslim East and openness to establishing new trade and economic ties, including strictly in accordance with Shariah norms.

Moreover, caused by real demand the need to develop and adopt an appropriate legislative framework will give a significant positive practical result, namely:

1. Will create a legal framework for the functioning Islamic financial institutions, as well as give a green light to those entrepreneurs who did not dare to start a new business without clearly spelled out rules, including foreign Islamic business;
2. Islamic financial institutions will attract to the economy the funds of Muslims who kept them at home, for religious reasons, not trusting them in traditional banks. In addition, labor migrants from Central Asian countries will be able to conduct banking operations through their usual Islamic financial institutions, introducing their financial resources into Russian economic circulation;
3. Insurance tankful companies, having serious financial advantages for policyholders over traditional insurance companies (first of all, the opportunity for policyholders to participate in the distribution of company profits), can attract customers and non-Muslims, thus diversifying the market and introducing an element of healthy competition, which will lead to cheaper and improved quality of services for customers;

4. The direct participation of Islamic banks in investment projects will improve the quality and elaboration of projects, reduce the risks of non-return on investments, increase the effectiveness of investments and reduce the payback period.
5. The principles of Islamic banks and the lack of interest allows you to provide funds to young entrepreneurs, small and medium-sized businesses, "startups." It is these categories that often remain "not captured" by traditional financial institutions.
6. Ownership of tools for Islamic financial products, knowledge of techniques and technologies, adopted standards will make it easier for Russian Islamic financial institutions to attract foreign investment in the Russian economy on preferential terms, allowing them to "speak the same language" with Islamic investors from the Middle East and Southeast Asia.

It is the implementation of this set of measures, at the heart of which will be the creation of a new, fairer and more understandable economic model for the population, built taking into account the ethical and confessional needs of the majority of the Russian population, will be able to accumulate funds of the population that are not trusted by banks before, as well as attract foreign investment, become an attractive example of the stable development of the national economy, protected from crises, volatility, external and internal speculative attacks. The successful development of Islamic financing instruments will also help improve and increase the attractiveness of the investment climate and attract funds to the economy. In addition, it is possible to increase the resilience of the country's economy to crises; dynamic and stable development of small and medium-sized businesses, which will ensure the growth of the well-being of the people; strengthening the unity of the nation and tolerance; formation of ethical relations and strengthening the morality of society, etc.

Conclusions

The sanctions pressure of Western states on the Russian Federation and its business sets the task of changing strategic benchmarks and finding new economic partners in order to replace areas of activity that are ineffective or closed to Russian business. One of the most attractive, effective, and sufficiently developed models that should be taken as a basis in the development of alternative financial systems is Islamic finance, that is, Shariah compliant business. It is advisable to consider reliable partners since the days of the USSR countries of the Middle East and Southeast Asia as potential investors.

The Islamic financial model in the world has proven its reliability and profitability over 60 years of its development. One of the catalysts for the development of Islamic finance in many countries was the initiatives of governments and regulators to issue sovereign Islamic bonds, which have proven to be a successful product in attracting medium and long-term investments of a large number of investors in the Islamic financial system.

The study showed that under the conditions of international sanctions and restrictions, the model of Islamic finance could become for Russia a new vector for the development of financial channels of interaction with the markets of Islamic states and countries of Southeast Asia and open up access to alternative sources of investment. In the context of

the ongoing experiment on testing participating finance in Russia, Islamic financial institutions, developing, in the future will be able to create worthy competition for traditional financial companies and banks, contributing to the further integrated development of the domestic banking system and the entire financial sector as a whole. And will Islamic finance become an effective tool for attracting foreign investment in the domestic financial and real sectors, depends on many factors, primarily the consistency and consistency of the joint efforts of the Russian state, business and the population, their ability to quickly integrate into the global Islamic financial system, to create in Russia a reliable and comfortable infrastructure for use, consisting of Islamic financial institutions in the banking sector, insurance and stock markets in order to attract and service significant foreign Islamic financial investments in the Russian economy.

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