

ANALYSIS OF THE PROBLEMS AND FUTURE EXPECTATIONS IN THE PROCESS OF IMPLEMENTING ISLAMIC FINANCE IN UZBEKISTAN

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***Abstract:** This article analyzes the latest trends, problems, and solutions in the process of implementing Islamic finance in Uzbekistan. Additionally, it discusses the impact of introducing Islamic finance on the country's economy and financial markets.*

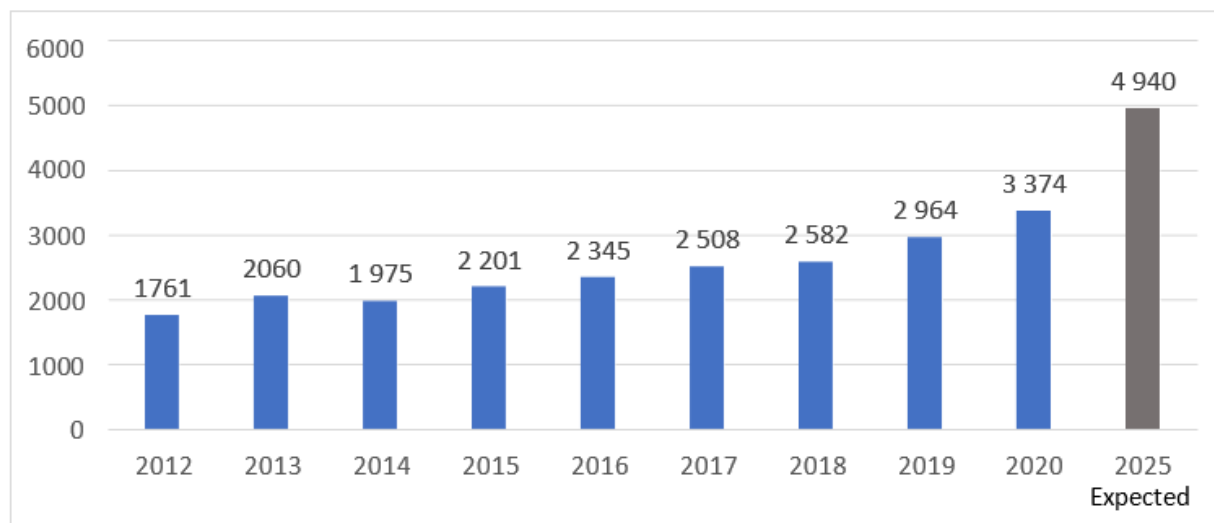
***Key words:** Currency, capital, inflation, GDP, investment, economic growth.*

In recent years, various negative and fluctuating changes occurring in the world economy are affecting the economy of Uzbekistan. This, in turn, creates the necessity to diversify the economy and attract funds from financial markets to maintain stable growth rates and further development of the economy in Uzbekistan. In this process, Islamic finance can create new opportunities for the Uzbek economy. The Islamic economy places special emphasis on the fair distribution of wealth within society and, thus, the provision of social stability. The most equitable method of creating and distributing wealth is through partnerships, as it creates certain conditions for the results of the activities to be fairly distributed among all partners.

The economy of Uzbekistan has been experiencing high levels of growth in recent years. The government is implementing extensive reforms aimed at liberalizing the economy, reducing state intervention, and increasing sources of financial resources. In this context, special attention is also being paid to Islamic finance. In particular, the decision of the President of the Republic of Uzbekistan dated March 5, 2019, No. 4224, regarding "Further Expansion of Cooperation with the Islamic

Development Bank Group and the Arab Coordination Group Fund" can be considered the first step in implementing Islamic finance. Additionally, in the President's address to the Oliy Majlis on December 28, 2020, it was emphasized that "it is time to develop the legal framework for Islamic financial services. Experts from the Islamic Development Bank Group and other international financial organizations will be involved." As a result, the 46th annual meeting of the Islamic Development Bank Group was held in Tashkent from September 1 to 4, 2021. During this meeting, the Islamic Development Bank provided a grant of \$265,000 to the Government of Uzbekistan for the development of the legal framework for Islamic finance. Consequently, the necessary legal documents for the implementation of Islamic finance in our country began to be developed. One of the first outcomes of this was the regulation on "The Procedure for Providing Islamic Financing Services by Microfinance Organizations," which was developed by the Central Bank and registered by the Ministry of Justice on July 26, 2024. Additionally, a law on Islamic banks is expected to be adopted by the end of 2024. Within the framework of Uzbekistan-2030 strategy, the sixth goal is to implement the principles and regulations of Islamic finance in at least three commercial banks under the direction of "Accelerating Reforms in the Banking System, Increasing the Volume of Banking Services Market, and Developing Competition in the Sector." Since the Islamic finance sector is one of the fastest-growing sectors in the world and is being utilized in more than 50 countries, the total assets of Islamic financial institutions exceed \$3.9 trillion. This indicates that this type of financing is widely adopted globally. During the global financial and economic crisis, many banks and insurance companies faced the risk of being unable to fulfill their obligations. While most of them were in crisis, Islamic financial institutions not only managed to reduce the negative impact of the global financial crisis but also succeeded in developing their operations. According to data provided by IFSL (International Financial Services, London), in 2008, when the global financial

crisis peaked, the strength of Islamic financial institutions grew by 20.3% compared to the end of 2007, increasing from \$758 billion to \$951 billion.



1. The Growth of Islamic Finance Assets

The rapid development of the financial sector in Uzbekistan is being observed, opening new prospects for investors and the country's population. The comprehensive implementation of Islamic finance services in Uzbekistan offers the following opportunities for the country:

- Increasing and diversifying the volume of foreign investments;
- Creating a fair and transparent competitive environment in the banking sector and diversifying the assets of the banking system;
- Ensuring the maximum participation of idle funds held by the population and business representatives in the development of the economy;
- Developing and diversifying the capital market in the country;
- Creating numerous new job opportunities;
- Raising financial literacy among the population, thereby increasing their activity in the financial market;
- Coordinating and modernizing infrastructure through the development of the Islamic finance services industry;
- Establishing new financial institutions;

- Creating a program for training specialists in a new direction.

In order to study the demand for Islamic banking and financial products and services in Uzbekistan, the application of Islamic financial products, and the opportunities for attracting investments in this sector, a study was conducted in 2020. This study was carried out within the framework of the "Financing Sustainable Development in Uzbekistan" project, which is being implemented in cooperation between the United Nations Development Programme, the Chamber of Commerce and Industry of Uzbekistan, and the Ministry of Finance. The research focused on the implementation and application of Islamic financial products in Uzbekistan. As part of the study, a survey was conducted among the population, business representatives, and commercial banks. The survey included 27 commercial banks, 2,235 entrepreneurs, and 4,938 individuals. The results revealed that the main issue for businesses and individuals was that traditional loans do not comply with Islamic principles. Specifically, 38% of business representatives and 55% of individuals stated that they do not use traditional loans due to their religious beliefs. Additionally, 61% of business representatives and 75% of individuals expressed a desire to conduct their financial operations with Islamic financial institutions if they begin operating in Uzbekistan. Furthermore, 44% of businesses and 42% of individuals mentioned that, if the Islamic banking and finance system were introduced in Uzbekistan, they would invest their available funds in Islamic bank deposits and partnership projects. Although Islamic finance has not yet been fully implemented in Uzbekistan, the Islamic Development Bank (IDB) Group has provided financial resources to the country based on Islamic finance principles. Notably, the Islamic Corporation for the Development of the Private Sector (ICD) has played a significant role in the development of Islamic finance in Uzbekistan. To date, the ICD has directed a total of \$400 million through 18 commercial banks and 2 leasing companies in the

country, directly financing more than 260 small and medium-sized enterprises (SMEs), which has led to the creation of over 5,000 new jobs. The policy of attracting foreign investments to the economy must take into account the unique aspects of the country, including its geographical, political, socio-economic conditions, as well as its national and religious values. Otherwise, foreign investors may face various challenges, which could negatively impact other potential investors, discouraging them from investing in the country. There are also qualitative changes occurring in the composition of investment sources. From 2005 to 2021, the share of direct investments in total investments increased, reaching 42.6% by 2021. In total, \$8.6 billion in foreign direct investment was attracted to Uzbekistan in 2021. Although this is lower than the \$9.3 billion recorded in 2019, there is no doubt that these figures reflect the results of ongoing economic reforms. Despite the programs being implemented and the measures being taken, the likelihood of a significant increase in the flow of investments into the country's economy in the coming years remains low. This is due to several persistent issues, particularly in the banking and financial sectors, in addition to the previously mentioned challenges:

- The challenges related to meeting the financial needs of entrepreneurs, including the high cost of financial resources and the lack of genuine competition among banks;
- The absence of investment funds, companies, and asset management firms that could enhance the competitive environment in the financial market;
- Despite the majority of the population being Muslim and there being demand due to this reason, Islamic banking and financial products and services have not yet been implemented;
- The shortage of qualified specialists in the fields of IT, financial engineering, and Islamic finance.

Today, attracting the attention of foreign investors and ensuring their investment in the country's economy is no easy task, as various countries are launching new innovative tools each year to enhance the attractiveness of their investment environments. In this regard, it is important to note that there is very little attention being given to developing Islamic finance and banking, and consequently attracting investments from Middle Eastern countries, primarily from the Gulf States and directly from international Islamic financial institutions. So far, the funds attracted from Islamic financial institutions have been mostly limited to the Islamic Development Bank Group. If the tasks mentioned above are successfully implemented, Uzbekistan has the potential to become a leading country in the field of Islamic finance among the CIS nations.

Research conducted by international organizations shows that there is high demand for Islamic finance and banking products in Uzbekistan. In particular, representatives of small and medium-sized businesses encounter many problems related to attracting financial resources during their activities. Complex requirements for bank loans, high-interest rates, and issues related to guarantees or collateral are among these challenges. Similarly, the general population faces issues with banks, specifically the uniformity of terms and offers for deposits across all banks, the lack of innovative solutions related to savings offered by banks, and the absence of investment funds. All these factors, in turn, lead to a shortage of funds available to finance entrepreneurs in banks. Due to these circumstances, approximately 70% of small and medium-sized businesses attempt to self-finance through their own savings or by borrowing from family members and friends. This clearly indicates not only the inefficiency of the Uzbek banking system in meeting the financial needs of small and medium-sized enterprises but also contributes to the circulation of funds outside the official banking and financial system, thus fostering the development of the shadow economy. In this context, introducing an Islamic finance system as an alternative to the traditional banking system may serve as one of the solutions to existing problems and a means

to facilitate venture financing, potentially yielding certain positive results. Therefore, the field of Islamic financial services can be a crucial factor and foundation for Uzbekistan in achieving high economic indicators. This can lead to increased interest from foreign investors in the country and enable the government to fully utilize this opportunity for the welfare of the people and the sustainable development of the nation.

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