

PROSPECTS FOR THE IMPLEMENTATION OF AN ISLAMIC FINANCIAL SYSTEM IN UZBEKISTAN

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Abstract: This article analyzes the relevance, opportunities and prospects of introducing an Islamic financial system in Uzbekistan. In recent years, our country has been implementing large-scale reforms aimed at diversifying the financial market, introducing new investment instruments and attracting foreign capital. From this point of view, the introduction of services based on the principles of Islamic finance will not only stabilize the economic system, but also expand the opportunities for different segments of the population to use financial services. The article discusses the basic principles of the Islamic financial system, international experience, the existing legal and institutional framework, as well as the main obstacles to the implementation of this system in Uzbekistan and recommendations for their elimination. The results of the study show that the introduction of Islamic financial services can serve to increase the competitiveness of the country's financial market and ensure economic stability.

Keywords: Islamic finance, financial market, investments, economic stability, banking system.

Introduction. In recent years, the financial market in Uzbekistan has undergone significant changes, and important steps have been taken to diversify, introduce new investment instruments, and attract foreign capital. These reforms are aimed at making the developing financial system more stable and in line with international requirements.

First, creating favorable conditions for investors has become one of the key priorities in state policy [1]. For example, by 2025, the government of Uzbekistan plans to attract about \$42 billion in foreign investment. Within the framework of these plans, the number of large and medium-sized projects is being increased, and the availability of grants and soft loans is being expanded.

Second, the financial institutions and banking sector is being reformed. For example, the volume of bank lending has doubled, and bank capital has increased by about 1.6 times. At the same time, foreign banks and financial institutions are entering the Uzbek market - banks from countries such as Turkey, Kazakhstan, Georgia, and Hungary are participating. Banks are receiving international ratings and are starting to operate in international financial instruments such as Eurobonds.

Third, in order to diversify the market, new financial instruments are being analyzed: green bonds, sustainability bonds, venture capital, and legislative initiatives on alternative investments [2]. For example, Uzbekistan has begun implementing green bonds and "sustainability bonds," which are increasing the prospects for financing environmental and social projects without harming the environment. Also, a draft law on "Alternative Investment Funds" is being prepared at the initiative of the President. The goal is to increase the volume of venture investments and other alternative investments to \$1 billion over the next five years.

Fourth, the development of financial technologies and the startup ecosystem has also become one of the important directions. For example, in 2024, the number and total value of startup transactions increased significantly: foreign investors are actively participating in this area. The state is carrying out legal, institutional structural reforms to stimulate startup and venture capital.

Fifth, mechanisms for attracting investments through new platforms are being created. For example, at the initiative of the President, it is planned to launch a special investment platform in



Uzbekistan, where individuals or organizations will register their projects, and investors will have the opportunity to evaluate them and co-finance them [3]. It is estimated that an additional \$ 1 billion in investment will be attracted through this platform annually. Also, transformations are taking place in the field of state-owned enterprises and state asset management. International investment management companies such as Franklin Templeton are considering the possibility of registering and selling state assets on international markets (privatization) through the National Investment Fund (UzNIF). This will improve the governance and transparency of state-owned enterprises, and reduce risks for investors. Another area is to strengthen the legal framework for improving export financing instruments and creating incentives for investors in special economic zones (SEZs). For example, in cooperation with the International Finance Corporation (IFC), measures are being taken to bring Uzbekistan's investment legislation into line with international standards and encourage private sector participation in special economic zones [4]. As a result, all these reforms are leading to diversification of the financial market in several ways: the banking sector - capital and credit volume; financial instruments - bonds, venture capital, alternative funds; new investments through platforms and startups; privatization of state assets and access to international markets; foreign trade and investments through SEZs and export financing instruments. These changes are aimed at increasing the transparency, efficiency and attractiveness of Uzbekistan's financial system, strengthening the confidence of international investors, and stabilizing economic growth. However, areas such as creating the right legal framework, improving financial market infrastructure (management, audit, risk control), and increasing financial literacy still require attention.

Currently, Islamic financial services in Uzbekistan are seen as an important opportunity to increase access to financial services for different segments of the population. Islamic finance includes asset-based financial contracts that do not charge *riba* (interest), are in line with the principles of Sharia. Such services provide an alternative for individuals who are far from traditional banking services for religious, moral or material reasons.

Firstly, there is a segment of the population that does not want to use traditional bank loans due to their religious beliefs [5]. For example, as noted by the Central Bank of Uzbekistan, a certain part of the population is excluded from financial services that operate on a simple interest basis. Services based on the principles of Islamic finance, such as loans, financial assistance, financial partnerships (*musharaka*), and profit-sharing financing (*mudaraba*), may be more convenient for this segment. Through such services, they will be integrated into the financial system.

Secondly, a legal framework has been created for the introduction of Islamic financial services in microfinance institutions. In 2024, the Central Bank of Uzbekistan allowed MFIs to provide services such as "*murabaha*", "*musharaka*", and leasing based on Sharia principles. This will provide small businesses and the population with easy access to credit, as well as increase the coverage of groups that do not use or have limited access to financial services.

Third, reforms are being carried out in the field of regulation of banks and financial institutions aimed at creating an environment of transparency and trust. For example, Moody's agency positively assessed the initiative to create a new legal and regulatory framework for Islamic finance [6]. This legal framework will allow banks to issue products in accordance with Sharia principles, and for customers, doubts about risks and uncertainties will be reduced.

Fourth, from the perspective of financial inclusion and social sustainability, it is important that Islamic financial services provide suitable offers to different groups of the population. For example, small business owners, farmers, those with low family budgets, women, and also the population living in remote areas (rural areas) may be more suitable for Islamic financial products, as they prefer forms such as fewer legal requirements, interest-free payments or profit-



sharing financing. This will attract them to the financial system, increasing their sources of income through savings or investments.

Fifth, the principles of Islamic finance increase the need for financial literacy and financial information [7]. Clients need to have a deep understanding of the features and conditions of Sharia-compliant financial instruments. Therefore, it is important for the state and financial institutions to create moral education, financial education and free access to information. This will encourage people to be careful and conscious in making financial decisions.

The economic benefits for the country are also significant: as the use of financial services expands, the flow of capital into society - in the form of deposits and investments in banks - increases; thus, banks and financial institutions acquire more assets, and the volume of credit expands. Thus, economic growth, job creation and investment attraction develop. In recent years, for example, an agreement was signed between ICD (Islamic Corporation for the Development of the Private Sector) and Turonbank for financing small and medium-sized enterprises in the amount of \$ 25 million. Such initiatives are an example of expanding the range of financial instruments that can serve the population and small businesses. At the same time, there are still problems that need to be resolved. These are: a shortage of Sharia experts, a lack of information about Islamic financial services among the population, an incomplete operational and legal infrastructure for the implementation of Sharia in banks and financial institutions, and the need to adjust risk standards for foreign investments. If these problems are resolved, Islamic financial services will be a decisive factor in expanding access to financial services for different segments of the population.

Islamic finance, i.e. a system of financial transactions in accordance with the principles of Sharia, is usually based on three main principles: not charging *riba* (interest), avoiding *gharar* (uncertainty of risk) and staying away from harmful elements such as *maisir* (gambling). In addition, it prefers asset-based transactions through contracts such as financial partnership (*musharaka*), profit-sharing financing (*mudaraba*), lease (*ijarah*), and trade contracts (*murabaha* and *salam*). In this way, resources are directed only to real economic activities, and risks and benefits are shared, that is, not just debt-based use. (International organizations such as AAOIFI, IFSB serve these principles).

In the world, countries such as Malaysia, Saudi Arabia, the United Arab Emirates, Turkey, and Qatar have successfully established Islamic banking and financial institutions. They:

- ✓ Sharia Supervisory Boards monitor whether financial products and services comply with Sharia rules;
- ✓ Created a legal framework for the issuance of Sukuk (Islamic bonds) and developed the sukuk market;
- ✓ Opened Islamic windows (i.e., a Sharia-compliant department within a conventional bank) in local financial institutions, usually without establishing an entire bank, but allowing them to offer services in accordance with Sharia principles;
- ✓ Expanded products such as microfinance, insurance (*takaful*), leasing, and *musharaka*, and penetrated deeply into the less financially serviced segments of the population;
- ✓ Resolved legal problems by adapting tax, banking legislation, and financial supervision institutions to Sharia.

These experiences show that if the financial market, legal framework, and social needs are aligned, Islamic finance can bring significant benefits to the population and the economy.

In recent years, Uzbekistan has undergone several major legal and institutional changes related to the implementation of an Islamic financial system. In 2024, the Central Bank approved a procedure that allows microfinance organizations to offer services in accordance with Sharia principles.



The president and the government are taking initiatives to legalize and expand “Islamic finance” services. In May 2024, a draft law was developed that would allow banks to provide financial services in accordance with Sharia principles, which is planned to be submitted to Parliament. Some banks are cooperating on the issue of opening “Islamic windows”. For example, “murabaha” financing lines have been established with established banks and the International Islamic Development Bank (IsDB) and its affiliates.

Given the Muslim majority of Uzbekistan’s population and the need for Islamic financial products, surveys show that a large percentage of individuals and businesses are interested in Sharia-compliant financial services.

However, a number of challenges — legal, institutional, infrastructural, and educational — remain:

✓ Uzbekistan still does not have a specific law that would allow banks to fully implement Islamic financial services. Traditional banking laws restrict “commercial banks” from engaging in commercial, trade, and manufacturing activities, but Islamic finance is often asset-based or through partnerships. Tax legislation can also create a double tax burden on transactions such as murabaha, which increases the cost of services.

✓ Sharia supervision and expertise are not yet fully established. Institutions such as Sharia councils, audit and risk control, and product compliance assessments are not yet robust.

✓ The necessary infrastructure for financial services and settlement systems, electronic banking, insurance (takaful), and new instruments such as sukuk are lacking. For example, market liquidity, investor interest, and the legal framework for sukuk issuance are not yet established.

✓ There is insufficient understanding among the population about Islamic financial products, Sharia-compliant transactions, products such as murabaha, mudaraba. These misunderstandings cause caution and suspicion.

✓ Islamic financial capital sources, international markets, and opportunities for foreign investors to cooperate with Sharia-compliant financial institutions have not yet been fully opened. This limits the growth of the sector.

The following measures can be taken to overcome these obstacles:

Adopt special laws and regulations: Special laws should be adopted for banks, insurance, investment funds and microfinance institutions to formalize Sharia-compliant activities. A regulatory framework should be created for instruments such as sukuk issuance, Sharia-compliant insurance (takaful), ijara, mudaraba, musharaka. (For example, the May 2024 project is a step in this direction)

Sharia councils should be independent, have a sufficient number of experts, and appropriate audit and control mechanisms should be developed for products and services. Financial supervisory authorities should also understand the risks of services in this area and establish appropriate guidelines.

The necessary infrastructure for the opening of the sukuk market, takaful, Islamic microfinance services and “Islamic windows” - financial markets, liquidity facilities, IT systems, Sharia-compliant processes for bank operations - should be introduced. Market participants and the state can jointly create a platform.

Conduct explanations, trainings, seminars for the population and business representatives on the principles, products and legal status of Islamic finance. State and non-state organizations should organize informatics campaigns.

Expand cooperation with the Islamic Development Bank (IsDB), other international financial institutions and financial leaders. With their help, it is possible to attract financial technologies, products, expertise and investment flows.



Develop a systematic plan (“roadmap”), which should identify the main stages, issues, responsible institutions and deadlines in this area. It is important that state policy establishes incentives and guarantees that support the Islamic finance sector.

Conclusion. In conclusion, Uzbekistan has great potential for implementing an Islamic financial system, thanks to its basic principles and international experience. Although the government and financial regulators have already initiated a number of legal and institutional measures, there are obstacles to a fully functioning system, such as regulatory gaps, a shortage of specialists, infrastructure problems, and low public awareness. If work is carried out based on the above recommendations, Islamic finance can enrich Uzbekistan's financial system and contribute to social justice, stability, and investment activity.

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