

## **STRATEGIC DIRECTIONS FOR THE MATURATION AND IMPLEMENTATION OF ISLAMIC FINANCIAL SERVICES IN COMMERCIAL BANKS OF UZBEKISTAN**

*Abduvosidova Gulandom Abdurashid kizi.*

*The basic doctoral student of Tashkent Institute of Finance*

**Resume:** The article discusses the features of the development of the Islamic banking sector, the principles of the Islamic financial institutions, as well as financial instruments that are used within the Islamic financial system. The distinctive features of Islamic and traditional banks are analyzed and the current state of development of Islamic finance in the global economy was studied. In addition, the main directions of the development of Islamic finance in the Republic of Uzbekistan are presented.

**Key words:** Islamic finance, islamic banking, islamic financial instruments, takaful, sukuk, murabaha, riba, maysir, gharar.

### **Introduction**

Nowadays, an interest is increasing in the topic of the functioning of the Islamic financial system, which developing dynamically and is conquering the world financial space. The activities of Islamic financial institutions are becoming more diversified and complex. Opportunities, potential and competencies of Islamic financial organizations are expanding to organize and support large-scale transactions. According to the World Bank, islamic financial assets are currently estimated at roughly \$4 trillion, covering bank and non-bank financial institutions, capital markets, money markets and insurance. In addition, the Islamic finance network is rapidly developing all over the world, and it is one of the areas that contain innovative financing mechanisms.

Legislation on Islamic finance has been introduced in about 60 countries around the world, including three Central Asian states: Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan[1].

In this regard, currently was adopted the Decree of the President of the Republic of Uzbekistan “On the strategy “Uzbekistan-2030””. In this strategy, the task was set to introduce criteria and procedures for Islamic financing in at least 3 commercial banks, as well as the formation of the legislative framework for Islamic financing. The adoption of this Decree will first of all help to interest the population in Islamic finance, as well as the introduction and development of Islamic financial products in financial organizations of the Republic of Uzbekistan [2].

### **Literature review**

World-renowned scientist Muhammad Taqi Usmoni noted in his scientific publications, that Islamic finance refers to how businesses and individuals raise capital in accordance with Sharia, or Islamic law. It also refers to the types of investments that are permissible under this form of law. Islamic finance can be seen as a unique form of socially responsible investment [3].

Gambeeva Yulia Nikolaevna and Medvedeva Svetlana Nikolaevna in their scientific article noted the foundations and trends in the development of the Islamic finance system, the principles of Islamic financial institutions, as well as financial instruments that are used within the Islamic financial system. This paper also analyzes the distinctive features of Islamic and traditional banks [4].

In the research carried out by O.Astanakulov, we see that in Islamic finance, priority is paid to the Institute "bank". The following points were expressed in these studies: "Islamic finance system - Islamic law, in other words, is a banking system with the principle of organization and functioning under Sharia law, that is, all practices of this type of bank, such as deposit or financing, will also be in accordance with Sharia guidelines [5].

Scientist Tursunov Anvar noted in his dissertation, that Islamic Finance is a term that includes a wide range of financial products and services. In many ways Islamic Finance products resemble conventional products. This is not surprising because their basic objectives are the same: to facilitate investment by someone who has money, used by someone who needs money [6].

### **Methodology research**

Islamic finance plays an important role in the development of the country's national financial sector. In particular, an important place is occupied by the introduction in Uzbekistan of new promising directions for the development of the securities market, alternative instruments of the Islamic financial securities market, increasing the investment attractiveness of the state, as well as Islamic financing of banking products. Therefore, the scientific article widely uses induction and deduction, systematic and comparative analysis, graphical presentation and economic and statistical methods in the development of scientific conclusions and recommendations based on the study of Islamic finance and the formation of the main directions of development of Islamic finance in the Republic of Uzbekistan.

### **Analysis and results**

Islamic banking is a form of banking based on Islamic principles. Basically, in Islamic banking it is not allowed to pay and receive interest but rather it is based on profit sharing. Islamic banks focus on generating returns on investments through investment tools that are "Sharia" compliant.

The issue of introducing Islamic finance and Islamic banking services into commercial banks has been raised for many years. It is necessary to introduce additional legislation for the comfortable operation of the Islamic finance system in the country's banking system. This procedure diversifies the list of banking services for clients. Many residents of the country would like to use the services of Islamic finance. The issue of increasing the financial literacy of the population is also on the agenda.

There are different kinds of restrictions in Islamic finance, such as riba, gharar and maysir. The prohibition of interest or usury, which is considered exploitative and unjust, is known as riba. Gharar is an Islamic prohibition against speculative or uncertain financial transactions. Maysir prohibits gambling or gambling entertainment.

"The fact is that the level of financial literacy among the population of the country is rather low. Majority of people know something about ordinary banking services, but practically nothing about

Islamic finance. This topic is especially relevant in the context of the development of financial technology. It is necessary to create a certain potential and increase the financial literacy of the population. With an increase in the financial literacy of the population, it will be much easier to introduce Islamic banking”.

There are some major differences between Islamic banking and conventional banking systems (table 1).

**Table 1.**

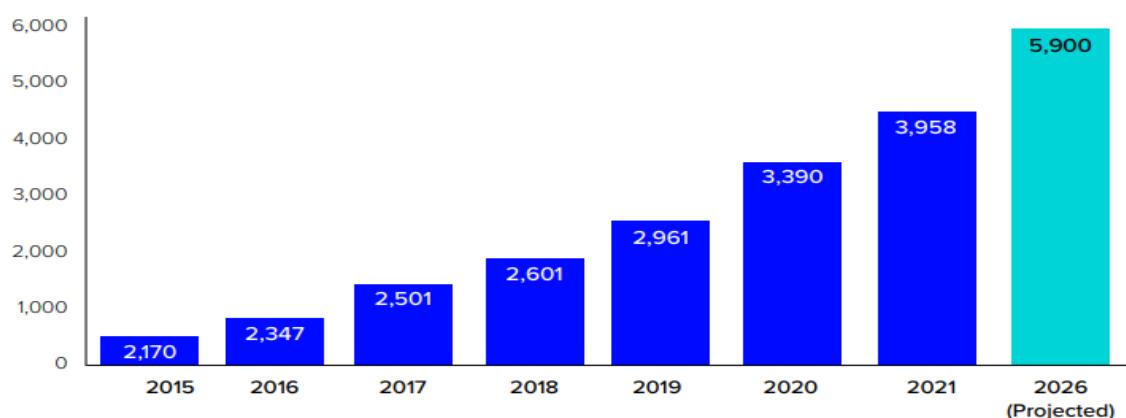
**Key differences between conventional and islamic banking[7]**

Conventional Banking System	Islamic Banking System
<b>INTEREST (RIBA)</b>	
Conventional banks operate on traditional financial models including interest-based transactions	Islamic banking is based on the principles of Islamic or Muslim law, which discourages usury (Riba) and promotes risk sharing
<b>PROFIT AND LOSS SHARING</b>	
The bank earns interest on loans and pays interest on deposits.	Profit and loss are shared between the bank and the customer.
<b>RISK SHARING</b>	
The customer bears the risk.	Risk is shared between the bank and the customer.
<b>COMMUNITY WELFARE</b>	
No such ethical restrictions are imposed.	Financial transactions must comply with ethical standards and contribute to the welfare of the community.
<b>INVESTMENT RESTRICTIONS</b>	
There are no restrictions on the type of investment.	Investments in industries deemed Haram (forbidden) – including those related to alcohol, pork, and gambling or maisir, among others – are strictly disallowed.
<b>CREDIT BASE</b>	
Often interacting with non-physical assets, conventional banking facilitates the generation of credit.	Islamic finance promotes asset-backed financing and encourages real Islamic economic activities.
<b>PRICING OF FINANCIAL PRODUCTS</b>	
The pricing of financial products is often based on the prevailing market interest rate.	The determination of the cost for financial products is linked directly to an underpinning asset, commodity, or specified project.
<b>MONEY CLASS</b>	

Money is a product besides a medium of exchange and a store of value.	Real Asset is a product. Money is just a medium of exchange.
<b>VALUE OF MONEY</b>	
Time value is the basis for charging interest on capital.	Islamic finance does not recognize the time value of money. Profit on the exchange of goods & services is the basis for earning profit.
<b>REAL ASSETS</b>	
The expanded money in the money market without backing the real assets results in deficit financing.	In Islamic banking, the financial equilibrium or a balanced budget results from the non-expansion of money.
<b>LOSS SHARING</b>	
Interest is charged even in the case, the organization suffers losses. Thus no concept of sharing loss.	Loss is shared when the organization suffers a loss.

Islamic banking refers to a system of banking, which is consistent with Islamic law, also called “Shari'a”, and guided by Islamic economics. In particular, Islamic law prohibits the payment and collection of interest, also commonly called “Riba” (usury). The main argument against interest is that money is not used as a commodity with which to make a profit but that it should be earned on goods and services only, not on control of money itself

The total volume of Islamic Banking and Finance assets grew to \$US 4 billion globally. Iran, Saudi Arabia and Malaysia were the largest markets of the 60 countries that reported Islamic financial assets, with all three recording more than \$US 500 billion in assets (figure 1).



**Figure 1. Islamic Finance Assets Growth (2015-2021, US\$ Billion) [8].**

The Global Islamic Finance market can be segmented by Financial Sector into Islamic Banking, Islamic Insurance 'Takaful', Islamic Bonds 'Sukuk' and Islamic Funds. By Geographic region Islamic Finance market can be segmented into Gulf Co-operation Council (Saudi Arabia, Kuwait, UAE, Qatar, Bahrain, and Oman), the Middle East and North Africa ( Iran, Egypt, Rest of MENA), South

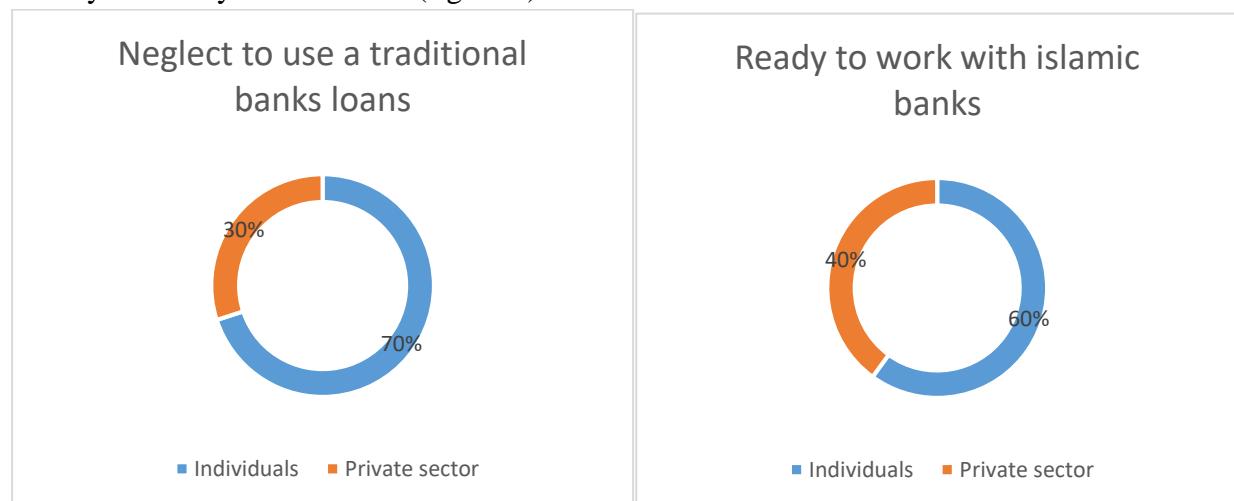
Asia, and Asia-Pacific (Malaysia, Indonesia, Brunei, Pakistan, Rest of South Asia and Asia-Pacific), Europe (United Kingdom, Ireland, Italy, Rest of Europe).

Malaysia is at the forefront in the development of Islamic banking, Islamic capital market and takaful (Islamic insurance). It has a strong and comprehensive Islamic financial system with a robust business driven regulatory regime and legal framework. Malaysia is one of the leading global hub for Islamic finance.

Bahrain is recognized as the global leader in Islamic finance, ranking 2nd in MENA and 4th globally for Islamic finance development (ICD 2021). We set the benchmark early for Islamic banking regulation by establishing the Bahrain Islamic Bank in 1978, and have nurtured the concepts, rules, and standards of Shari'a banking compliance in Islamic banks ever since. In this way, we are able to cater to the needs of both mainstream Islamic finance and the new breed of FinTech entrepreneurs who offer Shari'a-compliant products. Our continued focus on innovation and customer service has made Bahrain a top destination for Islamic finance development.

The growth of Islamic finance industry in CIS countries is slower than other but it is attracting the attention of the global international banking industry due to the rising opportunities in this region. Islamic banking will grow substantially in CIS countries in the next five years from a low base, if their governments took initiatives to boost this sector. Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan can be main players to lead this expansion of Islamic banking & finance in CIS. Uzbekistan is not only enriched with gas, oil and other natural resources but, along with this, it has been the center of knowledge and Islam for a long time. Uzbekistan has very low penetration of Islamic finance, despite a large Muslim population and 100% literacy rate.(figure 2).

Nowadays the demand of Islamic banking services is rising day by day especially in our country. Uzbekistan has all the ingredients for the introduction of Islamic finance – great Islamic heritage and roots, sizeable population, deep interest in Islamic finance, potential to disseminate successful Islamic finance experience to other countries of the region, political stability, good infrastructure, 100% literacy as well as real economic challenges and financial exclusion for a considerable stratum of society driven by faith motives (figure 2).



**Figure 2. Demand for Islamic financial services in Uzbekistan[9]**

The interest for Islamic finance is gradually growing in Uzbekistan. 93% of Uzbekistan's population is Muslims but no local bank nor any foreign institutions offering Islamic banking and capital markets services other than the IDB and ICD. Although more than 9 banks get grant from ICD on Mudarabah base to start Islamic Banking but still waiting for legislation to be passed which allow them to work under Shariah. Foreign institutions are not prevented from engaging in the market without being registered in Uzbekistan provided they satisfy requirements contained in CBU Regulation. In May 2019 the Government of Uzbekistan issued a draft resolution to create infrastructure for Islamic banking and finance in order to foster alternative financing opportunities, expand the range of banking, financial services and to open the doors for Islamic investors from the Middle East. The Government of Uzbekistan is also planning to introduce the issuance of different tenure Sukuk (Islamic Bonds) to address the long-term and short-term liquidity and investment requirements of Islamic finance industry. Many educational institution start offering Islamic Finance education to its senior students. Many Insurance and leasing companies are also working to start Takaful and Ijarah operations to meet the need of the Islamic financial market in the country [10].

The promotion of Islamic finance industry in Uzbekistan will also attract the Foreign Direct Investment (FDI) in the country which will strengthen the economic growth of the country and will reduce the headcounts living under the poverty line.

For Islamic finance to gain an institutional position following actions need to be taken:

- It must be acknowledged 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 should be allowed 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.
- Some Islamic Finance education and training courses at national level should be introduced to increase the basic and practical knowledge of people so that they can adopt this new change [11].

Despite the fact that Islam is a major religion, the Islamic financial sector in Uzbekistan is still relatively underdeveloped compared to its neighbors, although the country has great potential for development. This has been acknowledged by experts from major international financial institutions (Islamic Development Bank Group (IsDB), Islamic Corporation for the Development of the Private Sector (ICD), Asian Development Bank, etc.). However, in recent years, some work has been done in this direction in cooperation with international financial institutions.

Today, various measures are being taken in our country to introduce and develop Islamic financial services in financial organizations. For example, the attraction of credit lines for the development of the private sector ("Murabaha"-payment by instalments) through the International Islamic Trade Finance Corporation. These financial lines were allocated to commercial banks as well, "Trustbank", "Infin Bank", "Asaka bank" and "Uzpromstroybank".

Small and medium-sized businesses provide 81% of employment in Uzbekistan, and over the past 10 years, they have contributed to the country's gross domestic product (GDP) growth at an average annual rate of more than 5%. Uzbekistan is becoming the fastest growing economy in Central Asia. The mutually beneficial relationship between these organizations and the government has paved the way for Islamic finance to enter the Uzbek market and has taken the first step in this area [12].

According to a survey conducted by the United Nations Development Program in early 2020 on the analysis of Islamic financial products in Uzbekistan and a relevant survey, the main reasons for not using bank loans are religious beliefs, high-interest rates and the complexity of lending. If Islamic financial institutions are established in the country, the majority of respondents in the above survey noted that they can use the services of these institutions. Even traditional banks have expressed their views on the establishment of Islamic financial institutions in Uzbekistan, the emergence of fair and transparent competition in the financial sector, which will lead to an increase and diversification of investment flows into the country.

As a result of this work, Uzbekistan will undoubtedly become a leader in the field of Islamic finance among the CIS countries. The Islamic financial services sector will be an important factor, and foundation for the bright future of Uzbekistan, which will increase the interest of foreign investors in the country, which reflects the deep roots of Islam in its culture, and the government will take full advantage of this opportunity.

## **Conclusion**

Summarizing the above analysis, it can be pointed out that the establishment of Islamic finance is an important factor in the development of the Uzbek economy. Islamic finance is a new direction for the economy of Uzbekistan.

The emergence of alternative financial products contributes to the expansion of the population's access to financial services. However, existing expectations can be significantly distorted due to the lack of knowledge and experience of potential clients in the field of Islamic finance, imperfections in banking and financial legislation.

There must be a legal basis for the Islamic banks to start operating and carry out their activities at their fullest in Uzbekistan. Hence, as mentioned above, the activities of Islamic finance have their own characteristics and differ from traditional banks. At the same time, it should be noted that after the address of the President Shavkat Mirziyoyev to the Oliy Majlis (Parliament) and laments that it is the high time to create a legal framework of Islamic finance and the President informed that from 2022 year the new law "On non-bank credit institutions" will include the concept of Islamic finance. We can say that with the adoption of this long-awaited law in Uzbekistan, Islamic banks will have the opportunity to fully implement their activities. At present, officials should also keep in mind that the introduction of Islamic financial services in Uzbekistan will be carried out by parallelly solving a number of problems related to the lack of human resources, and the need on increasing literacy among prominent consumers.

## **References:**

[1] ICD-REFINITIV Islamic Finance Development Report 2022

- [2] Decree of the president of the Republic of Uzbekistan "On the strategy of Uzbekistan — 2030" dated September 11, 2023 No. 158 DP-158
- [3] Muhammad Taqi Usmani "an Introduction to Islamic finance" Study guide. 2021 y. page 6
- [4][https://www.internationalinvestor.com/chile/sectors/metals-mining/ps\\_if\\_projected-growth-of-islamic-finance-assets-to-2021/](https://www.internationalinvestor.com/chile/sectors/metals-mining/ps_if_projected-growth-of-islamic-finance-assets-to-2021/)
- [5] Astanakulov O. Islom moliya asoslari: taraqqiyot bosqichlari, istiqbollari. "Iqtisodiyot va innovatsion texnologiyalar" ilmiy elektron jurnalı. №5, sentyabr-oktyabr, 2021 y.
- [6] <https://cyberleninka.ru/article/n/islom-moliyasi-va-banki>
- [7] Compiled by the author
- [8] ICD-REFINITIV Islamic Finance Development Report 2022
- [9] Analysis of Islamic Financing Instruments in Uzbekistan" –UNDP Survey conducted in 2022
- [10] <https://alhudacibe.com/pressrelease>
- [11] <https://www.isdb.org/uzbekistan>
- [12]<https://m.kun.uz/en/news/2020/08/04/uzbekistan-can-become-a-cis-leader-in-islamic-finance>