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EMPLOYING BANGLADESH'S EXPERIENCE IN THE DEVELOPMENT OF ISLAMIC FINANCE IN UZBEKISTAN

Irgasheva Gulbakhor[1]

[1]PhD Candidate of Tashkent State University of Economics, Uzbekistan.

irgashevagulbahor77@gmail.com

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ABSTRACT

This article examines and analyzes the experience of Bangladesh, where the Islamic finance sector has significantly flourished. The study explores the historical development of Islamic finance in the country, its current state, and the establishment of infrastructure for organizing services in this sector. It delves into the establishment of Islamic banking, practices of financing projects through Islamic means, as well as the barriers to development and potential solutions to these challenges. Furthermore, it discusses the avenues for leveraging Bangladesh's expertise to address the deficiencies encountered in the advancement of Islamic finance in Uzbekistan.

Keywords. Islamic finance, regulatory framework, Islamic banking, Islamic windows, Bangladesh, Uzbekistan, investment projects, Islamic financial products, IIB.

1. INTRODUCTION

Currently, the Islamic finance industry is recognized as one of the rapidly growing sectors globally, with its influence on the international stage steadily increasing. Numerous countries are showing significant expansion in the adoption of the Islamic finance sector within their financial portfolios year by year. As a result, by the end of 2021, the value of global Islamic finance market assets reached $4.0 trillion, and the number of Islamic financial institutions approached 1,700. In comparison, during the mid-1990s, the Islamic finance system was predominantly present only in the Middle East and Malaysia, with the number of Islamic financial institutions totaling 144 and their aggregate assets approximately $150 billion.

By 2020, the total assets of Islamic finance amounted to $2.88 trillion, and it is projected to grow to $3.69 trillion by 2025, with an average annual growth rate of 5.5% expected during the 2020-2025 period. According to international experts, by 2023, the assets of Islamic banks are anticipated to reach $3.3 trillion, reflecting an 11% increase compared to the previous year. This surge in interest in Islamic financial instruments, including Sukuk, is projected to result in Islamic banks' assets reaching $3.7 trillion by 2025. Islamic finance prohibits the earning of profit through lending and borrowing, mandating that all financial processes be based on real economic activities. Additionally, it does not permit financing in sectors that could cause harm to individuals.

In Uzbekistan, several initiatives have also been undertaken in the field of Islamic finance. Notably, activities in this area commenced in the 2000s, particularly following the country's accession to the Islamic Development Bank in 2003. Since the initiation of collaboration with the Islamic Development Bank (IDB), over $2 billion in credit resources have been allocated to implement 25 projects in Uzbekistan based on the principles of Islamic finance (Sharia-compliant), covering sectors such as healthcare, energy, agriculture, housing construction, and road infrastructure.

The Private Sector Development Islamic Corporation (PSDIC), part of the Islamic Development Bank group, has allocated $617 million, while the International Islamic Trade Finance Corporation has directed $463 million towards commercial banks and local enterprises.

In a statement addressed to the Oliy Majlis and the public by the President of the Republic of Uzbekistan, a directive was issued to establish a legal framework for the implementation of Islamic finance services in the country. This involves engaging experts from the Islamic Development Bank and other international financial institutions. In collaboration with relevant ministries, agencies, and the foreign consulting company INFAAS, a draft law aimed at incorporating Islamic financial instruments into the existing legislation has been developed. This draft law is scheduled for parliamentary discussion by the end of 2024.

Several amendments are being made to the draft law on Islamic finance, specifically:

1. In the current version of the Civil Code, the opportunities for commercial banks to collaborate with legal entities under the musharaka model are limited. The draft law seeks to eliminate these restrictions, enabling banks to invest in collaboration with companies and to fairly distribute profits or losses.

2. According to the "Law on Banks and Banking Activities," there are restrictions preventing banks from directly engaging in trade and production activities, limiting their ability to utilize Islamic financing instruments such as

murabaha and ijara. The draft law proposes to abolish these restrictions for Islamic banks, allowing them to participate in such operations.

3. Changes are also being made to tax legislation to establish a favorable tax regime for Islamic finance. Specifically, tax exemptions are being stipulated for instruments such as sukuk, which are to be exempt from income tax.

4. Given that interest on deposits is prohibited within the Islamic finance system, relevant amendments to current legislation are being introduced. Banks will be able to offer mudarabah (profit-sharing) products to their clients, whereby the bank will manage depositors' funds and share profits derived from investments.

5. The draft law envisions the establishment of special divisions within banks, and each Islamic bank will have a dedicated unit—a Sharia Advisory Board—tasked with overseeing operations in accordance with Sharia principles. This advisory board will conduct internal audits of banking products and services, providing assessments on their compliance with Islamic la.

Utilizing the experience of Bangladesh, one of the countries where the Islamic finance industry has thrived, is expected to contribute significantly to the further development of Islamic finance in Uzbekistan. In this research endeavor, we aim to specifically examine the achievements of Bangladesh in the field of Islamic finance. Additionally, the study highlights the relevance of exploring Kazakhstan's experience in the Islamic finance sector and aims to develop scientific conclusions and recommendations that could be applied in Uzbekistan to implement this approach effectively.

2. LITERATURE REVIEW

This research primarily focuses on examining the experiences of Bangladesh, where the Islamic finance industry has developed significantly, with the aim of deriving valuable conclusions and recommendations for furthering the development of Islamic finance in Uzbekistan.

The term “Islamic finance system” emerged in the mid-1980s, making it a relatively new concept among scientific terminologies. Consequently, interest in the field of Islamic finance has notably surged, especially in the 21st century, which has led to an increase in academic activities, including research and the preparation of analytical materials. In particular, numerous foreign scholars, researchers from the CIS countries, as well as Uzbek scientists, have been actively conducting their investigations in the realm of Islamic finance and publishing their findings.

Among the prominent scholars engaged in research on Islamic finance is M. Kabir Hassan, along with Muhammed Tarik Islam, Zobayer Ahmed, and Jahidul Islam Sarker. In their study titled “Islamic Banking in Bangladesh: A Literature Review and Future Research Agenda”, they highlight the heightened interest in the field of Islamic banking. This is evidenced by the significant increase in publications worldwide on the subject, indicating that it has remained a priority topic for many scholars in Bangladesh

Additionally, Mohammed Imad Ali and Ikramur Rahman Falahi, in their research titled “Islamic Banking and Finance: Principles and Practices,” elucidate the concepts of Islamic finance and banking, as well as Islamic investments and their roles in the economic development of countries.

Abu Umar Faruq Ahmad, in his research titled “Islamic Banking in Bangladesh,” presents insights and reflections on the development of Islamic finance in Bangladesh, the history of the establishment of Islamic banks, the differences between Islamic banks and conventional banks, as well as the instruments of Islamic financing.

However, the number of researchers conducting studies and investigations in this field in Uzbekistan is steadily increasing, contributing to the body of knowledge to a certain extent. In particular, Rukhiddin Zayniddinov, in his research titled “Opportunities for Utilizing the Turkish Experience in the Development of Islamic Finance in Uzbekistan,” examines the organization of Islamic financial services in Turkey, the practices of Islamic project financing, as well as the obstacles and solutions on the path to development. He explores the avenues and possibilities for implementing the Turkish experience in Uzbekistan, and the author has developed his own conclusions and recommendations.

In our scientific research, conclusions and recommendations have been developed for utilizing Bangladesh's experience in the field of Islamic finance in Uzbekistan.

3. METHODS

In this research, a quantitative approach was employed for a comprehensive scientific analysis. Additionally, effective use was made of logical and structural analysis, as well as economic-statistical, systemic, and comparative analysis methods in the execution of the study.

4. RESULTS AND DISCUSSION

Bangladesh is recognized as one of the fastest-growing economies in the world. Alongside other economic activities, the Islamic finance industry has also experienced significant growth, as Bangladesh is the third-largest Muslim-majority country globally, with a population exceeding 173 million, of which 90 percent are Muslims. Consequently, efforts to establish Islamic banks in the country began in 1974, the same year Bangladesh became a member of the Organization of Islamic Cooperation (OIC). The public's hope and aspiration for managing the banking system based on Islamic principles materialized following the recommendation for developing a distinct banking system during the 9th conference of the OIC foreign ministers held in Senegal in 1978.

In 1980, the director of Bangladesh Bank, researcher A.M. Fakhrul Ahsan, indicated the necessity of establishing Islamic banks in the country. By 1981, the Ministry of Finance recommended the experimental implementation of separate Islamic banking counters in all branches of state banks in Bangladesh, along with maintaining separate accounts for this purpose. In 1982, a delegation from the Islamic Development Bank visited Dhaka to monitor and evaluate the feasibility of establishing a joint venture for an Islamic bank in the private sector of Bangladesh. During this visit, they proposed to the Islamic Development Bank to invest as an investor in the establishment of the Islamic bank.

As a result of these efforts, the first Islamic bank in the country, Islami Bank Bangladesh Limited, was established on March 30, 1983, and commenced its operations. This bank was founded by investors from Saudi Arabia and Kuwait, who provided 70 percent of the initial capital.Islami Bank Bangladesh PLC (IBBPLC) is the largest commercial bank in Bangladesh and the first Sharia-compliant Islamic bank in Southeast Asia, established in 1983. The majority shareholding of the bank is held by foreign institutions, and it is listed on the Dhaka and Chattogram stock exchanges. With 394 branches and 2,771 agent banking points, the bank boasts the largest branch network among private sector banks in Bangladesh. As of today, according to the data from Bangladesh Bank (BB) for the year 2022, there are 10 full-fledged Islamic banks in the country, which collectively operate 1,679 branches out of a total of 10,942 branches within the banking system.

Table 1: A List Number of Islamic Banks

	Name of Islamic banks	**Year of incorporation**	**Year of listing**	**Organizational status**
1.	Islami Bank Bangladesh Limited	1983	1985	Full-fledged
2.	ICB Islamic Bank Limited	1987	1990	Full-fledged
3.	Al-Arafah Islami Bank Limited	1995	1998	Full-fledged
4.	Social Islamic Bank Limited	1995	2000	Full-fledged
5.	EXIM Bank Limited	1999	2004	Full-fledged
6.	Shahjalal Islami Bank Limited	1999	2007	Full-fledged
7.	First Security Islami Bank Limited	1999	2008	Full-fledged
8.	Union Bank Limited	2013		Full-fledged
9.	Standard Bank Limited	1999		Full-fledged
10.	Global Islami Bank Limited	2013		Full-fledged

In Bangladesh, Islamic financial services are additionally offered by 511 Islamic banking windows of 13 conventional commercial banks and 23 Islamic banking branches of 11 conventional commercial banks.

Table 2: Islamic Banking Branches and Windows in Conventional Banks

	Islamic Banking Branches in Conventional Banks	**Islamic Banking Windows in Conventional Banks**
1.	The City Bank Limited	Sonali Bank Limited (58)
2.	AB Bank Limited	Janata Bank Limited*
3.	Dhaka Bank Limited	Agrani Bank Limited (48)
4.	Premier Bank Limited	Pubali Bank Limited (17)
5.	Prime Bank Limited	Trust Bank Limited (15)
6.	Southeast Bank Limited	Bank Asia Limited (5)
7.	Jamuna Bank Limited	Standard Chartered Bank (1)
8.	Bank Alfalah Limited	Mercantile Bank Limited (45)
9.	NRB Bank Limited	Midland Bank Limited (1)

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10.	One Bank Limited	NRBC Bank Limited (268)
11.	United Commercial Bank	United Commercial Bank (10)
12.		Meghna Bank Limited (3)
13.		Mutual Trust Bank Limited(15)
14.		Premier Bank Limited (25)

Islamic banks in Bangladesh currently play a significant role in the financial market, and their status continues to grow. The accompanying chart illustrates the performance of Islamic banks from 2013 to 2022.

Since their establishment, Islamic banks have been instrumental in attracting deposits and financing various economic activities. Presently, the Islamic banking system accounts for over 26% of total deposits in the banking sector and more than 28% of investments. Islamic banks hold approximately a 25% share in the overall banking system of Bangladesh. Their assets and credit portfolios are consistently expanding, demonstrating substantial growth over the past years.

The significant increase in the presence of Islamic banks reflects their vital contribution to the financial landscape of Bangladesh, indicating a robust trend in the adoption of Islamic finance principles among the population and businesses alike.

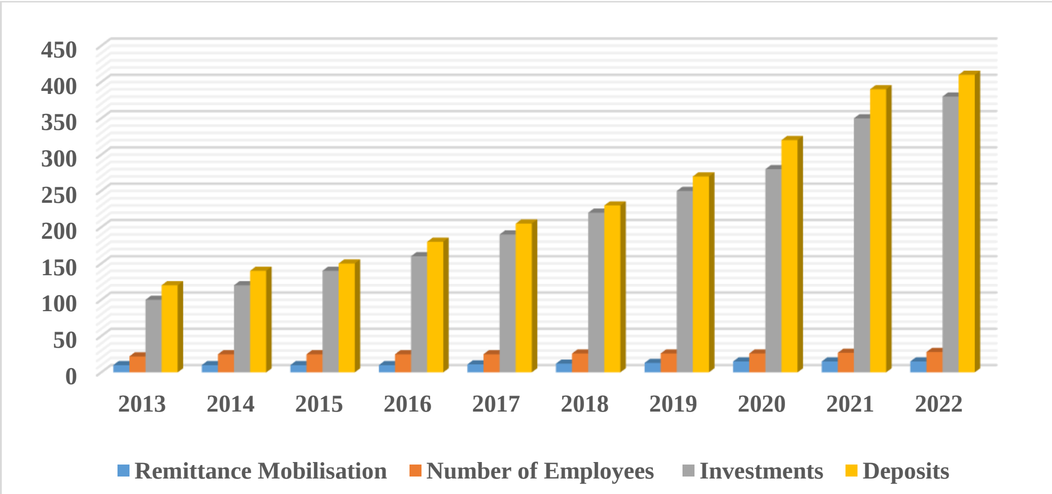

Figure 1. Rise of Islamic Banking in Bangladesh

The total deposits in the Islamic banking sector increased from 1,200.00 billion BDT in 2013 to 3,996.79 billion BDT by the end of March 2022, representing 28.21% of the total deposits in the entire banking sector at that time. Compared to March 2021, deposits in Islamic banks grew by 11.71%. From March 2017 to March 2022, the overall annual growth rate for Islamic banking deposits was 16%, in contrast to 10.75% for the entire banking sector.

This growth underscores the increasing trust and participation of customers in Islamic banking, reflecting a broader acceptance of its principles and services within the financial landscape of Bangladesh.

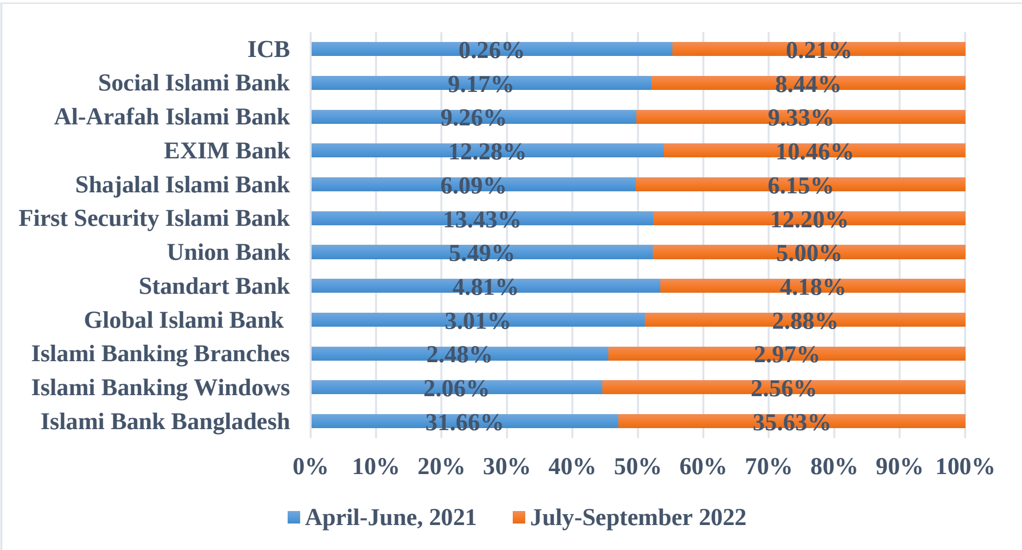

Figure 2. Share of Investments made by Islamic Banks

As of the end of September 2022, total investments (loans and advances) in the Islamic banking system reached 3,862.21 billion BDT, reflecting an increase of 43.92 billion BDT, or 1.15%, and a rise of 494.01 billion BDT, or 14.67%. Islamic banks account for 28.98% of the total loans and advances in the entire banking industry.

Among these investments, 94.47% are attributed to ten full-fledged Islamic banks, 2.97% to Islamic banking branches of traditional banks, and the remaining 2.56% to the Islamic banking windows of conventional banks. Among the ten full-fledged Islamic banks, Islami Bank Bangladesh Ltd. demonstrated the highest investment levels at both the end of June 2021 and September 2022, accounting for 31.66% and 35.63% of the total, respectively.

Following Islami Bank, First Security Islami Bank Ltd. ranked second in both periods, contributing 13.43% and 12.20%. Other notable banks include EXIM Bank Ltd. (10.46%), Al-Arafah Islami Bank Ltd. (9.33%), Social Islami Bank Ltd. (9.17% and 8.44%), Shahjalal Islami Bank Ltd. (6.00% and 6.15%), Union Bank Ltd. (5.49% and 5.00%), Standard Bank Ltd. (4.81% and 4.18%), Global Islami Bank (3.01% and 2.88%), and ICB Islamic Bank Ltd. (0.26% and 0.21%) (figure 2).

This data illustrates the significant role of Islamic banks in the overall investment landscape of Bangladesh, highlighting their increasing importance and contributions to the financial sector.

Bangladesh's sukuk market has grown significantly since the introduction of Islamic bonds in 2004. This mechanism draws in financial resources from the public and private sectors by operating according to the principles of Islamic finance. The main purpose of issuing sukuk is to fund different infrastructure projects. "Sukuk Al-Ijara," the first sukuk to be issued in Bangladesh in 2004, is intended to be used as a means of generating revenue through real estate leasing.

Sukuk issuances increased even more by 2010, with an emphasis on funding social and infrastructure projects in the nation. The business sector has also begun issuing sukuk since the 2020s, in addition to the public sector. Because this funding approach complies with Islamic finance rules, investors are showing interest in it.

The Bangladesh Bank has facilitated the issuance of sukuk (Islamic securities), notably launching the country's first sovereign investment sukuk to raise 80 billion BDT for the implementation of a clean water supply scheme on behalf of the government. On December 29, 2021, the Bangladesh Bank issued its second sovereign sukuk to finance the "Development of Essential Infrastructure for Government Primary Schools" project (Phase 1), successfully raising 50 billion BDT for the initiative.

Additionally, the Bangladesh Securities and Exchange Commission (BSEC) granted the Bangladesh Export-Import Company (Beximco) the right to issue 30 billion BDT worth of Beximco Green Sukuk bonds on July 8, 2021. The first sukuk, Beximco Green Sukuk Al Istisna', was launched on January 13, 2022, marking a significant entry into the country's capital market.

Currently, the Bangladesh government is striving to effectively attract financial resources through the application of sukuk. This approach not only contributes to economic growth but also aids in the development of social infrastructure projects.

Sukuk issuances are gaining traction in the country, aligning with the principles of Islamic finance and becoming increasingly popular among investors.

5. CONCLUSION

Based on the findings of our research, we can draw the following conclusions: despite the Islamic finance sector being relatively nascent in comparison to other segments of the economy, it has garnered significant interest and is experiencing notable growth in numerous countries due to its inherent reliability and resilience. In Bangladesh, for instance, initiatives pertaining to Islamic finance commenced quite early, resulting in a substantial level of interest that subsequently facilitates the development of Islamic banking institutions.

Additionally, Islamic banks, by offering financial services grounded in social responsibility, attract a diverse clientele, thus enhancing their customer base. To date, Islamic banks in Bangladesh are successfully advancing and continue to solidify their presence within the financial market.

Similarly, in Uzbekistan, there exists a pronounced interest among both the general populace and representatives of the business sector regarding this domain. A series of initiatives are currently underway in this context. Notably, during the plenary session of the Senate held on May 18, 2024, it was articulated that the "Uzbekistan-2030" strategy aims to establish the legal foundations and regulatory framework for Islamic finance within the Republic. Furthermore, Bekhzod Hamrayev, the Deputy Chairman of the Central Bank, indicated that a draft legislative proposal concerning the establishment of Islamic finance has been formulated, with intentions to present the document for parliamentary discussion by the conclusion of 2024.

The comprehensive implementation of Islamic finance services in Uzbekistan opens up the following opportunities for the country:

1.Increasing and diversifying the volume of foreign investments: The introduction of Islamic finance can attract new sources of capital and reduce reliance on traditional financing.

2.Creating a halal and transparent competitive environment within the banking sector: This development fosters opportunities for diversifying the assets of the banking system and promotes ethical banking practices.

3.Ensuring maximum participation of the population's and businesses' idle funds in the economic development: By mobilizing these resources, the economy can benefit from increased liquidity and investment.

4.Coordinating and modernizing infrastructure through the development of the Islamic finance services industry: This sector can play a pivotal role in financing infrastructure projects that align with sustainable development goals.

Following the adoption of legislation related to Islamic finance in Uzbekistan, it is imperative to first enhance the level of awareness among the population. The following recommendations can be made in this regard:

1.Training financial sector specialists: Providing the necessary knowledge for working with Islamic financial products and offering certification programs can strengthen expertise in the field.

2.Informing the public about the advantages, achievements, and principles of Islamic finance: Raising consumer interest, trust, and awareness can be accomplished through open lectures and seminars that disseminate valuable information.

3.Establishing Islamic finance courses in universities, institutes, and educational institutions: These courses should aim to help students understand the principles and practices of Islamic banking, takaful (Islamic insurance), and investment, thus preparing a knowledgeable workforce for the industry.

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[10] Developments of Islamic Banking System in Bangladesh, July-September 2022, 1Prepared by Islamic Banking Wing, Research Department, Bangladesh Bank (The Central Bank of Bangladesh). Feedbacks are welcome and may be sent to Farida Parveen, Director, Research Department, Bangladesh Bank (e-mail: farida.parveen@bb.org.bd), Md. Jasim Uddin, Additional Director (e-mail: jasim.uddin@bb.org.bd) and Md. Alamin, Assistant Director (e-mail: md.alamin962@bb.org.bd).