

# PROSPECTS FOR THE DEVELOPMENT OF ISLAMIC FINANCE IN THE REPUBLIC OF UZBEKISTAN

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## Abstract

Islamic finance has gained prominence worldwide as an alternative and ethical financial system, promoting economic stability and inclusivity. In recent years, Uzbekistan has shown a growing interest in developing its Islamic finance sector, recognizing its potential to attract foreign investments and foster economic growth. This report explores the perspectives of Islamic finance in Uzbekistan and emphasizes the crucial role of foreign investments in advancing this sector

## Keywords

islamic finance, modernization, globalization, Islamic Development Bank, murobakha, implementation, interest rates, entrepreneurship, microfinance, economic models, inclusivity, financial instruments, financing mechanisms, risks.

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## Introduction

Today, the role of Islamic finance in the modernization of the Uzbek economy can be huge. The Islamic financial sector offers alternative financing tools and approaches that can help develop the country's economy. After gaining independence, the Republic of Uzbekistan achieved freedom of religion and conscience, developed national legislation and the national economy. In our country, the banking and financial system is experiencing the era of modern globalization, and given that more than 90% of our population are Muslims, it is time for us to develop Islamic finance. This was stated by the head of state,

Sh.M.Mirziyoyev, who also stressed in his address to Parliament on December 29, 2020: "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 organizations will be involved in this."<sup>1</sup>

Principles of Islamic finance are standards developed and approved by international organizations (Accounting and Auditing Organization for Islamic Financial Institutions, Islamic Financial Services Council) for Islamic banking and finance, based on the principles of Shariah (Islamic law), which provide for the rejection of bank interest in favor of project investments based on the sharing of risks and equity participation of the bank and the client. [1]

The implementation of projects based on Islamic financing in Uzbekistan began in 2004, and this was followed in September 2003 by the Islamic Development Bank (IDB), which used leasing and Murobakha contracts to finance energy and healthcare programs. However, IDB began its activities in Uzbekistan from the first years of independence, and this was manifested in the implementation of grant calculations within the framework of the program to support Muslim communities of non-member states of the organization.

This is the same provision on raising funds from banks, investment funds and companies based on existing Islamic financing in Muslim countries in order to support the socio-economic development of our country and the private sector. To do this, of course, it is necessary to look at the national banking system from a new approach, that is, the introduction of partnership-based financing mechanisms, along with traditional financing mechanisms, is highly appreciated. In this sense, the Islamic Development Bank expressed its desire to support the development of "vaqf legislation" and legislation on Islamic finance in Uzbekistan, and the implementation of the necessary measures has begun. It should be recognized that our country lags far behind the CIS and neighboring countries in terms of Islamic financing. One of the main reasons for this is the lack of a legal framework, that is, legislation.

One of the basic principles of Islamic finance is the principle of prohibition of interest rates (Reba). Instead, Islamic financial institutions offer borrower-lender cooperation and risk-based mechanisms. This can help the development of entrepreneurship and investment in the country.

The following is a **SWOT** analysis of the development of Islamic financing in Uzbekistan:

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<sup>1</sup> Speech by the President of the Republic of Uzbekistan Sh. Mirziyoyev in an address to the Parliament.  
<https://kun.uz/ru/68958621>

### **STRENGTHS**

Support of the head of State;  
Targeted and effective use of additional funds from the IDB;  
Financing of the economy of Uzbekistan;  
The non-existence of bankruptcy and stability of mechanisms of Islamic banks in the world.

### **WEAKNESSES**

Emptiness and non-alignment of local tax and banking legislation with respect to the Islamic financing nature;  
Shortage of experienced employees working with Islamic products;  
Low financial awareness;  
Dependence of subsidiary Islamic financial organizations on the activities of Central organizations;  
Speciality of mazhab in Muslim countries;  
The complexity of borrowing from an Islamic Bank;  
Distrust of the population for whole new financial products;  
Lack of systematicity in current legislation;  
Serious problems with the taxation of Islamic financial products;  
The lack of general access to these services.

## **OPPORTUNITIES**

- Diversification of funding sources, especially for small businesses;
- Promotion of Real production in Uzbekistan;
- Direct benefits for the economy of Uzbekistan in the event of investment funds from the countries of the Middle East and Southeast Asia;
- The rise of Uzbekistan's reputation as a secular state that is successfully introducing Islamic financing;
- The presence of a financing market covered to the extent required by conventional financing;
- Since the main part of the population of Uzbekistan adheres to Islam, the expectation of a stable demand for these financial products;
- Islamic financing principles help reduce social inequality, promote social justice;
- Due to the emergence of alternative financial products, the ability of the population to use financial services expands;
- Increasing support from Western countries in the development of this sphere;
- Platform expansion for services and positive reception of the network rebranding process;
- The possibility of introducing tools and methods successfully implemented in the world within the framework of the public and private corporate sector of the country, in order to reduce the burden of usury debt and to improve the financial health of enterprises that can become the basis of the country's system.

## **THREATS**

- Fraud risk;
- There are erroneous opinions about Islamophobia, that is, terrorism and its involvement in extremist organizations;
- Mentality and cultural differences;
- Competitive risk by mutual insurance societies and microfinance organizations offering traditional financial services;
- In the eyes of large Islamic investors, the lack of creation of an investment asset in reality, the unwillingness to officially recognize the existing facts;
- As a result of the lack of understanding, the opposition from the side of private equity banks.

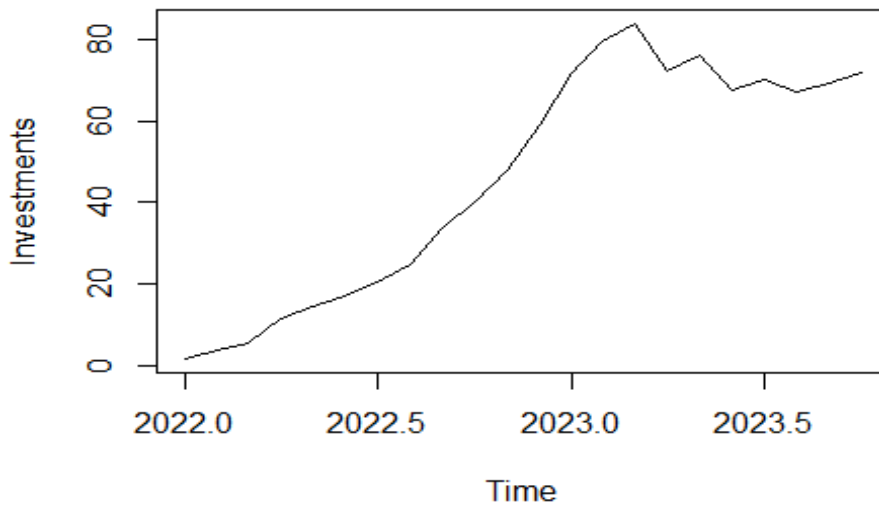
Islamic finance also supports the principle of ethical investing, which excludes investments in companies engaged in activities prohibited by Islam, such as alcohol, pork or gambling. This can contribute to the development of socially responsible business in Uzbekistan. In addition, the Islamic financial sector can provide access to financial services to small and medium-sized enterprises with limited access to traditional banking services. This contributes to the development of entrepreneurship and the creation of new jobs in the country.

Islamic finance can also attract foreign investment to Uzbekistan. Many countries with Muslim populations, such as Saudi Arabia, the UAE and Malaysia, have a developed Islamic financial sector. Attracting investments from these countries can serve to develop the economy of Uzbekistan and strengthen its position in the international market. In addition, Islamic finance can contribute to the development of microfinance in Uzbekistan. Microfinance provides small businesses and low-income populations with access to financial services that help combat poverty and inequality.

However, for the successful development of Islamic finance in Uzbekistan, it is necessary to create an appropriate legal and regulatory framework, as well as increase the financial literacy of the population. It is also important to conduct propaganda campaigns and inform the public about the benefits of Islamic finance.

According to the Islamic Financial Development Report for 2022 published by Thomson Reuters, 136 countries of the world have fully or partially implemented Islamic finance, with the Muslim population in countries such as the United Kingdom (4.4% of the population are Muslims), the United States (0.9%), Singapore (15.6%), Switzerland (5.2%), such Countries such as Canada (3.2%), Australia (3.2%), France (4%), Germany (3.5%) and Russia (15%) also use Islamic financial instruments. According to the distribution of Islamic financial assets by country, Iran had \$1.2 trillion in 2021. This is 31.2% of total assets. In Saudi Arabia, these figures amount to 896 billion US dollars (22.6%) compared to 650 billion US dollars (16.4%) in Malaysia and 252 billion US dollars (6.4%) in the UAE. [2]

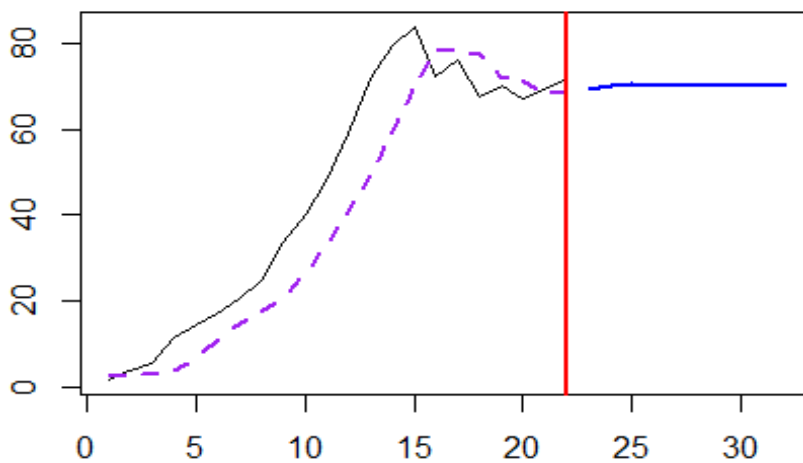
Below are the investments made in IMAN Invest, which for the first time started its activities in Uzbekistan on the basis of Islamic finance, analyzed and considered using TS econometric models. Investments in this company began in January 2022, and eventually we will see a forecast up to 2030 using an econometric model.



**Figure 1: Involved investments (in billion sums) in the Iman Invest Ltd.**

*Source:* This model done by author in R-Studio software

### Forecast from SMA(3) with Normal distribution



**Figure 2: Investment forecasting up to 2030 in Iman Invest Ltd.**

*Source:* This model done by author in R-Studio software

Islamic finance will play an important role in the development of the country's national financial sector. In particular, a significant 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. Uzbekistan does not yet have any laws regulating Islamic financial products and services. [3]

One of the main criteria for the introduction of Islamic banking in our country, taking into account the above points, can be implemented by making amendments and additions to the legislation on the activities of the Central Bank of the Republic of Uzbekistan, banks and offices, tax and Civil codes and other by-laws, or by adopting a separate law. In addition, from the financing mechanisms of Islamic banks, it should be noted that the segment of the population in need of financing also has funds in which the party seeking profit is equally interested. One of the main differences between traditional financing and Islamic financing is that Islamic banks prohibit usury and speculation. [4]

Many experts emphasize that there is a high demand for Islamic finance in Uzbekistan. They explain the presence of such demand by the unsatisfied demand for financial services from a certain category of the population of the republic. Thus, according to various estimates, about 15-20% of the population of Uzbekistan do not use the traditional credit system for religious reasons. According to the survey, which was attended by 2,235 business representatives and about 5,000 A person, 38% of business entities and 56% of individuals do not use traditional bank lending services because of their religious beliefs.<sup>2</sup>

Admittedly, the Islamic economy caused constant controversy and controversy a few years ago. The general principles of the Islamic economy and the mechanisms of its functioning have not yet been clearly formulated. That is, there is an ideology that formulated the rules of practice in accordance with Sharia as a system of views, but did not have a clear idea of the application of this mechanism on the scale of a single economy. In other words, there is a sense of how the elements of the system work, but there was no understanding of how such a system works. The problem was that the practice of developing the Islamic economy was ahead of the theoretical understanding of most pressing economic problems. From this point of view, today researchers involved in the formation or consideration of a financial, social and economic system based on Islamic principles are exploring these and many other issues. Different interpretations and approaches make a huge contribution to the richness and evolution of science. Returning to the Islamic foundations of finance, it should be noted that although this system was initially introduced by countries with an overwhelming majority of the population of Muslims, currently the Islamic financial system as an alternative financial system is conquering the territories of many developed countries of the world. This shows how effective this system is. [5]

Islamic finance operates on the principles of Sharia, promoting ethical and socially responsible financial transactions. This aligns with Uzbekistan's cultural values and can contribute to the development of a financial system that resonates with the local population. Inclusivity is a key aspect of Islamic finance, ensuring that financial services are accessible to a broader segment of the population. This inclusivity can address economic disparities in Uzbekistan, fostering social welfare and sustainable development.

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<sup>2</sup> <https://kun.uz/ru/news/2021/08/31/islamskiye-finansy-jdut-svoyego-chasa-v-uzbekistane>

Experts note the insufficient level of financial literacy of the country's population in the field of Islamic finance. Many people imagine Islamic banking as a bank providing loans without interest or believe that the prices of financial products and services of Islamic banks are lower than those of conventional banks, etc. This implies that it is necessary to carry out explanatory work among the population about the goals of Islamic finance, its functions and products. Legal prerequisites are the legislative framework that allows banking and financial organizations to provide financial services in accordance with the principles of Islamic finance. Currently, there is no such legislative framework in Uzbekistan. Some work is being done to solve this problem. So in 2022, two events occurred that are directly related to the creation of a legislative framework for Islamic finance in the country:

- An agreement has been signed with the international Islamic consulting company IFAAS (Great Britain) to develop legislation for the introduction of Islamic banking in the country;
- In April 2022, the country adopted a law on non-bank microfinance organizations, which includes the concept of "Islamic finance". This event is undoubtedly one of the most significant events in the development of Islamic finance in Uzbekistan. [6]

It should be noted that, within the framework of current legislation, the Central Bank of the Republic of Uzbekistan recently published a draft "Regulations on the procedure for providing microfinance organizations with services related to Islamic finance."<sup>3</sup>

Islamic finance offers a diverse range of financial products, including Islamic banking, Sukuk (Islamic bonds), and Takaful (Islamic insurance). The introduction of these products in Uzbekistan can provide alternatives to conventional financial instruments, contributing to a more robust and resilient financial system. The development of Islamic finance in Uzbekistan can attract foreign investors seeking Sharia-compliant investment opportunities. Foreign direct investments (FDI) can bring in capital, technology, and expertise, spurring economic growth and job creation.

**Importance of Foreign Investments.** Foreign investments play a pivotal role in providing the capital needed for the establishment and expansion of Islamic financial institutions in Uzbekistan. This capital can be utilized for infrastructure development, technology integration, and capacity building. Collaboration with foreign investors brings not only financial resources but also knowledge transfer. Uzbekistan can leverage the expertise of established Islamic financial institutions to build a robust regulatory framework, train local professionals, and enhance the overall efficiency of the Islamic finance sector.

Foreign investments facilitate the integration of Uzbekistan into the global Islamic finance market. This integration can lead to increased cross-border transactions, partnerships, and joint ventures, creating a more interconnected and dynamic financial landscape. Diversifying sources of funding through foreign investments can mitigate risks associated with economic fluctuations and domestic challenges. This diversification enhances the stability of the financial system, making it more resilient to external shocks.

The introduction of Islamic financial instruments, taking into account domestic demand in the country, serves to attract additional investments and stimulate economic growth. Islamic financial instruments are recognized all over the world, and various countries of the world use them effectively. We are confident that these tools will be of great benefit in our country as well.

<sup>3</sup> <https://regulation.gov.uz/uz/d/92036>

**In conclusion**, the perspectives of Islamic finance in Uzbekistan are promising, offering a unique opportunity to align the financial sector with cultural values and promote economic inclusivity. However, the successful development of Islamic finance in Uzbekistan is closely tied to the importance of foreign investments. By actively pursuing partnerships with foreign investors, Uzbekistan can foster the growth of its Islamic finance sector, ultimately contributing to sustainable economic development.

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