

ISLAMIC INVESTMENT CAN SOLVE THE PROBLEMS OF THE TRADITIONAL INVESTMENT SYSTEM

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Abstract:

This article describes the concept of Islamic investment, its differences and advantages from investing in the conventional financial system. International experiences are studied, the problems faced by legal entities and individuals in the process of financial investment are indicated, and ways to eliminate them using Islamic investment are suggested.

Keywords: Sharia, Islamic finance, Islamic investment, usury, riba, interest, risk, murabahah, musharakah, salaam, istisnah, ijarah, sukuk, mudarabah, zakat, sadaqah, waqf, takaful, financial capitalism

Introduction

Human civilization has been in need of a properly functioning economic system for thousands of years, because in order for a person to live, his basic needs such as food, drink, and clothing must be met. However, human needs are not limited to this, on the contrary, they are unlimited. In order to meet unlimited needs as much as possible, it is very important to use the available opportunities and resources very intelligently. It is for this purpose that until today humanity has used many different economic systems¹. For example, **mercantilism** in the 15th-17th centuries, **physiocratism**

¹ <https://arm.sies.uz/wp-content/uploads/2020/11/6-IQTISODIY-TALIMOTLAR-TARIXI-2005-oquv-qollanma-A.Razzaqov-va-bosh.pdf>

in the 18th century under classical economists' influence, later **Marxism** (non-market economy), and in different periods such systems as **socialism, capitalism, communism, marginalism, bureaucratism, liberalism, and neoliberalism** were applied to the economy. However, none of them turned out to be a perfect system without flaws. Most of them went into recession in short periods.

All the systems mentioned above have one thing in common that they treat Islam and Islamic finance as antiquated. But what we are witnessing today is the complete opposite, most of these systems themselves have become outdated and out of practice. And Islam is as relevant as ever, and today we can see how successful Islamic finance is in the example of several countries that are rapidly moving to this system (Sudan, Malaysia, Kuwait, Iran, Saudi Arabia, United Arab Emirates)².

Over the past few centuries, the political and economic domination of the West has pushed many Muslim-majority countries away from the Islamic environment, including in the economy, but today they have achieved political independence and now the urgent issue is returning all the economic and financial processes to their original Islamic state.³

Considering that more than 90 percent of the population in our country, Uzbekistan, are Muslims, the introduction and development of Islamic financial services would be beneficial in every way. Just like other directions in the traditional financial system, investment also presents certain problems to the state and the population, and switching to the Islamic method of investment could be a solution to addressing these problems.

The main differences between traditional investment and Islamic investment systems

Traditional investment	Islamic investment
Basic principles	
Traditional finance operates on the basis of interest or "riba" (usury), which involves the calculation and payment of interest on loans.	Islamic finance emphasizes the concept of Shari'ah compliance and strictly prohibits riba. Shari'ah, or Islamic law, governs financial transactions in Islamic finance, ensuring ethical and fair practices.
Interest and profit-loss sharing	
Conventional finance relies heavily on interest-based transactions, where lenders charge borrowers a predetermined interest rate. This interest-based model is common	In Islamic finance, interest is replaced by profit and loss sharing. One of the mechanisms of Islamic financing is Mudarabah, where capital is provided by one party (the investor)

² <https://gfmag.com/features/islamic-finance-just-muslim-majority-nations/>

³ An Introduction to Islamic Finance by Mufti Muhammad Taqi Usmani

in banking and financial institutions around the world.	and the other party (the entrepreneur) manages the investment. Profits are shared between the two parties based on a pre-agreed ratio, while losses are borne by the investor, adjusting for risk and reward. Another mechanism is Musharakah, in which both the investor and the entrepreneur contribute to the capital, and the profit or loss is shared in a pre-agreed proportion.
Asset-backed financing	
Traditional finance can involve transactions that are not backed by assets.	Islamic finance emphasizes asset-backed financing, requiring investments to be backed by tangible assets or services. This principle is derived from the Islamic concept of "materiality" and discourages speculation and uncertain transactions.
Prohibition of speculative operations	
Traditional finance, although regulated, may allow for a wider range of speculative transactions, subject to market rules.	Islamic finance prohibits speculative transactions and activities considered to be of excessive uncertainty (gharar). This prohibition is intended to promote fair and ethical practices and discourage activities similar to gambling or excessive risk-taking.
Socially responsible investing	
Traditional finance may be less specific about avoiding investments in industries or activities that are considered unethical.	Islamic finance places great emphasis on ethical and socially responsible investments. Investing in gambling, alcohol, pork and other prohibited (in Shari'ah) activities are strictly prohibited. This is in line with the broader principles of Sharia, which promotes economic development by ensuring that investments make a positive contribution to society.

In summary, the differences between conventional finance and Islamic finance are related to their basic principles, methodologies and ethical considerations. While conventional finance relies on interest-based transactions and a wide range of financial instruments, Islamic finance follows Shari'ah principles, emphasizing fairness, equity and asset-backed financing. Understanding these differences is critical for investors and financial professionals to navigate the diverse and evolving

landscape of global finance and contribute to a more inclusive financial system.

What are the Islamic investment rules?

Islamic investment is a special form of socially responsible investment, that is, Islamic investment does not aim only at economic profit, but at the same time it should be beneficial for the society in all aspects (spiritual, religious, moral), because Islam does not consider the spiritual and worldly to be completely separate from each other. This means that every step in Islamic investing is scrutinized because Shari'ah rules must be considered in all financial decisions. Therefore, investments under Islamic investment policy must follow a specific set of guidelines.

Islamic investment is different from other types of investment because in order to be compliant, managers and investors must comply with Shari'ah law. Establishing the Islamic investment policy, whether it is for an institutional or an individual investor, is carried out by a group of Islamic scholars (jurists) - the Shari'ah Council, which confirms the compliance of investment products with Islamic laws and carries out their continuous review.

All practices in Islamic investment are based on the Qur'an, the divine book of Allah's words revealed to Prophet Muhammad (peace be upon him) in the 7th century; judgments in the words (hadiths) and deeds (sunnahs) of our prophet (peace be upon him); comparisons, they are scientific and logical conclusions; and ijma, that is, it must be in accordance with the rulings of the ulama on a certain issue.⁴

How can Islamic finance be a solution to today's investment challenges?

As mentioned above, Islamic finance is a system that considers the development of society as a priority, works in accordance with Shari'ah rulings that are in line with ethics and Islamic values, and can provide a potential solution to many of the problems related to investment in today's capitalist economic system.

Firstly, Islamic finance prioritizes not only profit, but also moral responsibility. Therefore, it does not invest in business activities in areas prohibited by Shari'ah and in activities that hinder the harmonious development of society. These activities may include gambling, production and sale of narcotic products, alcohol products, and the industry of pornographic products. In the Capitalist/Traditional investment system, investors (banks and other financial institutions) do not care about how the investment is used, because in any case, the main thing is that their invested funds will return to them with a good interest (profit). As a result, products that are extremely dangerous for human health (cigarettes, alcohol, drugs), and various immoral services (casinos, pornography) that distract the young generation from science are increasing in society. It is certain that the generation disconnected from science will not become good specialists in the future.

⁴ <https://hikmah.co.za/wp-content/uploads/2019/11/4-ijma-and-Qiyas.pdf>

Secondly, in Islamic investment, profit and risk are fairly distributed between the investor and the entrepreneur. For this, the Mudarabah and Musharakah mechanisms of Islamic finance mentioned above are used. In the traditional investment system, the investor gives his capital to the entrepreneur for use on the condition that he returns it with a certain amount of additional money, and after that the investor is not interested in how the entrepreneur will use this capital, for what purpose, how much profit or how much loss he will make, because what is important for him is the return of the specified amount within the specified period. Thus, the investor does not bear any risk, and in case of loss, he does not cover this loss. Such an unfair distribution of profits causes huge capital to accumulate in the hands of the few, and the economic inequality between the rich and the poor is increasing more and more. This is confirmed by statistics today. Half of the total wealth owned by people today belongs to only 1% of the world population⁵, and after the global economic crisis of 2007-2008 the Gini coefficient⁶, which represents income inequality, has also increased. Fair distribution of profit and loss in Islamic investment system is the best solution to such economic imbalances.

Thirdly, Islamic finance's requirement that investments must be backed by tangible assets offers a good potential solution to the serious problem of excessive money supply and consequent inflation. It is known that in traditional finance, since the investor can get back his money at any condition with interest, he does not require the entrepreneur to generate tangible assets or provide services. Therefore, too much borrowed money does not create a real product or service, and as a result, the money supply increases much faster than the product and service supply, which causes a rapid increase in the level of inflation in the economic system. In Islamic investment, there is a condition for obtaining real value or assets.

Fourthly, in real estate investment processes, Islamic finance can eliminate the problems of the capitalist system. Property financing in a traditional profit-making system often involves interest-bearing loans, which can lead to speculative bubbles and instability. For example, the global financial crisis of 2008 was related to speculative lending practices.⁷

In this regard, Islamic finance offers the concepts of Musharakah and Ijarah. In Musharakah, both the financier (investor) and the client contribute capital to a joint contract for real estate transactions, thereby encouraging risk sharing and discouraging speculative behavior. Ijarah, on the other hand, is an interest-free rental of property, providing a safer and more ethical approach to real estate financing. For example, the Islamic real estate market in Malaysia has witnessed significant growth with the use of sukuk (Islamic bonds) to finance real estate development and infrastructure projects. One notable project is the development of the Tun Razak Exchange (TRX⁸), a financial district in Kuala Lumpur. TRX's financing was structured through Islamic mechanisms, demonstrating the effectiveness of Islamic finance in large real estate ventures.

⁵ <https://www.wider.unu.edu/publication/global-inequality-rising-or-falling>

⁶ https://en.wikipedia.org/wiki/Gini_coefficient

⁷ <https://www.economicsobservatory.com/why-did-the-global-financial-crisis-of-2007-09-happen>

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