



ISLAMIC FINANCE: NEW PROSPECTS FOR UZBEKISTAN

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The Islamic financial system is one of the fastest-growing systems in the world, which is actively strengthening its position internationally. This is evidenced by the fast growth in the number of Islamic financial institutions, the opening of Islamic windows and branches by traditional banks, as well as the growth in sales of Islamic securities on leading stock exchanges. The global financial and economic crisis of 2008 and the global financial crisis caused by the COVID-19 pandemic made it an urgent task to use and expand Islamic financial mechanisms that rely on the real sector and contribute to the development of society. This article presents the results of the research, including a survey on the opportunities for the introduction and development of Islamic finance in Uzbekistan.

Islamic finance • sukuk • issue • real economy • financial market

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INTRODUCTION

Governments are taking steps to transform the financial sector to maintain economic stability. In particular, in 2021 Uzbekistan plans to issue sukuk-Islamic securities on a trial basis. It is planned to attract local and international investors, develop the financial market and accelerate the reform process [1]. In addition, starting this year, several commercial banks intend to launch Islamic Window services. It is known from world experience that these processes are the first stages of the introduction of Islamic finance.

While Islamic financial products were rapidly introduced and developed all over the world in the second half of the twentieth century, in the twenty-first century Islamic finance is subject to financial crises, fair distribution of risks, reliance on real assets





and expensive services for the economy. Islamic financial services and products, especially sukuk, are also widely used in developed countries where Muslims are sparsely populated.

Research shows that although the share of Islamic finance in the global financial structure is small, their growth rates are high and their efficiency is much higher.

LITERARY REVIEW

Among the scientists of the CIS countries are V.Antropov [2], T.Gafurova [3], S.Mokina [4], O.Trofimova [5], I.A. Zaripov [6], I.Bekkin [7]. Their work reflects the issues of Islamic securities and Islamic finance.

Researchers in the field of Uzbek researchers X. Khasanova [8], [9], M.Sultanova [10] and O. Davlatyarov [9] also conducted research in this area, and this work continues today. Also, B.Juraev [11], [12], [13] translated from Russian into Uzbek some literature on Islamic finance. In addition, our previous works [18], [19], [20] are also related to this area. These scientific works are based on the theoretical foundations of Islamic finance and the activities of Islamic financial institutions, and sukuk has not been studied on a scientific basis.

Although the number of scientific research related to sukuk is growing, it is relatively small compared to other fields. For this reason, it is very important today to conduct a study on the introduction of sukuk in Uzbekistan to increase the activity of the stock market and attract public funds.

Ibrahim and Mina studied the importance of sukuk to attract investment in enterprises [14]. The results show that it is worthwhile for enterprises with smaller and higher investment potential to issue sukuk. It is also inevitable that the government's support for the sukuk market will give a positive result.

There is little scientific research on the impact of sukuk on the economy, and the first attempt has been made to study the impact of sukuk issuance on GDP, gross fixed capital growth and trade. [15]. This article examines the impact of sukuk issuance on GDP, fixed capital growth and trade processes in 2005-2012. And it was found that sukuk issuance has a positive effect on GDP when all the issuing countries combined. Although the studies did not yield the expected results, they are important because they have taken a new direction. It is noteworthy that subsequent research in this area has led to significant results [16]. The work differs from the previous one in other factors and the choice of style. The influence of sukuk on the economic development of sukuk-issuing countries in 2000-2015 was studied. As a result, sukuk supports economic growth in the long term. Corporate and state sukuk play an equal role in this.





RESEARCH METHODOLOGY

The article uses scientific abstraction, empirical, descriptive statistics, expert assessment, grouping, dynamic analysis and survey methods.

ANALYSIS AND DISCUSSION

The main objective of the survey was to study how the population and entrepreneurs can meet their financial needs through existing banking and financial institutions, what obstacles they face in this process (formal and informal), as well as their demand for Islamic financial services, institutions and their financial products.

Also, the survey attempts to explore the opportunities and propose the necessary steps and procedures for implementing an Islamic banking-financial system in the Republic of Uzbekistan.

The survey was conducted among business representatives, banks and individuals.

Business representatives/entrepreneurs

The survey was conducted in the form of direct conversations between 1,000 (one thousand) entrepreneurs/business representatives, and another 1,235 surveys were conducted online, using the Google form and Survey Monkey software. Thus, a total of 2235 entrepreneurs (business representatives) were surveyed.

Banks

Official letters were sent to all commercial banks in the country (30) with the application form attached, and response letters (along with completed questionnaires) were received from 27 banks.

Individuals

The survey was conducted online using Google form and Survey Monkey software. A total of 4938 respondents took part in the survey.

Both individuals and businesses were asked if they were aware of and fully understood Islamic finance products/ financing methods. Ijara (leasing) is the most known Islamic finance products among both group of participants followed by Mudarabah agreement. Salam, Istisna, and Sukuk were the least known financing agreements by respective participants.

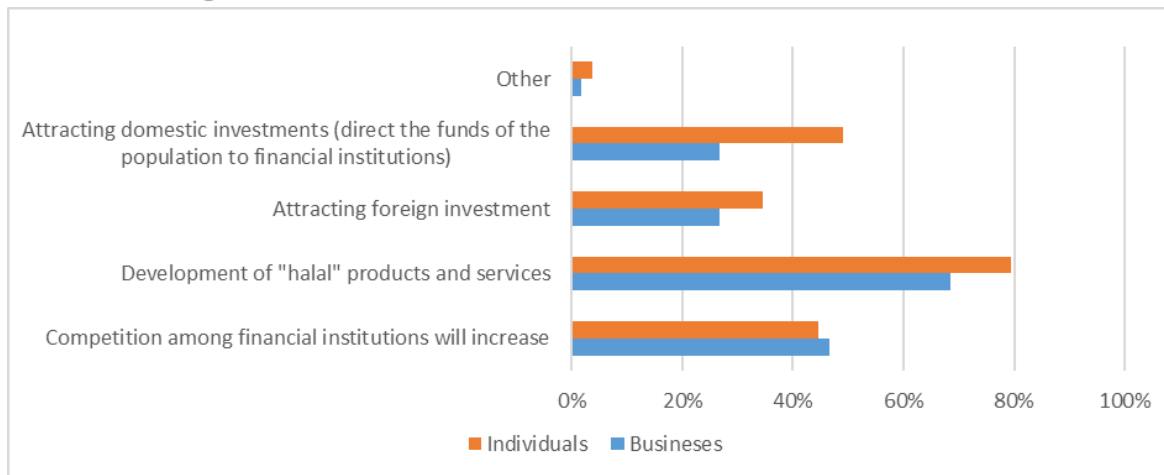


Figure 2: The impact of implementing and developing IF system in Uzbekistan

Furthermore, in case of the development of Islamic Finance system in the country, 79 percent of individuals and 68 percent of businesses believe that it will impact the development of “halal” (permissible) products and services in the market, while 45 percent of individuals and 47 percent of businesses are of opinion that IF will increase the competition among financial institutions in the country as described in figure 2.

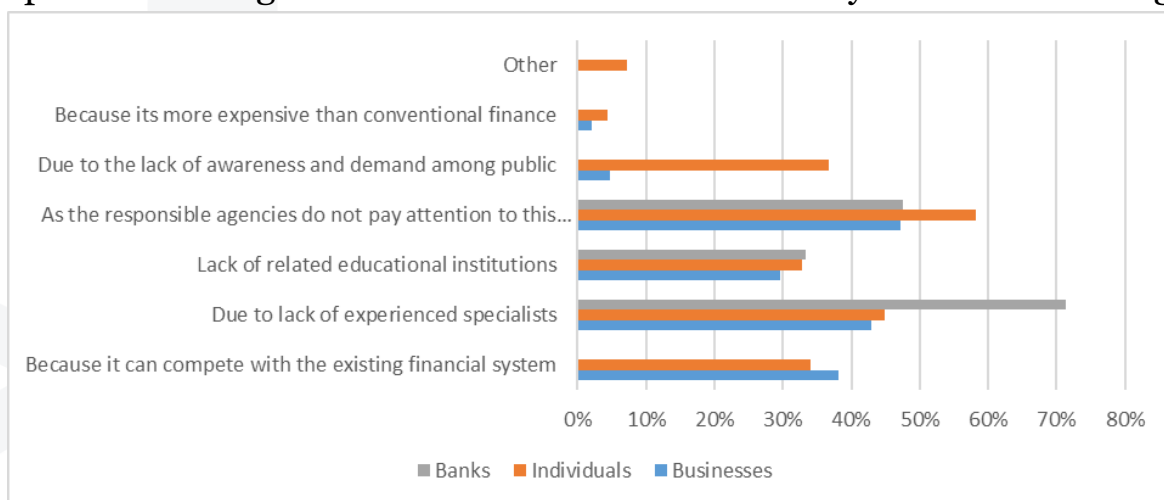


Figure 3: Reasons for not having Islamic Finance services in Uzbekistan

However, 47 percent of businesses and 58 percent of individuals held pessimistic views about the possibility of implementation of Islamic banking and finance in Uzbekistan by stating that responsible agencies were not paying much attention to this area. Other factors included competition, lack of specialists, lack of educational institutions, etc. (Figure 3).



Despite the pessimism, respondents acknowledged that the demand for Islamic finance products and services would be “average (39 percent of businesses) to high (42 percent of individuals)” in Uzbekistan. Also, businesses were asked about types of Islamic Finance products that could be successful. Ijara (26 percent) along with Musharakah and Mudarabah (24 percent) were expected to be the most successful, while 43 percent of businesses could not name products that could be the most demanded in the local market.

Banks were asked if they would support Islamic finance including the establishment of Islamic banks in the country. All 27 banks stated they would fully support the opening of Islamic banking in Uzbekistan. Some banks commented “yes, we will support as almost 90 percent of the population are Muslims and there is a high demand from businesses”. 67 percent of banks considered that implementation was very necessary because it would increase competition among financial institutions, the market for “halal” products and services would develop, and more investments would come from Muslim countries.

26 percent of banks considered it a good option to establish because individuals and entrepreneurs need to be offered a variety of new products and services. In contrast, 2 other banks (7.4 percent) think that opening one or two Islamic banks is enough due to low demand, or even opening an Islamic window will cover the market need.

Table 1. Capacity to introduce Islamic Finance system in Uzbekistan

Do the banks have enough capacity to implement the Islamic banking in the short term period?	Numbers	Percentage
Yes, we have enough trained professionals to start our business in this field	3	11.11%
Yes, though we have limited knowledge about how IB operates but we welcome to open it	12	44.44%
We know only the basic principles of Islamic banking, but it is not enough to start activity in this area	12	44.44%
We have no specialists who have the necessary knowledge and skills in this sphere	0	0.00%
Total	27	100.0%

Upon further investigation about introducing IF system in the short term, 44 percent of banks are in the opinion that commercial banks have no enough opportunities but they are ready to develop this system, while 44.44 percent are in the opinion that they know the main principles of how IF system works but it is not sufficient to launch it. Table 1 summarizes the results.



Banks are also of the opinion that there is a high opportunity (81 percent of banks) for attracting financial resources of the population into savings or partnership agreements in the case of implementation of IF in Uzbekistan due to the high demand for IF products among the population. In contrast, 15 percent of banks (4 banks) show the opposite opinion that opportunities are low as demand is low, while 4 percent say there is no opportunity as there is no demand in the market.

Upon further investigation on which types of Islamic finance products/ financing instruments will be more effective in promoting entrepreneurship in the country, 81 percent of bankers stated Musharakah and Mudarabah as they are based on partnership, followed by Murabaha (66 percent) and Ijara (66 percent).

Both individuals and businesses think that social networks/ websites, special TV programs, training, and university courses are the most effective way to transfer knowledge and skills in the field of Islamic Finance, while for 74 percent of banks internships at Islamic financial institutions is considered the most effective way for learning IF followed by training and seminars (67 percent)

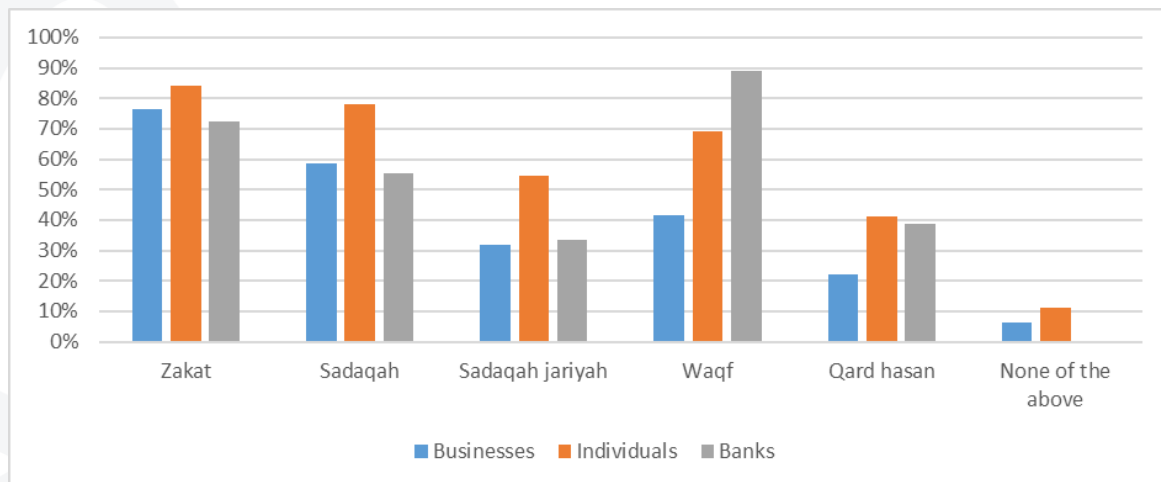


Figure 4: Types of Social Finance known by respondents

Interestingly, there is a very high level of awareness found pertaining to various types of Islamic Social Finance by individuals, banks, and businesses alike such as zakat, sadaqah, and waqf as displayed in Figure 4.

60 percent of businesses, 75 percent banks and 73 percent individuals believed that Islamic Social Finance can help alleviate poverty in Uzbekistan, and 55 percent businesses, 75 percent banks and 83 percent individuals believed that it can provide more Sharia compliant services to the public as described in figure 5.

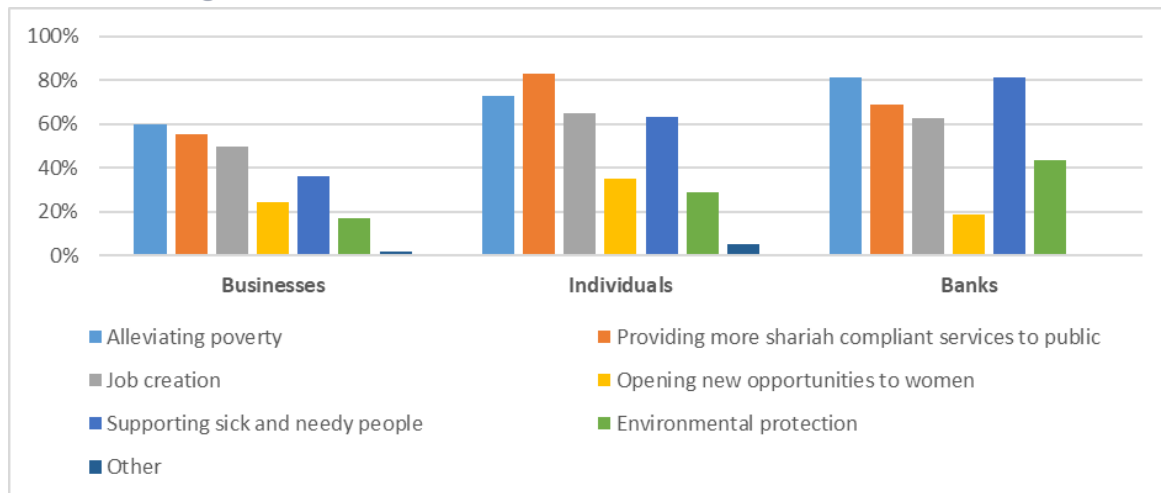


Figure 5: Benefits of Social Finance

When asked about the zakat payment, 64 percent of businesses stated their willingness to pay zakat on corporate activities, while 81 percent of individuals were willing to do so. Furthermore, 25 percent of businesses and 17 percent of individuals, though stated their willingness to pay zakat but did not have adequate knowledge on the calculation methods and technicalities of zakat.

Bankers were given open-ended questions on how Islamic banks could contribute to economic development in Uzbekistan. 12 banks stated that Islamic banks would diversify funding sources and give interest-free loans to SMEs; Investment funds would be attracted from Muslim countries (from OIC member countries); the public would increase its confidence in banks; idle funds on the hands of the public and businesses would be invested in permissible (halal) projects/products through banks which will increase healthy competition among financial institutions and contribute to the GDP of the country; it will help to alleviate poverty by mobilizing funds appropriately; there will be justice in the financial transactions; literacy on Islamic finance products among public and bankers will also expand. Some banks also stated that according to their research 30 percent of the population do not use conventional banks' services due to religious reasons and they believe that if Islamic banks start operating here this gap will be narrowed down.

According to ADB study, 30% of the population did not use traditional banking loans due to their religious beliefs, and the opening of Islamic banks would fill this gap.

Obstacles: Banks were also asked about the biggest obstacles and problems to the introduction of Islamic banking in Uzbekistan. The respondents stated the biggest problem was the lack of a legislative framework regulating Islamic finance products and services and that the current legislation of banking and taxation was not adapted for banks operating based on Islamic law principles. They also pointed to the



inconsistency of local tax and banking legislation with the nature of Islamic finance operations, and the difficulty of processing Islamic products in the existing banking software systems. It was also recommended that the new legislation on Islamic banking and finance be made along with regulation covering Islamic insurance. Another obstacle that the country faces is insufficient expertise in Islamic finance area.

Suggestions by Banks:

Banking legislation should be amended in a short period to establish Islamic banking and finance operations in Uzbekistan;

Cooperation with developed countries and Islamic banks should be enhanced to attract international funding;

AAOIFI certificates to be introduced, and bankers in the field of Islamic banking and finance should be trained;

Through the implementation of Islamic finance, the country will be able to introduce new types of financing instruments for the financial and banking sector, analyze foreign experience, reduce their shortcomings and risks, and effectively develop the sector in the short run. At the same time, the formation of partnership skills between the parties will be achieved.

To introduce partnership-based or ethical (Islamic) financing in the Republic of Uzbekistan, it is necessary to form a corresponding legal and regulatory framework which, in turn, will allow the country to receive additional capital and offer alternative financing mechanisms to the population.

CONCLUSION

The demand of society is a key factor in the formation and development of Islamic finance, especially the sukuk market. In the financial system, Islamic finance has already formed as a separate sector, and the existing rules of trade in Sharia have become the basis of the modern Islamic financial system. Today, this system is effectively used even in countries with a small Muslim population.

The conclusion drawn from the experience of dualistic countries that have introduced Islamic financial instruments and products is that Islamic finance brings economic growth and efficiency to society, competing on an equal footing with the traditional financial system. The analysis shows that the increase in the issuance of sukuk, an instrument of Islamic financing, has a positive effect on economic growth. In our opinion, sukuk issuance has a positive impact on the economy due to the following factors: Firstly, Muslims who cannot invest in traditional bonds are attracted to the economy due to the presence of factors such as usury and maysir from the point of





view of Sharia. vision. Secondly, it is a convenient tool for reducing the level of risks by diversifying the investment portfolio. Thirdly, the principle of risk sharing encourages the issuer of sukuk to implement more investment projects. Fourth, the development of the stock market will increase competition among financial sector participants.

Our hypothesis about the high need for Islamic finance, since the majority of the population of Uzbekistan professes Islam, was confirmed by the results of the survey. The conclusion from the entire analysis is that the introduction of Islamic finance will serve as a new factor in the development of the economy of Uzbekistan.

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