



ISLAMIC BANKING: PROBLEMS, SOLUTIONS AND PROSPECTIVES

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Article history:	Abstract:
Received: 20 th February 2023 Accepted: 20 th March 2023 Published: 26 th April 2023	This article reveals the role and importance of Islamic finance and banking in the world economy. In particular, the article focuses on the structure of Islamic banking, the form of management, the impact on the state economy, some problems and solutions in the field of Islamic banking. Analysis of a new promising direction in the field of banking and finance - Islamic banking on the example of Uzbekistan.
Keywords: Islamic finance, GIFT index, IsDB, Board of Sharia, OIC, Islamic banking, Islamic Fintech Market.	

INTRODUCTION

Today, the Islamic financial network is one of the rapidly developing and innovative financing mechanisms in the world. The development of this network is especially relevant for countries where the majority of the population is Muslim. President of the Republic of Uzbekistan Sh. Mirziyoyev in his speech at the opening ceremony of the 43rd session of the Council of the Organization of Islamic Cooperation, said, "The Islamic world has huge economic, investment potential, and energy resources. Proper use of them, expansion of international trade-economic, financial, investment cooperation of the member states of the Organization of Islamic Cooperation, organization of transport routes connecting our countries will allow to achieve high indicators of economic development, and this will ultimately lead to the improvement of all other sectors, serves as a basis for its development," he said.

Therefore, it is important to attract the funds of existing banks, investment funds and companies whose activities are based on Islamic financing in Muslim countries in order to support the socio-economic development of Uzbekistan and the private sector. For this, it is necessary to look at the national banking system with a new approach, that is, it is important and urgent to research the issue of introducing partnership-based financing mechanisms along with traditional financing mechanisms. The main difference between Islamic financial institutions and conventional financial institutions is that Islamic finance involves profit and loss sharing and financing based on real assets. In other words, Islamic financing is based on partnership. Such institutions can build an object at the customer's request, buy equipment, goods, raw materials or rent them. In the speech of the President of the Republic of Uzbekistan Shavkat Mirziyoyev to the parliament on December 29, 2020, they said: "The time has come to create a legal framework for the introduction of Islamic financial services in our country. In this regard, experts

from the Islamic Development Bank and other international financial organizations will be involved." Also, within the framework of the 46th annual meeting of the Board of Directors of the Islamic Development Bank (IsDB), which was held in Tashkent in September 2021, he received the President of the Islamic Development Bank, Muhammad bin Suleiman Al-Jassir, who is in our country. Today, the portfolio of practical cooperation is worth more than 2.5 billion dollars, covering transport, housing and communal infrastructure, energy, agriculture and water management, health, education, entrepreneurship and other priority areas. It was noted that it consists of 30 projects, and at the meeting special attention was paid to the prospects of expanding multilateral partnership. In this regard, it was emphasized the importance of quickly adopting and implementing the new cooperation program for 2022-2025, launching a full-fledged representative office of the Bank in Tashkent, and improving the efficiency of financing instruments.

Based on the above, it can be said that Islamic finance is a constantly developing international economic system. Implementation of this field in Uzbekistan on the basis of foreign experiences and development of measures aimed at further development is an urgent issue of international integration. The Islamic financing system is important in the further development of the financial system and in increasing the weight of promising investment projects in the country's economy, in ensuring the well-being of the people, in the positive change of the social and political environment, as well as in the creation of banking and insurance products and services based on the rules of Sharia. In order to introduce partnership-based or Islamic financing in the Republic of Uzbekistan, the appropriate legislation and legal framework should be formed. This, in turn, creates the ground for additional capital to enter our country and offer alternative financing mechanisms.



LITERATURE REVIEW:

The economic, social and political development of any country depends on the existing banking structure in that country. In particular, Islamic banking, which is entering the banking sector with new products, is being studied by many scientists around the world, the problems arising in this field and their solutions are recorded.

Y.A.Baydaulet in his scientific research covered several issues of the foundations of Islamic finance, the Islamic banking and insurance system, as well as the tax system on the example of the USA, Russia, Kazakhstan and Uzbekistan.

As part of his research in Islamic finance, Simon Archer discusses risk and risk management in Islamic banking.

Roderick Millar conducted research on the history and stages of development of Islamic banking. In his works, the author has discussed how important Islamic financing is in the current global integration process.

Mohammed Hasim Kamali, professor of law at the International Islamic University of Malaysia, states in his book "Principles of Islamic Jurisprudence": It must be noted ... that unlike the Quran and Sunnah, ijma does not directly partake of divine revelation. As a doctrine and proof of Shari'ah, ijma is basically a rational proof. The theory of consensus is also clear on the point that it is a binding proof.

A collection of questions and answers has been published by Mabid Ali and Al-Jarhi Munawar Iqbal in which several questions in the field of Islamic banking are answered. In this, it is possible to find a solution to issues related to Islamic loans, risk in the banking system and its reduction, and investment.

Monzer Kahf, Tariqullah Khan, in their scientific works, the principles of Islamic financing, some problems that arise in practice and their solutions are presented.

RESEARCH METHODOLOGY.

Empirical analysis, synthesis and analysis, comparison, prospective forecasting methods were used during the preparation of the article.

ANALYSIS AND RESULTS.

In recent years, due to the high level of interest in its working mechanisms and the growth of globalization, Islamic banking is experiencing a rapid development. About 500 Islamic financial institutions offer a wide range of services, ranging from simple retail financing to corporate equity financing. In general, the activities of Islamic banks are based on the following basic rules:

- money should not arise from money, that is, capital growth cannot be realized in the sphere of net money circulation;
- investors' income should be related to investments in trade and production;
- the relationship between the participants of the transaction should be built on the basis of partnership;
- money is not a commodity, it is only a measure of value.

The methods of mobilizing funds are equity participation (attracting funds in return for investment in equity capital) and sukuk certificates. On the basis of the circulation of goods and money there are only transactions related to goods and services that exist in reality. The general definition of the activities of Islamic and conventional banks is as follows:

- Islamic and traditional banks have a commercial purpose and are focused on making a profit;
- the rule of banks' activity is financial intermediation;
- banks specialize in commercial, investment and universal activities;
- the standard lines of business of banks are divided into corporate and individual branches;
- forms of practice in banking activity: settlement practices, money transfers, currency exchange, documentary practices, financing practices and investment-banking practices;
- organization and management of banks: corporate management, risk management, liquidity management, compliance control, internal control system.

The characteristics of the activity of Islamic banks are defined by the following aspects:

- construction of corporate management with internal control over activities in accordance with Islamic jurisprudence (shari'ah monitoring board, internal audit function ensuring compliance with shari'ah);
- the task of risk management represents the characteristics of products (services) and mutual relations between the bank and the client;
- the function of liquidity management reflects the description of the bank's assets, especially the short-term (current) liquidity of the bank, in order to ensure compliance with Sharia;
- participation of the bank in the result (profit and loss) of the activity of the client and depositors, participation of the client and depositor in the result (profit and loss) of the bank;
- accounting standards of banking practices that express the characteristics of Islamic banking products and services;



- complete openness of banking activities for depositors. The depositor is considered as one of the partners of the bank¹.

Below GIFT index is analyzed. The index applied a total of 19 indicators across five different categories for each country. These five categories are: Talent; Regulation; Infrastructure; Islamic Fintech Market & Ecosystem; and Capital. These categories were weighted before an overall score was determined, with a heavier weighting given to the Islamic Fintech Market & Ecosystem category, since this is the most indicative by far of a country's current conduciveness to Islamic Fintech specifically. Examples of indicators used:

Talent: Employment in knowledge-intensive services, university ranking.

Regulation: Presence of Fintech regulations.

Infrastructure: ICT use, domestic credit to private Sector, university-industry collaboration.

Islamic Fintech Market & Ecosystem: Number of Islamic Fintechs in a country, number of Islamic financial institutions

Capital: New business density, number of venture capital deals.

Table 1
GIFT (Governance Index for Trusts) index in Islamic finance²

Ranking	Country	Score (max 100.0)
1	Malaysia	80,8
2	Saudi Arabia	80,4
3	Indonesia	64,7
4	United Arab Emirates	59,8
5	United Kingdom	49,9
6	Bahrain	46,4
7	Kuwait	44,8
8	Singapore	41,4

9	Qatar	41,2
10	Hong Kong	38,7
...
54	Syria	7,4
55	Uzbekistan	5,5
...
62	Niger	2,7
63	Gambia	2,1
64	Suriname	0,7

In Islamic banking, the profit of banks and their depositors is formed in the course of business activities that create real goods and services at the expense of funds invested in various projects. Capital works only for trade and production purposes. The bank mainly participates as a partner (partnership agreement) or as a trust fund (partnership agreement). Both parties - the bank and the client - share the profit and loss from the project according to the contract and, accordingly, make efforts to make a profit. Islamic banks carry out their activities in two forms of banking system:

1) a system fully compliant with Islamic jurisprudence standards (banking systems of Pakistan, Sudan, Iran);

2) a dualistic system in which the activities of Islamic banks are regulated separately by the state body and operate alongside traditional banks.

For full-fledged Islamic banks, regulation of banking activities in accordance with Sharia rules is carried out at the level of the central bank and bank supervisory bodies. The Shariah Board, which works under the Islamic bank, supervises the compliance of bank transactions with the rules of Islamic financing. The result of the research can serve as an additional means of attracting funds from customers, that is, it participates as a guarantee of compliance with Islamic standards in the use of these funds.

¹ N.Nazarov, "The engagement between islamic and conventional banking"
<https://inlibrary.uz/index.php/financial-market-growth/article/view/19186>

² www.salaamgateway.com/Global Islamic Fintech Report 2022

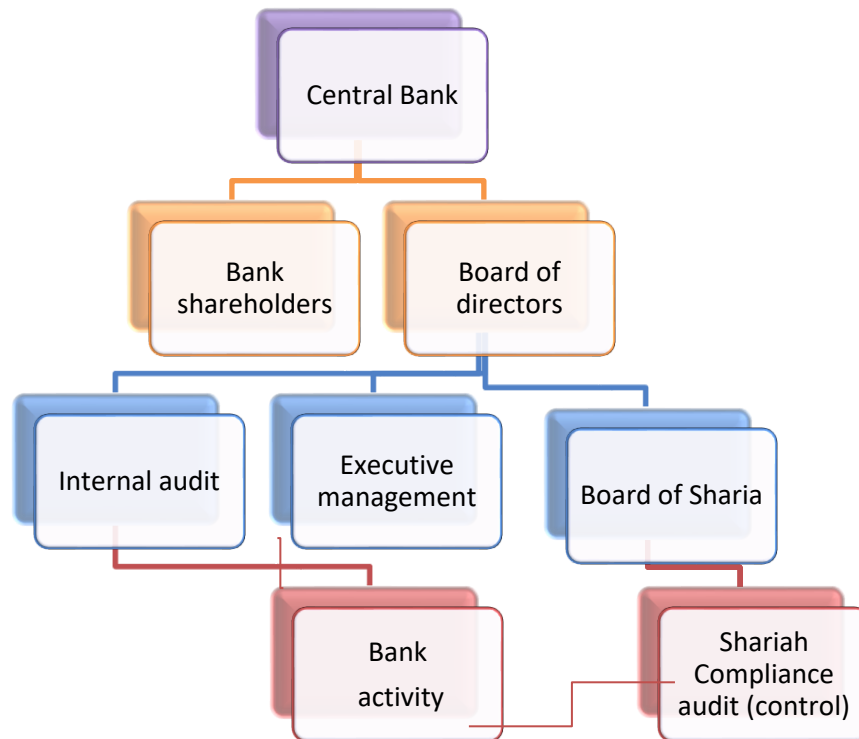


Figure 1. Management system of Islamic banking³

In addition to the internal audit of the Sharia compliance of products, banks also conduct an external Sharia audit, which serves as a means of increasing the bank's rating and reputation on the international stage. The corporate governance system of an Islamic bank is given in Figure 1. The operational (practical) activity of an Islamic bank is state and is based on the principle of financial mediation between individuals, financial institutions, subjects of the real sector of the economy. Like modern banks, Islamic banking involves attracting and deploying funds through passive and active operations.

Deposit products form the basis of passive practices. The basis of active operations is the financing products of customer activity or participation in trade deals with customers.

According to this picture, Islamic banking is defined by the following business processes:

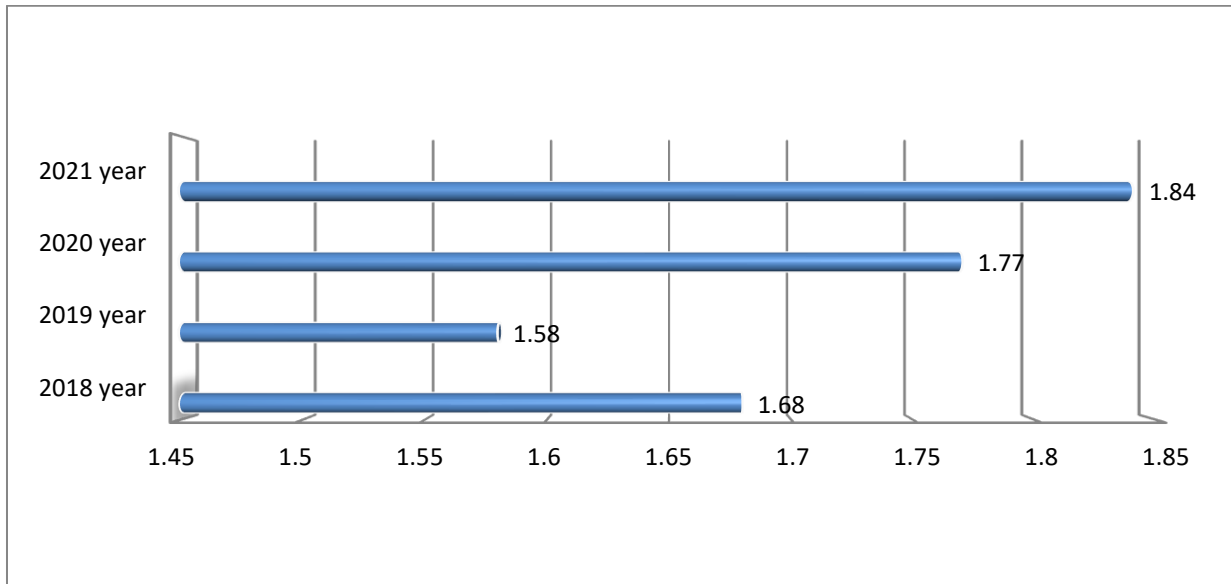
- a) shareholders establish a bank and pay the charter fund:
 - 1) the bank attracts additional savings through depositors' deposits;
 - 2) formed funds are directed to finance client practices and conduct documented practices;
 - 3) at the end of the operations, the bank will receive the profit (loss) distributed between the client and the bank

- and the result in the form of a commission from documentary operations;
- 4) the bank distributes the obtained final result between depositors and shareholders of the bank.

Islamic banking products and tools according to banking practices are listed in Figure 1. In the Islamic banking system, there are two main methods of attracting funds and directing them. The first method is the so-called bilateral negotiation: in its framework, all funds are attracted based on the rule of profit and loss distribution between depositors, banks and debtors, and are directed to finance projects.

Another common scheme of the Islamic banking system is the two-tier method. Using this method, the bank's liabilities are divided into two parts: one part of it includes demand deposits (guaranteed return), and the other part includes investment deposits. Demand deposits belong to depositors during the entire term of the contract, so banks must create reserves (in the accounting sense) for possible losses on such deposits. At the same time, investment deposits are directed to the financing of risky projects in which depositors participate. They are not guaranteed by banks and are not subject to reserve requirements.

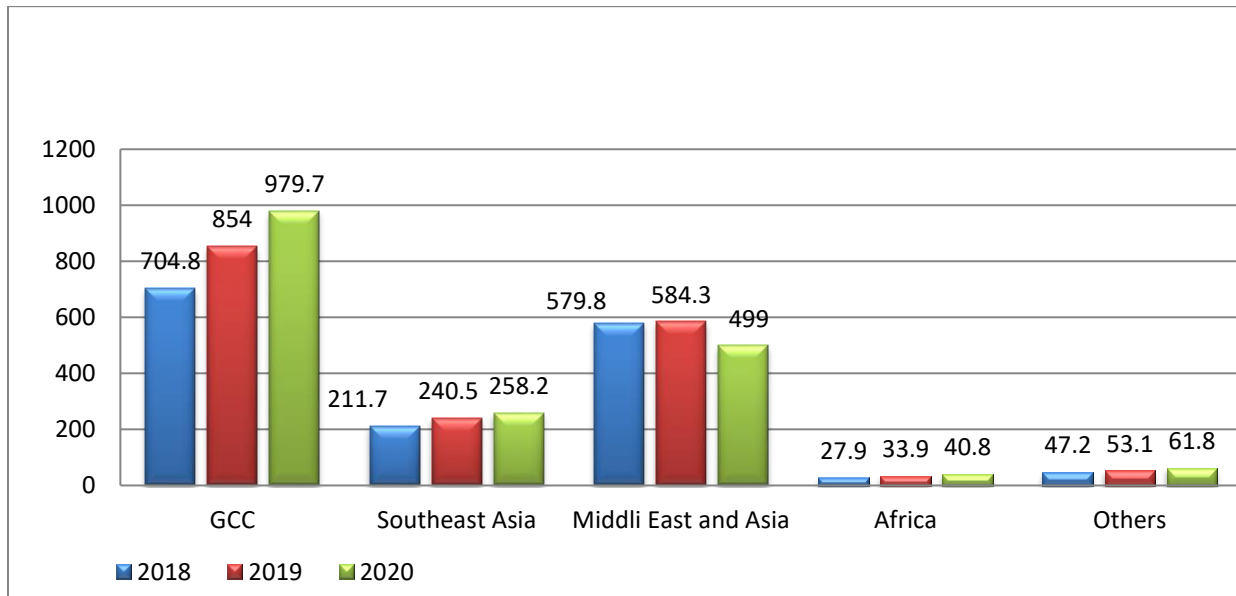
³ Done by author according to gathered information



Bar chart 1. Global Islamic banking size (USD trillion)⁴

In the chart above, we can see the growth rate of global Islamic banking assets from 2018 to 2020. In 2018, it was 1.68 trillion US dollars, and by 2021, it increased by 9.5% and its volume was 1.84 trillion US dollars.

In 2021, the amount of Islamic finance assets was 3.958 trillion USD. Additionally, 2.765 trillion USD of them is Islamic banking assets, 0.713 trillion USD is assets of sukuk, 0.238 trillion USD is Islamic-fund assets, 0.073 trillion USD is assets of takaful, 0.169 trillion USD is assets of other Islamic financial institutions.



Bar chart 2. Regional Islamic Banking Assets (USD billion)⁵

Bar chart 2 shows the share of assets of Islamic banks by region. For example, if we focus on Central Asia and

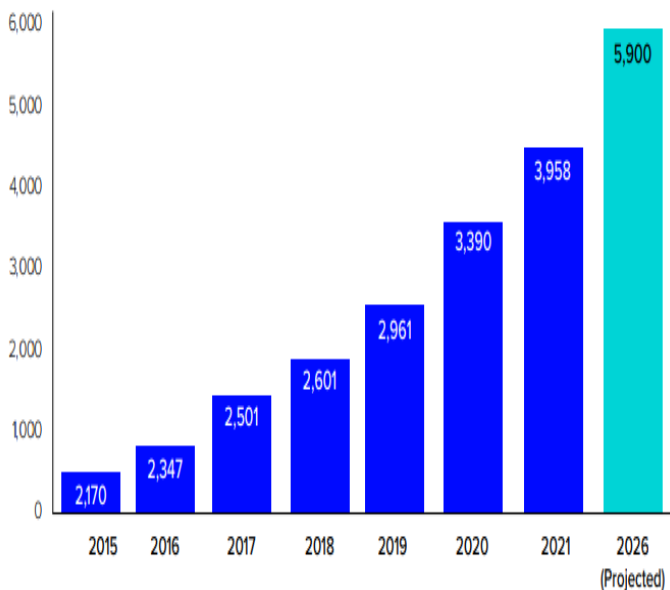
the Asian region, it will be 579.8 billion US dollars in 2018, 584.3 billion US dollars in 2019, and 499 billion

⁴ Stability report of IFSI 2021

⁵ [www.salaamgateway.com/Global Islamic Fintech Report 2022](http://www.salaamgateway.com/Global-Islamic-Fintech-Report-2022)



US dollars in 2020. That is, compared to 2018, in 2019 it increased by 0.78 percent, compared to 2019, bank assets decreased by almost 15 percent in 2020.



Bar chart 3. The projected total asset value for the global Islamic finance markets⁶ (USD billion)

Islamic Finance is developing at a remarkable pace. Studies by Moody and the General Council for Islamic Banks and Financial Institutions (GCIBAFI) stated that the number of Islamic Financial Institutions (IFIs) was expanding worldwide. The studies reported that there are more than 200 IFIs with a total combined asset in excess of 3,9 trillion USD, growing at 10-15 percent a year. The projected total asset value for the global Islamic finance markets will amount to 5,9 trillion USD by 2026.

DISCUSSION AND CONCLUSION.

Since the 90s of the last century, Islamic finance has entered the game in a large area of the traditional financial system and secular legal systems. That is, Islamic banking and financial institutions have entered into direct competition for customers with the traditional banking and financial system, which is working smoothly and effectively. This situation has turned the attention of the Islamic financial system from creating unique and complete offers to "reverse engineering" of traditional financial products, that is, traditional lawyers and Islamic bankers have comprehensively modified traditional banking and financial products. have started to create Islamic products that give customers

mathematically similar financial results. Naturally, all documents were formalized in compliance with the necessary standards. This absorption/adaptation of Islamic finance and its orientation towards "lending" has been the cause of serious criticism and accusations. Critics pointed out that Islamic finance is losing its unique features, its role and importance in the process of reducing poverty in society, increasing the financial coverage of vulnerable segments of the population, creating new jobs and economic growth is not high. In their opinion, if Islamic finance continues such an "official" approach to the issue, it will be separated from its main essence and gradually become one of the "pillars" of the existing traditional banking and financial system. Therefore, the turning point and the main problem for the industry is the development and activation of the real economy, the fair and efficient distribution of financial resources among economic entities, and the creation of an alternative financial system to the traditional banking system. It is a clear understanding of the original goals and tasks of increasing the coverage.

Increasing the share and importance of Islamic microfinance institutions. Today, two-thirds of Islamic finance is concentrated in Islamic banks. Due to the lack of stable and sufficient income of potential customers, lack of collateral and credit history, high risk of projects and business activities and other reasons, a large part of the population and small businesses in most Muslim countries do not have access to the services of Islamic banks. Although Islamic microfinance organizations have all the necessary tools to work with the most vulnerable segments of the population, this opportunity is rarely used in practice. Therefore, huge social strata cannot get out of the dead end of poverty. Moreover, the share and importance of such institutions in the Islamic financial system is very small. At the moment, there are great opportunities to use tools such as debt hasana, zakat, waqf and modern financial methods (fintech) to finance the needs of vulnerable populations and reduce poverty.

There are a number of countries where the population consists mainly of Muslims or where the majority of the population is made up of Muslims. At the moment, for various reasons, a wrong or biased opinion and attitude towards Islamic finance has been formed by the population, at the state level or within the traditional banking community. This is one of the main reasons for the low level of implementation,

⁶ Annual report of IsDB 2022



development and use of the sector in society. Therefore, international Islamic organizations, the scientific community, educational institutions, Islamic banking and financial institutions and groups should go beyond their narrow national framework and share the experience of countries that have successfully introduced Islamic finance with the population and national coordinating organizations, financial market participants and officials. should be widely promoted and thereby increase the level of acceptance and understanding of the essence of Islamic finance.

Islamic finance is working successfully in a number of countries. Islamic finance has relatively successfully weathered the global financial crisis, proven its resilience to systemic risks, viability and flexibility in a secular legal environment, and continues to contribute significantly to overall economic growth. In this, it provides opportunities for those who turn to Islamic finance based on their religious beliefs, and for those who intend to more fully satisfy their financial needs through this system. Another problem is that the traditional banking community exaggerates the "threats of the Islamic banking system", worrying about the decline of its share in the financial market and the mass migration of customers to Islamic banks. However, the experience of the development of the Islamic banking and financial system over the past 30 years shows that even in Muslim countries that have preserved their religious traditions and beliefs, the main share of the financial sector is the contribution of the traditional banking system. is coming For example, apart from Saudi Arabia (where the share of both systems is equal), if we look at other Gulf countries, Pakistan, Bangladesh, Malaysia, Indonesia, Egypt, Turkey and others, they all have a large Islamic banking system. has been content with a very small share for years. At the same time, it is the Islamic banking system that serves to bring out large amounts of money lying idle in the hands of the population "from under the bed" and attract them to the real economy, thereby significantly activating the economy, commerce and the well-being of the population. Therefore, within the framework of any legal system and under any circumstances, Islamic banks can be a source of economic activation and growth, as well as an alternative system that ensures healthy competition in the banking and financial sector.

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