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## The Ways of Development of Islamic Finance in Uzbekistan

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**Annotation:** The article discusses the features of the development of the Islamic finance system, 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. In addition, the main directions of the development of Islamic finance in the Republic of Uzbekistan are presented.

**Key words:** Islamic finance, Islamic banking, takaful, murabaha, riba, sukuk.

### Introduction

The modern financial system, generating crises on a global scale, requires the need to diversify national financial markets based on the introduction of new principles and tools. Today, Islamic finance is such an effective alternative, which has proved not only its viability, but also turned out to be the least susceptible to crisis phenomena.

Islamic Finance is one of the fastest growing industries in the world. Legislation on Islamic finance has been introduced in about 60 countries around the world, including three Central Asian states: Kazakhstan, Kyrgyzstan and Tajikistan. Total assets of more than 1500 Islamic financial institutions operating around the world exceed 3.5 billion US Dollars.

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.

In this regard, the President of the Republic of Uzbekistan Sh. Mirziyoyev in his Address to the Oliy Majlis on December 29, 2020 said, "It is time to create a legal framework for the introduction of Islamic financial services in our country. Experts from the Islamic Development Bank and other international financial institutions will be involved in this".[1]

### Literature review.

According to Ernst & Young, in 2018, Islamic finance reached \$ 5 trillion worldwide. According to the Islamic Economic Research Agency (ICRA), it reached \$ 6.5 trillion in 2020.

Economists Ishmukhamedov (2011) and Zaripov (2016) noted in their scientific articles that in the modern world Islamic finance is developing steadily and demonstrating high growth rates, and new term "capital efficiency" was introduced into Islamic finance instead of the traditional concept of "money price".

Dzhuravlev (2017) noted that, creating a legal framework, traditional and Islamic financial institutions can operate in the same legal field, in which case two separate laws can be applied to regulate them.

Gambееva Yulia Nikolaevna and Medvedeva Svetlana Nikolaevna (2018) 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.

Abrorov (2019), who conducted research in the field of Islamic finance in our country, also noted in his scientific article that one of the main factors of the growing interest in Islamic finance is its steady growth. [2]

### 3. 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.

### 4. Analysis and results.

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.

“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,”

The total volume of Islamic Banking and Finance assets grew to \$US 3.5 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.)

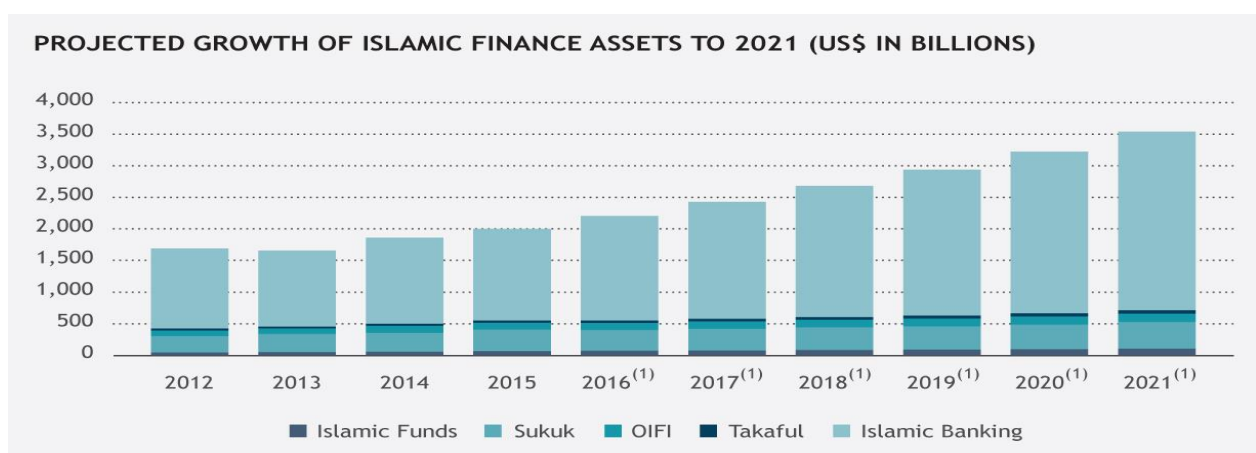


Figure 1 Islamic Financial Assets 2021 (Billion USD).[3]

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).(figure 2.)



Figure 2 Islamic Finance Assets by Region 2021 (US\$ Billion).[4]

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 3.)**

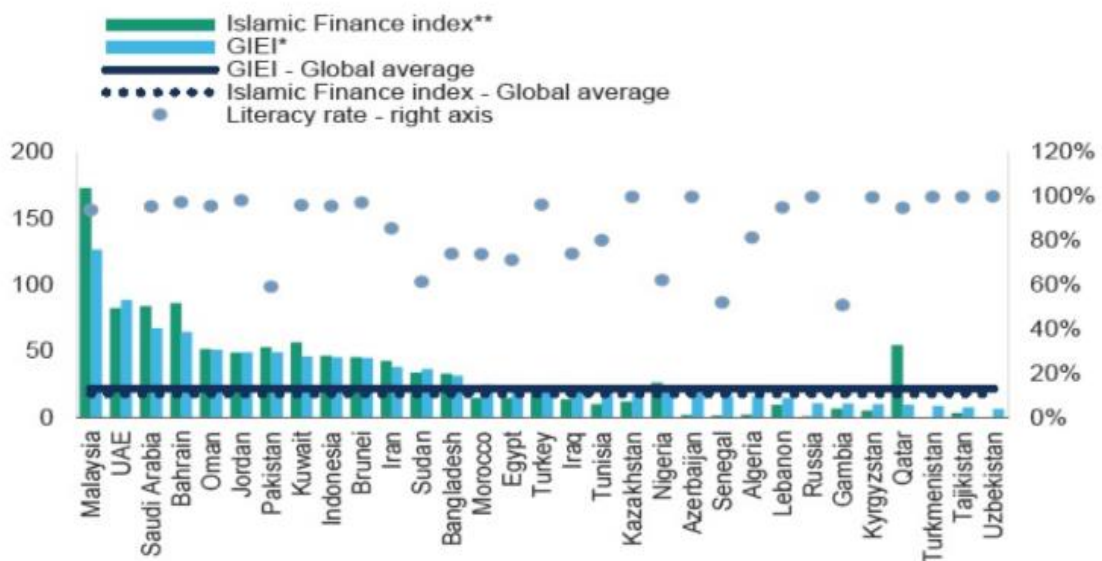


Figure 3 The role of Islamic finance in the economy of countries.[5]

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

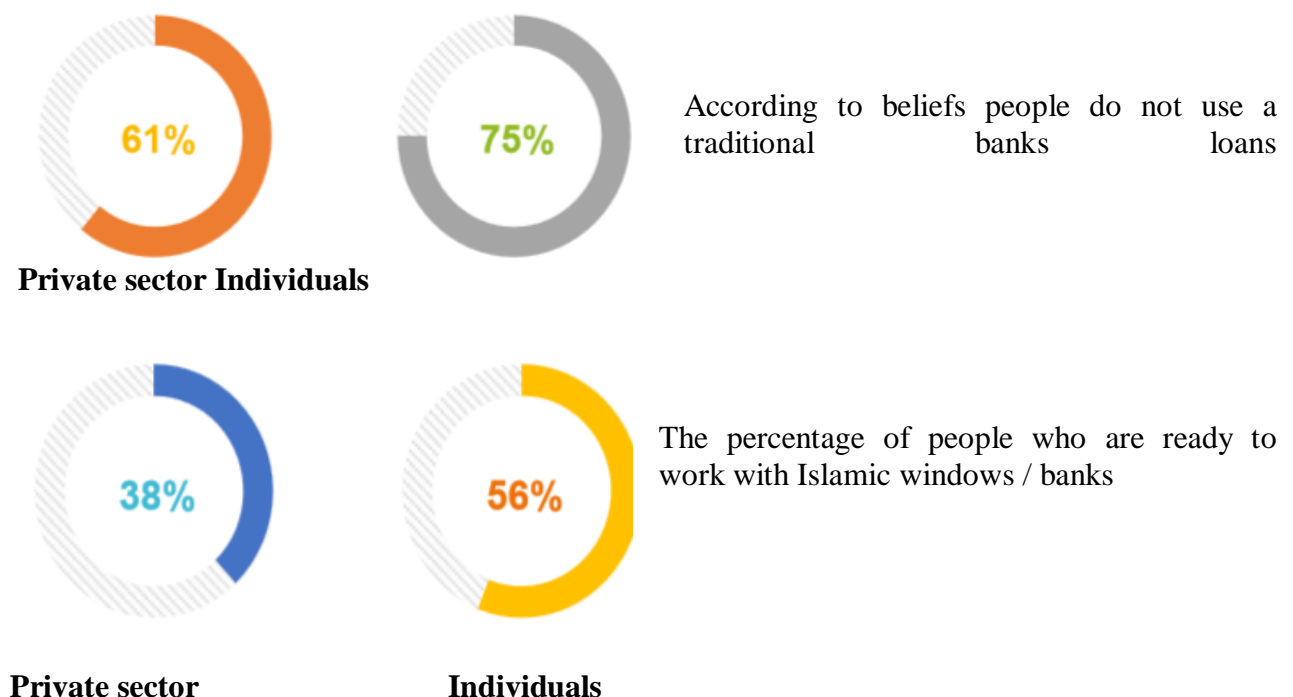
the Middle East. The Government of Uzbekistan is also planning to introduce the issuance of different tenure Sukuk (Islamic Bonds) to address the long-term and short-term liquidity and investment requirements of Islamic finance industry. Many educational institution start offering Islamic Finance education 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.[6]

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.[7]



**Figure 4 Demand for Islamic financial services in Uzbekistan.[8]**

One of the basic assumptions is that Islamic financial services should mainly attract Muslims, who represent about 93 percent of the Uzbekistan population or about 32 million in number. Other communities may also be marginally interested. This is particularly true in the early stages of development of Islamic finance in a country. Later, with an increase in awareness of Islamic finance, non-Muslims also tend to patronize Islamic banks. This has certainly been a trend in

countries like Malaysia where an increasing number of Chinese are using Islamic financial services, after an initial reluctance for over 15 years.

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.

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.[9]

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 parallels solving a number of problems related to the lack of human resources, and the need on increasing literacy among prominent consumers.

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