

ISLAMIC FINANCE AND ITS IMPLEMENTATION TO OUR COUNTRY

Yusufov Isfandiyor

Teacher of Tashkent State University of Economics

A B S T R A C T	KEY WORDS
The article covers Islamic finance, its place in the world market, Islamic financial instruments, aspects different from traditional financing. Also, an analysis of the practice of capital market development based on Islamic finance in developed and developing countries was carried out. Having studied the experience of foreign countries, proposals were made on the development of organizational mechanisms for the development of the capital market through Islamic finance in our country.	Islamic finance, deposit, sukuk, capital market, joint-stock companies.

Introduction

Recently, developed and developing countries want to ensure the integration of the Islamic financial system and its instruments into their financial system, which is rapidly developing and conquering the world financial environment more and more reliably, and the number of researches on this topic is also increasing.

The number of organizations and institutions operating in the Islamic financial system is constantly increasing, and in non-Islamic developed and developing countries, financial instruments of this type are actively developing their activities. The activities of Islamic financial institutions are becoming more diverse and complex [1]. The opportunities, potential and powers of Islamic financial organizations to organize and support large operations are expanding. In the era of increasing globalization and the background of global crisis, the stable growth of Islamic finance is increasing the interest of non-Islamic countries.

Today, the Islamic economy is a sector whose main products are under the structural influence of Islamic ethics and legislation. The Islamic finance sector is one of the fastest growing sectors in the world. Islamic finance is used in more than 50 countries of the world. Currently, the total assets of more than 1,500 Islamic financial institutions operating around the world exceed 2.5 trillion dollars. For information, the Islamic finance network is developing rapidly all over the world today and is one of the directions that includes innovative financing mechanisms. In 2024, the total assets of Islamic financial institutions are projected to reach 3.7 trillion dollars [2].

The stock market is one of the most important sectors that should be developed in the economy of Uzbekistan, and its main activity should be focused on increasing the volume of money circulation and issuing new products, for example, sukuk, green bonds and other products [3].

2. Literature Review

The prohibition of *riba* (interest) in Islam has been in force since 1400 and Islamic banking has emerged only in the last 15 years. From the point of view of the development history of the Islamic bank, it is necessary to note the uniqueness of the emergence of such a financial institution in Malaysia [4].

The Islamic financing model involves the sharing of risk between the lender and the borrower. The bank receives a part of the profit under the loan agreement, not the loan interest. For small enterprises, such a financing model, which involves the sharing of risks between the borrowing enterprise and the lending bank, is attractive [5].

At the initial stage of development, enterprises need external sources of financing and their financial capabilities due to the minimum stability and financial strength of companies. In times of economic instability and crisis, it is more desirable for small and medium-sized businesses to use Islamic tools, as it reduces the risk of bankruptcy [6].

Also, U. Yuldasheva, S. Narimonov and Sh. Bolibekov studied the tax base of Islamic financial organizations [7].

J.Khoshimov and others in their researches noted that in the context of increasing modernization processes, it is appropriate for the state's to implement different types of financial market models to achieve sustainable growth [8].

3. Research Methodology

In this article, comparison, synthesis, logical and comparative analysis of research, economic analysis, deduction, calculation of quantity and quality indicators, statistical processing method by comparing them with each other, and scientific abstraction are discussed in this article.

4. Analysis and Discussion of Results

The term "Islamic finance" was coined in the mid-1980s. Islamic finance is described by many developed countries as an interest-free financial system.

In the first formative period (622–661 AD), the principles of Islamic finance were used by the Arabs living in the Arabian Peninsula. Even Prophet Muhammad (pbuh) traded according to these principles before his revelation. Their first wife, our mother Khadija, traveled to the country of Sham (now Syria) with her goods to trade. They hired assistants based on a profit-sharing contract. In Islam, this type of contract, called "*mudaraba*", is still used today. Also, during this period, *musharakah* (another contract based on the distribution of profits), *zarraflik* (the practice of exchanging different currency units), *murabaha* (trade), representative contracts (transferring a debt from one person to another) were developed. At the same time, financial relations based on *riba*, i.e. interest, were on the rise at that time. After the revelation to our Prophet Muhammad, first of all, the use of *riba* was prohibited. Today, the Islamic banking system has gained the greatest popularity among developed countries in the United States, as well as to some extent in Great Britain, Germany and France. World-famous banks such as HSBC, DeutscheBank, Citibank, BNP Paribas, Chaise Manhattan Bank, Goldman

Sachs, JP Morgan and others are opening Islamic branches in their structures for financing, in order to serve not only Muslim clients, but also local citizens.

The first Islamic bank in the West, Islamic Banking System (now Islamic Finance House), was established in Luxembourg in 1978. Many international and national banks are opening Islamic branches in France and Germany. Among them are such well-known banks as Deutsche Bank AG, ABN Amro Holding NV, Societe Generale SA and BNP Paribas, Bank Sepah, Iran, Commerz Bank, HSBC. At the same time, many countries of the CIS, in particular, Azerbaijan, Kyrgyzstan, Kazakhstan, Tajikistan, Turkmenistan, Uzbekistan are members of the Islamic Development Bank. Due to the increasing demand, some Muslim countries have accumulated large financial resources and this has caused the number of Islamic financial institutions to spread widely in the world. It can be seen that as the oil-exporting countries earn significant profits, as the financial markets of Islamic countries continue to develop, and as Western companies compete to attract foreign investors, the current trends in the development of Islamic banks will continue. All this gradually creates the necessary conditions for an in-depth study of the characteristics of Islamic banks and their entry into the traditional financial markets.

Table 1. Characteristics of Islamic and traditional banks

Characteristics	Islamic banks	Traditional banks
Guaranteed payments on demand deposits	Available	Available
Guaranteed payments on investment deposits	Not available	Available
Interest rate on deposits	Not available	Specified and guaranteed
The mechanism for determining the interest rate on deposits	The profitability of the bank is determined by the profitability of investments	It does not depend on the profitability of the bank
Participation of depositors in bank profits and losses	Available	Not available
Use of Islamic financial products	Available	Not applicable
The right of the bank to make a decision on granting a loan depending on the collateral	With the participation of depositors in the profits and losses of an Islamic bank, it often does not have the right to discriminate against customers based on their provision.	Always available

Understanding the principles of Islamic banking is also important in ensuring financial stability. First, in order to ensure financial stability, traditional banks pay special attention to the development and expansion of their relations with Islamic banks. Secondly, the non-use of hedging instruments by Islamic financial institutions leads to the accumulation of risks. Analyzing the above, it is necessary to consider the main differences between Islamic banks and conventional banks (Table 1).

The Islamic capital market operates as a parallel (alternative) market to the traditional capital market and is implemented in ways that do not contradict the Islamic religion.

Investing in Shariah-compliant securities is not limited to Muslims, as Shariah-compliant securities also resonate in stock markets based on the traditional financial system. In general, all Islamic capital market instruments and institutions must comply with the principles of Sharia and not apply riba, use

al bay' (trade and commerce), avoid gharar in contractual agreements, prohibit maisir (gambling), refrain from producing prohibited goods (alcohol, pork, tobacco, etc.).

Sharia-compliant products currently available in the Islamic capital market include:

Sukuk is a financing instrument used by companies or governments (issuers) to raise funds, and the underlying transaction is based on various Shariah principles/contracts. Sukuk investors are entitled to income/profits arising from the underlying transaction.

In 2021, global sukuk issuance has been growing steadily for five consecutive years and reached \$196.5 billion. Although that's an 8.2 percent increase from \$181.6 billion in 2020, the five-year average annual growth is 21 percent. After picking up issuance in early 2021, it began to slow in the second half of the year as the global economy began to recover and oil prices strengthened, reducing the need for sovereign debt in the main sukuk markets (Figure 1).

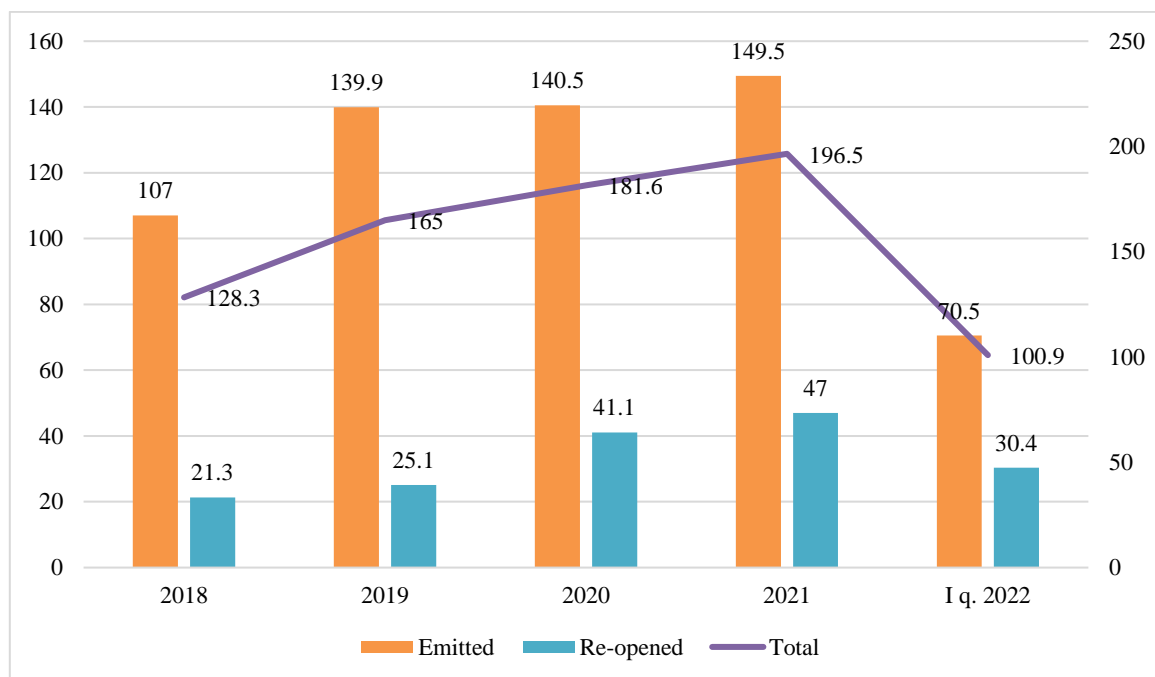


Figure 1. Sukuk issuance in international markets in 2018-2021 and the first quarter of 2022 (billion dollars)

The total volume of sukuk issued in the first half of 2022 was \$104.2 billion, down slightly from \$104.2 billion a year ago. Excluding a large \$6 billion issuance from Saudi Aramco in 2021, issuance rose 2.6 percent.

In early 2022, continued economic recovery and higher oil prices were forecast to reduce the need for sovereign debt in key sukuk markets in the GCC and Southeast Asia. Although these developments did not significantly affect sukuk issuance in Q1 2022, issuance slowed due to high interest rate hikes and high oil prices. The slowdown in the second quarter was largely the result of smaller issuance by the Saudi government, whose financing requirements eased amid rising oil revenues. Figure 2 shows the volume of sukuk issuance in the leading countries of Islamic finance in 2018-2021 and the first quarter of 2022.

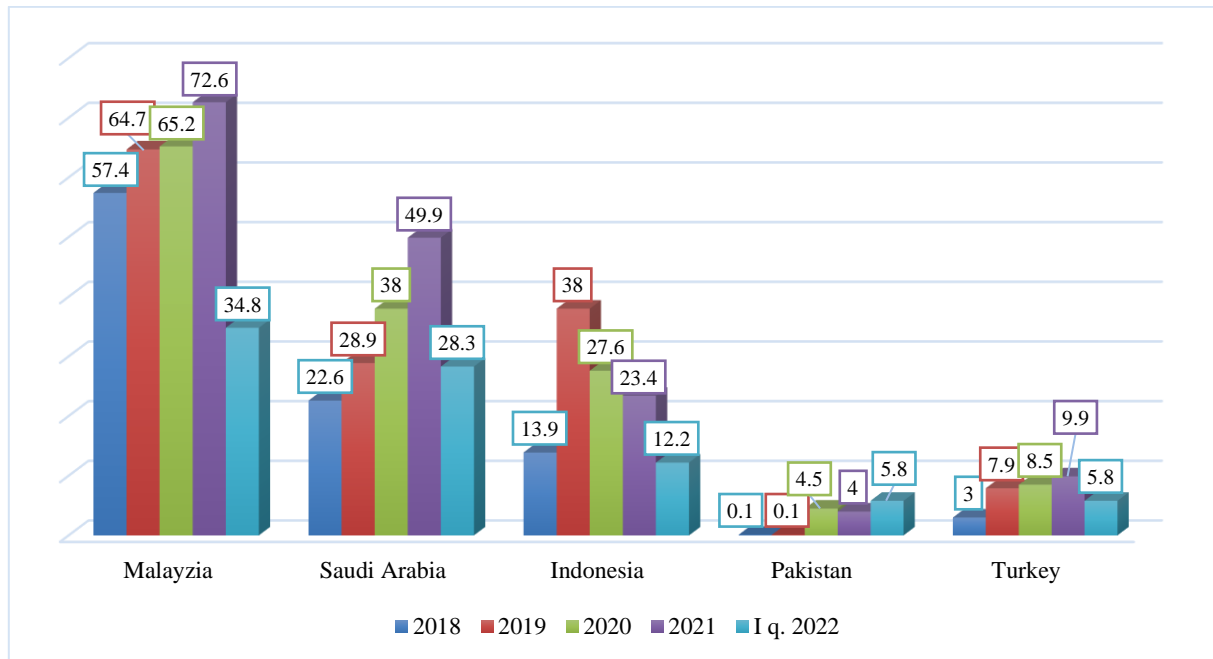


Figure 3. Leading countries in terms of sukuk issuance in 2018-2021 and the first quarter of 2022 (billion dollars)

In 2021, sukuk were issued in international markets by companies located in 21 countries, among which Malaysia totaled \$72.6 billion, Saudi Arabia \$49.9 billion, and Indonesia \$23.4 billion. These three countries accounted for 75 percent of sukuk issued in 2022 by issuers.

Malaysia maintained its usual lead in annual emissions, but was overtaken quarterly by Saudi Arabia in Q4 2021 and Q1 2022. Malaysian issuers' sukuk fell by around \$15 billion in each of these quarters, before corporate activity picks up in Q2 2022 due to lower corporate issuance. Malaysian-based issuers raised \$34.8 billion in the first half of 2022, down 14 percent from the first half of 2021.

Saudi Arabia's sukuk issuance activity slowed in the second quarter as the government reduced monthly domestic issuance. Nevertheless, issuers based in Saudi Arabia raised \$28.1 billion in the first half of 2022, up \$3.9 billion from the same period in 2021. Indonesia remains the third-largest issuance base, although domestic market activity is expected to fall from record levels in 2020 due to budget cuts and funding requirements.

As Pakistan's foreign reserves have been depleted by international debt repayments, the government has returned to the international sukuk market for the first time since the introduction of five-year sukuk in 2017.

In January 2022, it raised \$1 billion from the sale of seven-year sukuk on the sovereign Eurobond market. The issue will carry 7.95 percent of interest payments to the government, the highest coupon rate offered in Pakistan's history of sukuk borrowing in international markets. The sovereign was able to negotiate a rate cut from 8.25 percent to 8.375 percent, backed by long-term sustainable economic growth potential, improved energy sector performance and structural reforms to mobilize revenue.

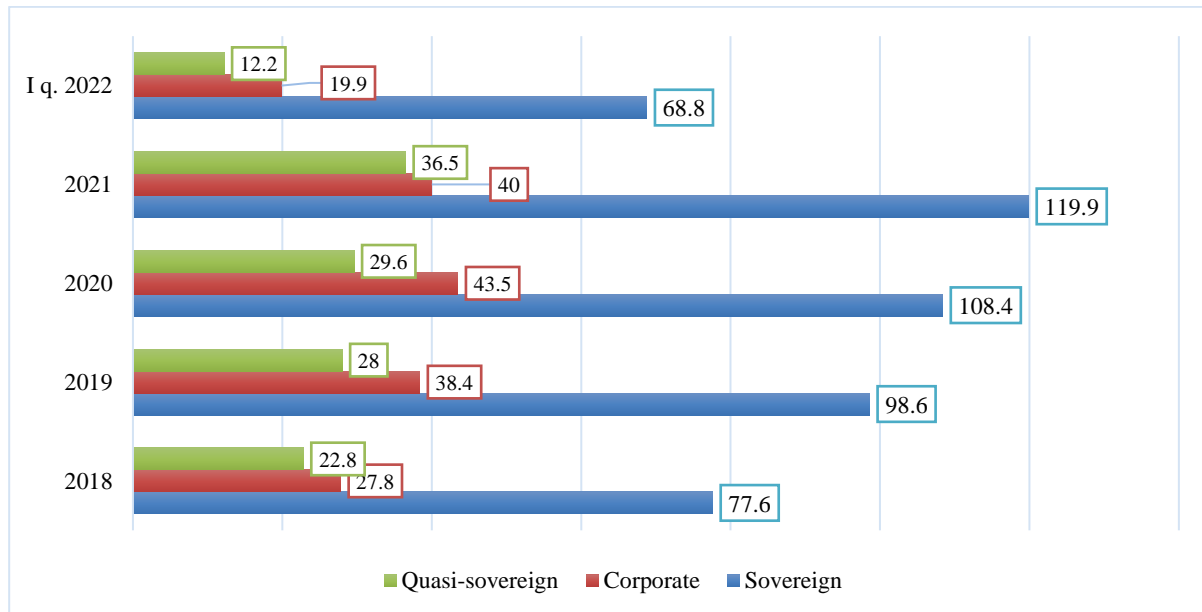


Figure 4. Sukuk issuance by issuer type in 2018-2021 and the first quarter of 2022 (billion dollars)

A total of \$21 billion is required in fiscal year 2022-23 to repay international debt and service existing debt, at least \$15 billion to cover the current account deficit, and \$1 billion to cover other financing needs. The \$37 billion added to the existing debt burden limits Pakistan's ability to raise debt. In Figure 2.7, we analyze the sukuk issue in 2018-2021 and the first quarter of 2022 by issuer type.

Governments remain the main issuers of sukuk issuance, maintaining around 60 percent of global issuance since 2017. The volume of sovereign country sukuk issued in 2021 was \$119.9 billion, of which 87 percent was issued by the governments of the GCC, Malaysia and Indonesia. These countries issued 83 percent of the total global sovereign issuance of \$68.8 billion in the first half of 2022.

The government of Saudi Arabia was the largest sovereign issuer in the first half of 2022, maintaining the position it gained in the third quarter of 2021. Despite oil prices hitting their highest levels since the global financial crisis, the Saudi government has stepped up issuance to meet strong demand for debt. In the first half of 2022, it raised \$22.1 billion, and in March, a \$7 billion sukuk is planned to be issued to consolidate domestic public debt as part of the country's sukuk program.

The volume of corporate issuance in the first half of 2022 amounted to 19.9 billion dollars and decreased by 7.8% compared to the same period last year due to the rapid growth of interest rates. Financial institutions typically account for the bulk of corporate sukuk issuance, which accounted for 65 percent of the global total of \$38.1 billion in 2021.

Quasi-sovereign issues in the first half of 2022 almost halved compared to the same period last year and amounted to \$12.2 billion. The difference is due to a slowdown in Saudi Aramco's \$6 billion sukuk issuance in 2021 and Islamic Development Bank's \$1.6 billion sukuk issuance in Q2 2022, linked to the first Secured Overnight Financing Rate (SOFR).

5. Conclusions and Suggestions

There are a number of key factors that contribute to the success of Islamic banking and Islamic investment products, which include:

- possibility of diversification of capital sources for economic development based on expanding the composition of banking market participants;
- existence of demand for Islamic bank products due to the uniqueness of the ethnic composition of the population of our country;
- The need to strengthen the investment direction of lending in the economy of Uzbekistan;
- the opportunity to use practical experience in changing traditional banking products in accordance with the principles of Islamic banking.

The following conclusions were formed regarding the development of Islamic finance and its introduction to the capital market of our country:

1. Opportunities for the development of Islamic banking in Uzbekistan are largely related to the difference in the market models of banking products. If the European model is mainly focused on short-term and medium-term financing, debt resale, then the Islamic model, on the contrary, is important to create and support long-term cooperation with customers or introduce long-term financing of an investment nature. This is especially important considering the investment needs of our country's economy. Based on the integration of European and Islamic banking products into the banking system of Uzbekistan, it is necessary to create the necessary conditions to meet not only short-term, but also long-term resource needs of the economy. In addition, customers who are not ready to use traditional banking products based on religious approaches can use Islamic banking products.
2. Our country has adopted a number of legal norms on the use of the Islamic financial system and its tools. In particular, the decision of the President of the Republic of Uzbekistan dated March 5, 2019 "On measures to further expand and deepen partnership with Islamic Development Bank Group and Arab Coordination Group Funds" was adopted. According to the decision, it is decided to attract the consulting assistance of the Islamic Corporation for the Development of the Private Sector within the framework of the development of the infrastructure of Islamic financing in the banking sector of the Republic of Uzbekistan.
3. The decision of the Cabinet of Ministers dated May 23, 2019 "On measures to further develop cooperation with the ITB Group and the Arab Coordination Group Funds" also emphasized the further expansion of cooperation with the ITB Group and the Arab Coordination Group .
4. In order to ensure the effective implementation of the above decisions, on August 22, 2019, "Trustbank" JSC and the Islamic Corporation for the Development of the Private Sector (ICD) signed an agreement on "Consultancy Assistance". In accordance with this decision, it was planned to introduce "Islam window" services into the banking system, and on January 10, 2023, the opening ceremony of "Trust Muamalat" LLC, a subsidiary leasing company of "Trustbank" JSC, was held. This event was attended by the management of "Trustbank" JSC, the chief specialist of the Advisory Service Department of the Investment Investment Department of the Islamic Corporation for the Development of the Private Sector, representatives of the public, and media workers. As noted, the main task of "Trust Muamalat" LLC is to implement the strategy of expanding financial services by implementing effective "Murabahah (Nation Trade)" and "Ijara (Leasing)" operations within the framework of the current legislation, as well as to expand cooperation with international Islamic

financial institutions. The long-term successful cooperation of "Trustbank" with the Islamic Development Bank (ITB) group allows "Trust Muamalat" LLC to attract financing lines of ITB corporations. In addition, this stage of development will encourage the company to finance projects of individuals, small and medium-sized businesses, expand their activities and create new jobs.

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