

# The difference between Islamic and traditional banks, the development of Islamic financial organizations in Uzbekistan

*Ozoda Pardayeva*

*Associate professor,  
Samarkand branch of Tashkent State University of Economics  
[ozodapardaeva@yahoo.com](mailto:ozodapardaeva@yahoo.com)*

*Zukhriddin Saidakhmatov*

*Master's student in economics (business management in Islamic banks).  
Samarkand branch of Tashkent State University of Economics  
[saidakhmatovzukhriddin@gmail.com](mailto:saidakhmatovzukhriddin@gmail.com)*

## Abstract:

The main difference between Islamic banks and conventional banks is that Islamic banks are based on the principles of Sharia, while conventional banks are only created by man. Thus, all aspects of operations, such as product features and business approach, are derived from Sharia law, making it significantly different from traditional banks. This article talks about these and other differences and proposals for starting Islamic banks in the Republic of Uzbekistan, as well as the need for banking sectors based on Islamic laws and solutions to the problems of opening such banks in Uzbekistan.

**Keywords:** *Islamic bank, traditional banks, ribo, sukuk, mudarabah, murobah, murabaha, profit, loss, bond, risk, interest, finance, ITB, consumer loans, portfolio of Islamic banks, XSRIK, usury, Islamic financial system, IKT, IRB*

## Introduction

Islamic banking is based on the principles of Sharia law. Interest is prohibited in Islamic banking, which is asset-based financing in which trading of elements is not permitted by Islam. Traditional banking is based on man-made laws and the banking system is profit oriented. The purpose of traditional banking is to earn money through interest. It is not based on Sharia law, but is regulated by the banking regulations of its countries. The factor of risk distribution differs between

Islamic banking and conventional banking. Risk management factors and risks in financial markets are different in Islamic banking and traditional banking.

Islamic banking includes two forms of bank finance and Islamic securities, also known as sukuk. Although these are called bank loans and bonds in conventional banking, these categories do not apply to Islamic finance. Because interest is prohibited in Islamic banking, the risk of loss is not fairly distributed if an organization is financed by debt with an obligation to pay interest. According to Islamic finance, financing activities are carried out on the basis of the principle of profit and loss sharing. According to Sharia law, financing activities are carried out with various contracts. In Sharia law, mudarabah determines how profits and losses are distributed between entrepreneurs and financial institutions. Profits are distributed in a pre-determined ratio, so the income in the business varies according to the profitability of the business. Losses are covered by the financial institution. On the other hand, in traditional banking, a financial institution has the right to receive interest on loans, regardless of its business activity.

Banking and finance sectors are playing a very important role in our life in the period of high development. As we all know, almost all banks on earth have interest rates of different forms. Of course, the role of banks in our lives is important and necessary. Why, if a person wants to start his own business or do something for his own benefit, he will certainly turn to banks for financial assistance. Banks have been helping their customers without any misunderstandings. That is, banks have been applying their loans to consumers. Of course, these loans have their own interest rates. Our President Shavkat Mirziyoyev, in his appeal to the Parliament on December 29, 2020, stated that Islamic Commercial Banks will start operating in our country in order to reduce interest-bearing loans. From this point of view, this article discusses various proposals for the establishment of Islamic banking activities in Uzbekistan.

## **LITERATURE ANALYSIS AND METHODOLOGY**

There are many Muslim-majority countries in the world. We would be wrong if we say that in these countries, only prayers and hajj, funeral and marriage have been preserved from Islamic law. Perhaps, many countries are paying attention to Islamic finance, and every Muslim wants to have Islamic banks in their country. The example of some Muslim countries clearly shows how obligations such as zakat, ushr, fitr alms, which are performed as religious prayers, can be combined with the modern tax system.

In recent years, the concept of the Islamic financial system has taken a firm place in the vocabulary of financiers of many countries. In fact, in various countries, even in countries where the majority of the population does not belong to the Islamic religion, including the United States and Great Britain, this financial institution is steadily developing as an alternative financing system to traditional banking services. Therefore, the study of Islamic banking is an urgent topic in the global economy. It is interesting and useful to know that there are alternative forms of financing to the

traditional banking system. First of all, it is important that we know the nature and main objectives of the Islamic bank. The basic operations of this bank are the same as those of other banks. Only such banks do not provide loans for consumers, money with interest. On the contrary, they work without interest.

Islamic banking is an Islamic financial system that conducts banking and business activities in accordance with the rules and principles of Islamic Shariah. It follows the beliefs and principles of Islamic jurisprudence on trade and business, called *fiqhal-muamalat* or Islamic rules on transactions. The Qur'an, Sunnah, and other sources of Islamic law, including *ijma'* (general consensus among Shariah scholars), *qiyas* (analogy), and *ijtihad* (personal judgment), form the basis of which the rules of *fiqh al-muamalat* and practices. Islamic jurisprudence). Islamic banking avoids *riba* (usury), *gharar* (uncertainty), *haram* (forbidden) trade and all prohibited activities such as financing alcoholic beverages, pornography, gambling, etc.

If we look at history, the first attempts to establish scientific research and interest-free financial institutions took place in the 50s and 60s of the last century in India, Pakistan and Egypt (for example, Mit Gamr Bank, which operated in 1963-1967 Although (Egypt) is called the first Islamic bank, the founders of this bank themselves did not claim the name Islamic bank for political reasons). Thus, "Dubai Islamic Bank" and "Islamic Development Bank" established in 1975 were recognized as the first Islamic banks. Later, several Islamic banks appeared in the Persian Gulf countries, Sudan and Egypt. In this matter, the 3rd Conference of the Organization of Islamic Cooperation (OIC) held in Jeddah, Kingdom of Saudi Arabia in 1972 was of great importance. The participants of the event developed a detailed plan for reforming the monetary and financial system in accordance with the legal, moral, spiritual and other principles of Islam. Such a system had to be compatible with the standards of Islamic law and be viable in modern conditions. The main current banking law in Egypt was passed in 1975 (Law 120/1975), according to which banks are divided into 3 types: 1) commercial banks (accept deposits and finance a number of different operations) ; 2) business and investment banks (implement medium and long-term practices such as promotion of new businesses and financing of investments); 3) special banks (they carry out operations serving a certain type of economic activity, and they can also accept deposits on demand). It should be noted that the diversification of banks in this way was one of the first steps towards a major reform in the banking sector. But despite the fact that the first Islamic banking movement in the country started about 10 years before the adoption of this law, Islamic banks are not separately distinguished in the above classification. Despite the fact that Egypt was the first country to start Islamic banking and served as an experiment for the establishment of future Islamic banks, for a long time, as a result of political and social changes in the government, this sector remained underdeveloped, and as a result, the sector's performance is not very satisfactory. not to the extent To date, there are about 40 banking activities in Egypt, of which 3 are full-fledged Islamic banks, and the number of traditional banks that have introduced Islamic branches is equal to 12. According to the Egyptian Islamic Finance Association, the assets of Islamic banks in 2017 amounted to 12.8 billion US dollars, which is a 10.24% increase compared to the previous year. done The share of Islamic banking in the total banking sector of Egypt was equal to 6%. The emergence of Islamic banking in Egypt took place in

3 different stages: first, the creation of public and private Islamic banks, then the establishment of Islamic branches in traditional banks, and the last process is related to the start of activity of informal Islamic financial organizations. The first established state Islamic banks include Meet Ghamr Bank (MGB) and Nasser Social Bank (NSB, in 1971). Meet Ghamr Bank is recognized as the first Islamic bank in the world of Islamic banking.

**The main tasks of Islamic banks are as follows:**

- ❖ investment of means in share capital
- ❖ providing loans to production enterprises and projects
- ❖ providing financial assistance to member states in other forms for the purpose of economic and social development.
- ❖ management of special funds created for specific purposes. Among them is the aid fund for Muslim communities in non-Muslim countries.
- ❖ transfer of financial resources and acceptance of deposits by means of financing methods.
- ❖ Providing technical assistance to member states.
- ❖ Providing services in training members of the organization on the development of Muslim countries.
- ❖ free loans.

The Islamic Commercial Bank (ITB) provides services to consumers in all of the above-mentioned activities without any interest payments. The sole purpose of this bank is to influence the economic development and social development of member countries, Sharia-based Muslim communities

**Differences between conventional banking system and Islamic banking system**

Below are the differences between conventional banking system and Islamic banking system.

<b>Traditional banking system</b>	<b>Islamic banking system</b>
<p>Money is a commodity with a trade value and a source of exchange. Interest is calculated depending on the term of the loan. Loss sharing is not used in traditional banking</p>	<p>Assets are products, and money is a source of exchange. Profit from trade is the main source of income. If the enterprise suffered a loss, the losses can be distributed.</p>

<p>Interest is charged regardless of business performance. There is no agreement for exchange of goods and services during the disbursement of cash for operational financing.</p>	<p>In Islamic financing, there is no concept of interest and losses are shared.</p> <p>According to the Murabaha, Salam and Istisna contracts, the contract for the exchange of goods and services is mandatory for the distribution of funds.</p>
<p>Goods and services are not available during the appropriation process. An expansion of money can cause inflation.</p>	<p>Goods and services are available at the time of fund transfer. Because money is not expanding, inflation does not occur.</p>
<p>A business entity increases the price of goods and services due to inflation. Product cost includes the inflation aspect in price determination.</p>	<p>High control over inflation is established and additional prices are not charged by business entities.</p>
<p>Long-term financing and bridging loans are not processed on the basis of capital funds.</p>	<p>Before disbursing cash, Musharaka and Musharaka reduction agreements are drawn up, ensuring that capital is available for the project.</p>
<p>Regulators obtain loans from the central bank and money market operations without incurring capital expenditures. Money circulates in a few hands and there is no real growth. If the loan is unpaid, it becomes a non-performing loan and is written off.</p>	<p>After the delivery of goods is confirmed to the National Investment Fund, it makes a decision to transfer ownership to another organization. mat can get loans from financial agencies. Real wealth has a multiplier effect because real wealth passes through many hands and money circulates among different people. If the project fails, management will cover the losses</p>
<p>Debt funds have interest costs that are part of taxable income, which imposes a tax burden on individuals and therefore severely affects savings income, leading to a reduction in GDP.</p>	<p>In Mudoraba and Musharaka, the profit is shared and it reduces the burden on the wage earners and earns the income of the people, which shows the increase in savings and GDP.</p>

Islamic banks perform almost all operations of traditional banking operations. They are investing a lot of money in the industry, agricultural sector, trade and service sectors.

With an annual growth rate of 15-20%, the Islamic bank has expanded its horizons around the world and has its institutions in more than 75 countries. The development prospects of this financial system in Uzbekistan are also growing sharply. of course. According to Husan Hasanov, head of the Islamic Development Bank's representative office in Uzbekistan, Uzbekistan cooperates with the Islamic Corporation for the Development of the Private Sector (ICD) and the International Islamic Trade and Finance Corporation (IITFC). To date, ICD has established cooperation with 15 commercial banks and 2 leasing companies and has allocated financing lines to banks in the amount of 285 million US dollars. The value of the projects approved by the Ministry of Education and Culture is 82 million US dollars.

The advantages of the Islamic Development Bank for the government of Uzbekistan and mainly for the population of Uzbekistan are much higher than those of traditional banks. First of all, the approval of the people is important. It is not for nothing that President Shavkar Mirziyoyev says “In everything we do, the approval of our people comes first”. From this it is known that the first thing is to please the people. We all know very well that if the people agree, our work will be fruitful and blessed. The development of Islamic banking in Uzbekistan is very fast. Why?

About 90 percent of the population of Uzbekistan are Muslims, and this fact alone indicates the great interest in Islamic finance and banking in Uzbekistan. We know that Islam forbids usury, profiting by lending money at interest, while the traditional banking system relies on interest. It is safe to say that if banking services based on the principles of Islamic financing are offered to the segment of the population that relies on religious beliefs and does not want to use interest, credit and similar banking services, it will be a great impetus to the growth of the economy of Uzbekistan and the increase in the volume of domestic investment. we can The introduction of this system serves as a basis for attracting savings and unused funds to the banking system in Uzbekistan, reducing the weight of the informal economy, and developing entrepreneurship.

The Republic of Uzbekistan is one of the member states of the Islamic Development Bank (IDB). During this short-term cooperation, ITB Group's portfolio in Uzbekistan has grown significantly, largely due to active cooperation with the Government. This was reflected in the approval of the financing of a number of priority national projects of the Investment Programs of the Republic of Uzbekistan. At the moment, IDB's portfolio in Uzbekistan is the largest in Central Asia (more than 1.8 billion dollars). In addition, today the bank has financing lines totaling 30 million US dollars in cooperation with Aloqabank, Asia Alliance Bank and Turonbank. On the other hand, the Ministry of Finance provided 32 million USD financing lines to Asia Alliance Bank, Kapitalbank, Uz sanoatqurilishbank and Trustbank and 50 million USD to the fund under the Ministry of Finance. USD allocated.

If we dwell on the current state of cooperation of the Islamic Development Bank with the banks of Uzbekistan, the Islamic Development Bank group includes a number of organizations, among them the Islamic Corporation for the Development of the Private Sector (XSRIK) and the International Islamic Trade and Finance Corporation (IICFC). Cooperation with the banks of

Uzbekistan does. According to the decision of the Cabinet of Ministers of the Republic of Uzbekistan No. 596 dated December 21, 2004, Uzbekistan is a member of the CSRIK and has been cooperating with local commercial banks and entrepreneurs.[4] In particular, financing lines were allocated to commercial banks through the Murobakha (sale at a premium) financing method. Entrepreneurs operating in Uzbekistan, enterprises working in production, service, processing and other sectors of the economy use these lines for further development of their activities.

As mentioned above, a number of projects are being implemented through the Murobakha method with the help of local banks, in addition to this, a number of private and joint-stock companies are also offering services based on term sales or leasing that conform to the principles of Islam. For example, the Toiba leasing company established under the auspices of XSRIK has launched a leasing (Islamic leasing) service for customers, in which customers have the option of paying back funds through an interest-free leasing contract, i.e. in installments with the company's premium on the purchase of equipment. Under similar conditions, the Uzbek leasing company and several private entrepreneurs have established services for the sale of automobiles, real estate and household appliances on the basis of installments. The Islamic Development Bank is also financing government projects on the basis of rent and installments. However, local commercial banks do not have Shariah-compliant financing methods in Uzbekistan. The main reason for this is the lack of legislation necessary for Islamic financing in Uzbekistan and the existence of inconsistencies in the existing legislation for the operation of this system. In addition, about a year and a half ago, the draft decision of the President of the Republic of Uzbekistan on the implementation of the principles of Islamic banking in Uzbekistan was announced, and the draft decision was brought to the attention of the general public on the portal for discussing drafts of normative and legal documents of the Republic of Uzbekistan. A number of local and foreign experts expressed opinions and comments on the development of this decision, including a number of suggestions by representatives of the Islamic Development Bank. This idea was approved by the public and attracted a lot of interest. But unfortunately, this decision did not take effect and was removed from the portal for unknown reasons.

## **CONCLUSION**

Islamic banks play an important role in social responsibility. In addition, the basis and guidelines of Islamic economics achieve justice and equality by itself, for example, the annual payment of zakat by Islamic banks is transferred to the needy and zakat channels as stated in the Holy Qur'an. in poverty alleviation. Zakat is a religious levy that is deducted from a bank's net income and paid annually. In addition, microfinance products contribute to achieving a certain balance in society by financing a limited income category.

The social responsibility of Islamic banks refers to all the activities that they perform in order to fulfill their religious, economic and moral obligations. In other words, Islamic banks are responsible and obliged to the society to perform banking and services in accordance with the full Sharia, and to observe the rules of Islam in all transactions and business, which is related to religious responsibility. From the point of view of economic responsibility, Islamic banks should conduct profitable and financially profitable business, reserve and develop the funds of shareholders

and depositors. Ethical responsibility refers to the obligation of Islamic banks to respect and appreciate the religious and customs that are not defined in the laws.

In conclusion, Uzbekistan is very much in need of Islamic Development Banks and we expect such banks to be established in Uzbekistan in the coming years from our government and the Central Bank. And, of course, we believe that such banks will start operating in our country. If such banks start operating in Uzbekistan, then the main thing is that the principles of Islamic banking will help to attract people's savings into the banking system, the Mudarabah (investment) deposit of the Islamic bank will be the distribution of profits between partners and will become a clear example of cooperation based on social justice in financial relations. . I think that it is this principle that motivates people's savings to put money in Islamic banks, for any project, and to benefit from it. In addition, based on the financing mechanisms of Islamic banks, it should be noted that the segment of the population in need of financing also has funds, and the party seeking to benefit from it is equally interested. I would like to add that we cannot say that our currently operating banks are compatible with our Islamic religion. According to Islam, the working processes of banks consist of usury, giving money at interest. Usury is strictly forbidden in our religion.

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