



## Ways of Development and Formation of Islamic Banking in Modern Economy

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**Abstract:** The article describes the origin and development of Islamic banks. The differences between the traditional and Islamic banks are compiled.

**Keywords:** islam banking, riba, islamic windows, musharaka, mudoraba.

### INTRODUCTION

The concept of the “Islamic financial system” spread in the mid-1980s. This is a little-known and significant way of organizing financial relations, which proved its right to exist during the financial and economic crisis. The history of the development of Islamic finance appeared due to the origin of Islamic banks.

In accordance with the draft Resolution Of the President Of the Republic Of Uzbekistan, Dated 05.03.2019. Pp-4224 “On Measures To Further Expand And Deepen Partnership With The Islamic Development Bank Group And the Funds of the Arab Coordination Group”<sup>1</sup>, measures are being taken to further expand cooperation of domestic financial institutions with the Islamic Development Bank. The document was developed in order to create alternative financing opportunities and meet the growing needs of the population and entrepreneurs, expand the range of banking and financial services offered, and mobilize resources from domestic and foreign markets based on the principles of Islamic banking and finance.

The works of foreign scientists such as Shelgunov R. V. [2], Bekkin R.I. [3], Juravlev A.Yu. [4], jdanov N.V. [5], Sudin Kharon [6] were studied.

Studying the work of scientists, the following conclusions can be drawn: firstly, the liberalization and globalization of banking services, especially after the application of the international trade agreement, this shows a great demand for the introduction of Islamic banking products, secondly, the technological gap and the weak development of the Islamic financial industry compared to the traditional financial industry, since this is a new direction in the economy and requires Third, in 2019, it was observed that Islamic banks in the world have the largest capital (\$1.7 trillion). than traditional banks, this was transformed by sukuk securities.

### THE MAIN PART AND CONCLUSIONS

Islamic banks are financial commercial organizations that attract deposits from the population and entrepreneurs and place them on investments in accordance with the principles of Sharia for profit. These include both balanced Islamic banks and separate divisions of traditional banks that provide certain services using various Islamic financing methods, called “Islamic windows”.

<sup>1</sup> Постановление Президента Республики Узбекистан, от 05.03.2019 г. № ПП-4224

n accordance with the norms of Sharia, the organization of Islamic financial activities is based on such principles as a ban on interest-bearing lending, risk sharing with its clients, a ban on financing projects involving prohibited types of activities<sup>2</sup>, the absence of investment in high-risk derivatives and speculative transactions, the certainty of contract terms with respect to goods, terms and remuneration.

The main reason for the formation and development of Islamic financial institutions (including Islamic banks) can be considered the growing demand for services provided by traditional financial institutions, but contrary to the religious norms of Muslims. Their further development was facilitated by:

- significant inflow of petrodollars to the Muslim countries of the Middle East as a result of the 1973 oil crisis, which provided a large amount of temporarily free liquidity, not directed to financing investment projects within these countries;
- Intensive development of financial infrastructure through the creation of financial centers in Saudi Arabia, Kuwait, the UAE and Malaysia.

The origin of Islamic banking began in the 60s and originated for the first time in Egypt. For more than half a century, it has been observed that Islamic banks are developing at a rate of 15-20% annual growth and have steadily and dynamically expanded their horizons around the world and have their institutions in more than 75 countries.

The revival of Islamic banking led to the fact that in the 1940-1950 years began to attract serious attention in the social and economic sphere. This is due to the fact that Islamic banks do not have loan interest.

Before the development of Islamic banking, financing was based either on the principle of the prohibition of loan interest, that is, “riba”, or on the models of the partnership of mudarab and musharak. Since Islam prohibits “riba” – usury, or interest – diplomats and legal experts have carefully studied the properties of mudaraba and musharaka and developed a thorough legal framework from various legal sources regarding these two types of investment in order to combine with Sharia. A sufficient number of legal opinions on these two types of financing allowed laying the foundation for the modern theory of Islamic banking.

The first modern scientist who contributed to the theory of the Islamic economic model was Anwal Iqbar Qureshi in 1946 in the book “Islam and the theory of interest”. He proposed to build a relationship between an Islamic bank and a client on the principle of partnership. However, he did not give a clear definition of partnership, suggesting that capital should be provided by one side and work by the other, while profits and losses were assigned to both.

In 1947, Sheikh Mahmoud Ahmad, in his book *The Economics of Islam*, repeated the same point of view with a proposal to establish Islamic banks as joint-stock companies with limited liability. He believed that the placement of the client's capital can be carried out on the principle of partnership.

The authors who responded later – Mohammad Uzair (in 1955), Irshad (in 1964), Al-Arabi (1966) – also saw mudaraba as the main principle of Islamic banking.

In 1968, the scholar Siddiqui explained thoroughly from the theoretical point of view of Islamic economics and the legal foundations of Islamic financial intermediation. According to his proposed banking model, which worked on the basis of mudaraba and musharaka, Islamic banking operations were divided into three categories: services provided for commission and other types of fixed payments, financing under the “mudaraba” scheme or a partnership agreement and services provided free of charge.

В 1985 году была предложена концепция исламского банка, основанная на том же принципе распределения прибылей и убытков. Ключевым моментом было продвижение идеи исламского финансового института как, прежде всего, инвестиционного института. Идея банковской системы пересеклась с идеями других ученых, которые упоминались ранее, и обеспечила более благодатную почву для заключения соглашений о долевом участии в

прибылях и расходах между банком и клиентом. Утверждалось, что исламский банк должен служить, прежде всего, интересам общества, а не отдельного человека или группы лиц. Таким образом, главной целью исламского банка является обеспечение социального благополучия, а также стремление к максимальной прибыли.

An Islamic bank can receive income only if it is a participant in the project itself, the bank must fully share both income and expenses with the client. Therefore, Islamic banks prefer business relations with enterprises of the real sector of the economy. They actively finance both large long-term projects and small non-profitable business projects.

A prerequisite for conducting financial transactions is their conduct on the basis of real assets or transactions with these assets.

Modern Islamic law differs significantly from the traditional one in form, content, and correlation with positive legislation. In modern legal systems, Muslim law relatively rarely appears in the traditional form of doctrine, which remains its leading source in few countries and only in relation to certain branches. In most cases, its norms are fixed in the legislation adopted by the State. As a result, the doctrine (fiqh) as the main source of Islamic law gives way to legislation, and the pluralistic views of various schools are replaced by precise unambiguous norms.

Unlike traditional banks, Islamic banks invest significantly less resources in securities. At the same time, securities permitted by Sharia ("sukuk") have their own characteristics. They must necessarily be associated with a certain asset. The owners of such securities do not have a fixed income, but share risks with the issuer. The profitability of these securities is related to the return on investment in real assets.

Another important feature of Islamic banking is the obligation of the parties to the transaction to strictly fulfill contractual obligations.

The main differences between Islamic and traditional banking are summarized in Table 1.

**Table 1. The main differences between Islamic and traditional banking**

Criteria for differences	Islamic Banking	Traditional banking
Interest rate	No	There are
Speculative nature of operations	No	There are
Risk sharing	There are	No
Focus on the real sector of the economy	High	Low
Social orientation	High	Low
Customer focus	The relationship is based on an individual approach	The basis of the relationship is the implementation of a certain banking product
The bank's right to change the terms of the agreement	No	There are
Information openness for depositors	Full	Low

Basically Islamic banking products are divided into four parts:

1. Products based on the principle of partnership;
2. Products based on the principle of participation in the transaction;
3. Commission banking products;
4. Charitable banking products [7].

Banking products based on the principle of partnership, in turn, are divided into two main types: products with a full partnership and with a trust partnership. A full partnership ("musharaka")

involves the joint participation of the bank and the client in the implementation of a business project and its joint financing. The profit or loss from the implementation of the business project is subject to distribution between the bank and the client in proportion to their contribution to the capital. “Musharaka” is used in the framework of the bank's active operations for export–import financing, project financing, as well as in syndications, securities issues (“sukuk”).

One of the most significant problems hindering the development of Islamic banks are their competitive disadvantages, an undeveloped infrastructure of the Islamic financial services market, a high degree of regional fragmentation, and an imperfect system of banking supervision and regulation.

The competitive disadvantages of Islamic banks are usually investigated in the context of the peculiarities of the development of the Islamic financial services market, as well as in comparison with traditional financial institutions. According to Y. M. Mirkin, “within the framework of Islamic finance (taking into account the hierarchy inherent in Islamic society), it is difficult to expect a mass retail investor in securities taking high risks, focused on large-scale and liquid stock markets” [8].

As a result, the market structure becomes simplified, the share of banks is excessive, and there is a predominance of large family investors in joint — stock capital. Kuran is even more categorical, arguing that at this stage of development — in conditions of weak organization and lack of appropriate skills — the Islamic banking model is in principle not viable [9].

In their activities, they use different methods of financing, implement credit services for direct investments, carry out credit operations on the basis of leasing, leasing, etc. in various countries of the world. These banks take equity participation in modern enterprises, credit trade transactions, including installment payments, and provide comprehensive settlement services to their customers. Some of the Islamic banks are quite widely engaged in investing in the production sector, including in the national industry, previously conducting a comprehensive analysis of the investment project, monitoring the progress of its implementation, and then the activities of the newly created enterprise on the basis of a loan [10].

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