

# ACTUAL ISSUES OF ISLAMIC FINANCING IN THE CONTEXT OF REFORMS

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**Abstract:** *This article highlights the importance of Islamic financing in the context of reforms, a brief interpretation of Islamic economics. Financial instruments such as murabahah, musharakah, muzabahah and analysis of projects implemented at the expense of the resources of the Islamic Development Bank in Uzbekistan over the years are studied.*

**Keywords:** *Murabahah; muzabahah; Islamic finance; istisna'; musharakah; IsDB; ICD; MENA; ETF; sukuk; takaful.*

Foreign experience shows that the mechanism of Islamic finance as a form of alternative financing is rapidly developing and improving. Islam and finance are complementary elements of the Islamic economic model. It is explained in some literature that the scientific study of Islamic finance as a science began in the 1970s. The Islamic financial system can be described as a set of financing mechanisms and methods that allow economic activity without violating the basic principles established by Sharia.

Muhammad Najatullah Siddiqui briefly formulated the main tasks of the Islamic economy as follows:

- to meet the basic requirements for education and medical care, housing, clothing and food for all people;
- providing equal opportunities for all without exception;
- prevention of accumulation of wealth and elimination of inequality in the distribution of income and resources;
- to give everyone the same opportunity for spiritual development;
- ensuring stability and economic growth for the implementation of the above goals.

Nowadays in Uzbekistan's mortgage market, the widely used mechanism for buying houses is actually explained by the concept of istisna' in Islamic finance. Istisna' is a sales contract between two parties, according to which the buyer must

build or prepare to order, agrees to purchase goods that are not available. Or, as another example, we can cite auto loans, unlike conventional finance in Islamic finance, when taking a car on a loan basis, the bank first transfers the ownership of the loan object to its own name. This can be an example of murabahah activity.

One of the most common forms of doing business in modern finance is partnership, and in Islamic finance it is characterized by the concept of musharakah, that is, musharakah reflects the partnership of two or more people, in which the parties pool their funds for a common project and according to the rule of proportional participation establish an enterprise. Also, the type of activity carried out by investment companies is explained by the concept of muzorabah in Islamic finance. Muzorabah is a partnership agreement made for profit, one party (rabb al-mol) participates with capital, and the other party (muzorib) participates with his own business activities to manage the capital.

The unique feature of the Islamic economic model is that it takes into account the spiritual, social needs of people in addition to their material needs, and therefore approves the laws of the free market in general, in order to ensure the interests of society and to prevent the absurdity and injustice that may be allowed in the market.

"What can be produced?" The model of Islamic economy solves this problem by paying attention to the true nature of the human being and his needs, and it does not aim to satisfy all the unlimited desires of the human being.

It can be said that the goal of the Islamic economy model is to create a morally responsible market economy system. One of its unique aspects is to satisfy the real needs of the individual and the society. The Islamic economic model places special emphasis on the fair distribution of wealth within society, without which it is impossible to ensure social harmony (harmony) and economic growth.

With a 72 percent stake in Islamic finance assets in 2022, Islamic banking is the largest contributor. Additionally, the industry's fastest-growing segment is this one. In terms of assets, the Gulf Cooperation Council (GCC) and other Middle East and North Africa (MENA) nations, such as Iran, are getting closer together. In 2022, their combined assets will reach USD 1,4 trillion, up from USD 1,2 trillion for the

GCC and USD 1,1 trillion for Other MENA. At 13 percent and 23 percent, respectively, both areas' asset values from 2021 have also increased significantly.

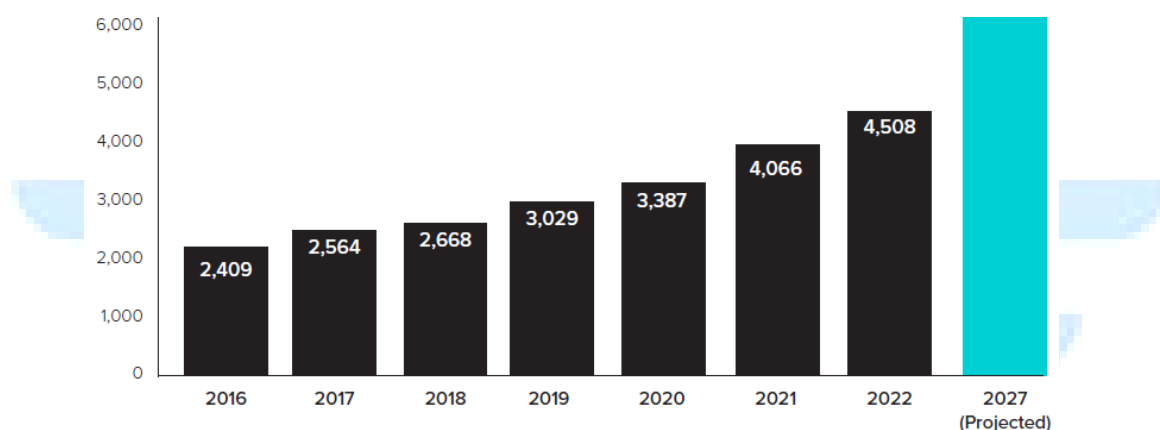


Figure 1. Islamic finance assets growth (2016-2022, USD bln) [1]

The world's financial sector struggled in 2022 with an unstable economy marked by fluctuating commodity prices internationally and a worldwide supply chain that had not fully recovered to its pre-pandemic stability. These factors conspired to raise inflation rates. Throughout the year, there were moments when central banks tightened monetary policy and raised interest rates repeatedly, pushing yields to all-time highs. At those moments, financial institutions (and their clients) held their breath. In this context, the global Islamic finance industry's growth decreased from 17 percent in 2021 to 11 percent with assets valued at 4,5 trillion USD.

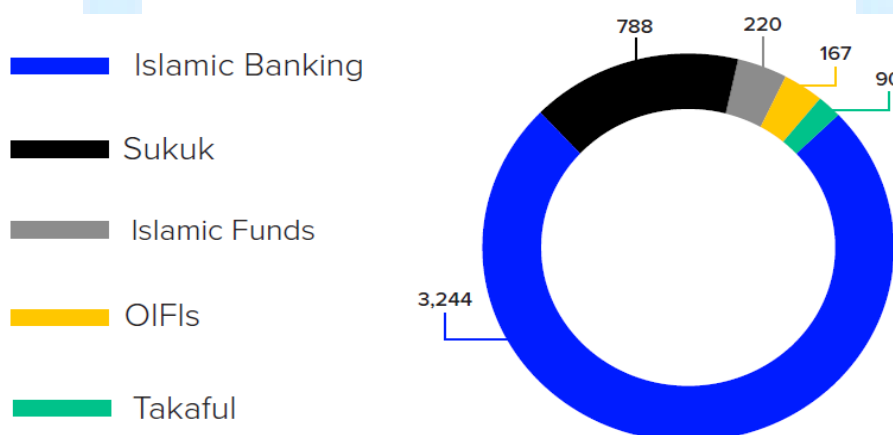


Figure 2. Islamic finance assets (2022, USD bln) [2]

Although the Islamic finance sector gained overall, several of its asset classes and sectors saw declines in performance. The most severely impacted were Islamic funds, with the majority of Islamic mutual funds and exchange-traded funds (ETFs) in most markets reporting negative growth as a result of the bad sentiment in equities brought on by several rate rises in numerous jurisdictions.

As a result, the number of new Islamic funds decreased dramatically from 223 in 2021 to 71 in 2022, while the assets under management (AuM) of Islamic funds fell by 10 percent from 2021 to 220 billion USD. Nonetheless, a few noteworthy fund releases occurred in 2022, including the first Islamic ETF introduced in Australia and ESG ETFs introduced in several areas.

Of the 3,2 trillion USD in assets held by Islamic banks in 2022, 24 percent of them reported higher losses or lower earnings. During the year, a few Islamic banks reported a decline in their stock investments. Additional factors contributing to reduced growth or returns include cost increases associated with digitalization and inflationary adjustments. In places like the GCC, banks that reported good performance - some of which were even better than pre-pandemic levels - saw their growth supported by both fewer impairment charges and increased profit income. Better economic confidence was recorded by these markets, which increased financing activity.

With 788 billion USD in outstanding value in 2022, sukuk - the second-largest contributor to Islamic finance assets - posted a strong performance. Issues from Malaysia, a significant market, rose annually as corporations increased their involvement in the industry. However, as a result of a spike in oil prices in 2022, issues from the GCC decreased in light of reduced finance requirements from sovereigns and state-backed corporations. Tanzania and Nigeria, two Sub-Saharan African countries, notably had business problems in 2022.

Takaful, the third-largest segment in the worldwide Islamic finance business, expanded by 16 percent in 2022 to reach total assets of 90 billion USD. Throughout the year, just 52 percent of takaful operators reported favorable results. This is

mostly because business lines like automobile takaful are paying out more claims. Investment losses also affected a few operators.

Table 1

**Projects financed in Uzbekistan by IsDB and ICD, 2022[3]**

| Uzbekistan<br>(member of IsDB, ICD)  |                              |                   |
|--------------------------------------|------------------------------|-------------------|
|                                      | IsDB                         | ICD               |
| Joining date:                        | 27.08.2003                   | 14.09.2004        |
| Capital subscription (million):      | ID 13.44                     | USD 0,24          |
| Capital subscription (percent):      | 0,03                         | 0,01              |
| Total projects and financing:        | 116 projects (USD 2 602,8 m) |                   |
| Completed:                           | 55 projects (USD 1 077,7 m)  |                   |
| On-going:                            | 61 projects (USD 1 525,1 m)  |                   |
| New commitments:                     | USD 427,2 m                  |                   |
| Business insured:                    | USD 381,5 m                  |                   |
| Agriculture                          | 9 projects                   | USD 702,4 million |
| Education                            | 11 projects                  | USD 78,4 million  |
| Energy                               | 5 projects                   | USD 203,1 million |
| Finance                              | 54 projects                  | USD 653,5 million |
| Health                               | 15 projects                  | USD 413,2 million |
| Industry                             | 9 projects                   | USD 59,9 million  |
| IT                                   | 1 projects                   | USD 0,1 million   |
| Real estate                          | 0 projects                   | USD 0,0 million   |
| Transport                            | 4 projects                   | USD 348,1 million |
| Water, sanitation and urban services | 3 projects                   | USD 93,1 million  |
| Others                               | 5 projects                   | USD 51,0 million  |

Uzbekistan has been a member of IsDB since August 2003 and ICD since September 2004, respectively. IsDB and ICD have provided a total of USD 2 602,8 million in financing for 116 projects in Uzbekistan. Out of these projects, 55 have been completed with a financing of 1 077,7 million USD while 61 are on-going with a financing of 1 525,1 million USD. The sectors that received the most funding are agriculture, finance, and health, respectively 702,4 million USD, 653,5 million USD, and 413,2 million USD in financing. However, the other sectors such as education, energy, transport, water, sanitation and urban services also received significant funding from IsDB and ICD. As of March 2024, according to the Islamic Development Bank, the total number of projects in Uzbekistan is 156, of which 72

are completed, 84 are in progress, and the total amount of financing has reached 3,7 billion USD. As stated in the "Uzbekistan-2030" strategy, it was intended to allow non-bank credit organizations to provide Islamic banking services in the Republic of Uzbekistan by 2030. As a result of this, today in Uzbekistan, pawnshops, mortgage refinancing organizations, and microfinance organizations have the right to provide Islamic financial services on the basis of legislation.

Today, there are the following issues in the improvement of Islamic financing in Uzbekistan:

1. One of the main problems for the widespread implementation of the Islamic financing mechanism is the lack of a legal basis.

2. In our country, there is a shortage of qualified specialists in the field of Islamic finance as a result of the mismatch between education and practice.

3. In order to widely promote Islamic finance in the Republic of Uzbekistan, there is a slowness in the utilization of financial resources allocated by international financial institutions.

4. Potential customers operating in our country - legal and natural persons - are not fully prepared for the Islamic financial system from the point of view of financial literacy and faith.

5. There is insufficient foreign experience and practice for the transition to the Islamic financing system, as a result of which there is no clear methodology for the modification of the existing financial system to Islamic finance.

6. While positive results have been achieved as a result of the application of Islamic finance as an experiment in the fields of investment and insurance in our country, there is a slowness in the implementation of measures developed in the field of banking, non-banking credit organizations and securities, which make up a large part of the financial market.

The following hypotheses can be confirmed in the conditions of the economy of Uzbekistan:

- the implementation of financial intermediaries operating on the basis of the principles of Islamic financing may have a negative impact on the activities of intermediaries in the traditional system.

- operating on the basis of Islamic financing, especially in banking, insurance and non-banking credit organizations, there is a risk of increasing financial risk.

- there is a possibility that the transition to Islamic finance in Uzbekistan will have a negative impact on the number of potential customers.

- the implementation of Islamic financing in our country can increase the confidence of the population in financial institutions.

- switching to a dual system, i.e. a traditional and Islamic financing system, can have a positive effect on the investment attractiveness of the state.

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