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The Effectiveness of Implementing Islamic Finance in The Activities of Uzbekistan's Commercial Banks

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Abstract: The growing need to diversify Uzbekistan's financial system and expand financial inclusion has driven interest in Islamic finance. Given that more than 90% of the country's population is Muslim, implementing Sharia-compliant financial mechanisms provides both economic and social advantages. Despite the successful collaboration with the Islamic Development Bank (IsDB), Uzbekistan's commercial banks have not acquired a holistic understanding of the Islamic finance value proposition in terms of GDP, employment, and investment diversification benefits in the long long-term. At the macroeconomic level, there are few empirical models of these types of effects. Theoretical, comparative, empirical, and statistical analyses were performed in this research with data from the IsDB, Central Bank of Uzbekistan, and the Institute for Economic Research. The impact of Islamic finance on GDP growth, jobs, and fiscal revenues was estimated using the economic multiplier method. Islamic financial instruments: murabaha, mudaraba, musharaka, ijara and sukuk for about \$18 billion in new investments; 16.3% of GDP, and 2 million new jobs. These tools also offer the opportunity to broaden financial inclusion through the involvement of citizens who used to stay away from traditional borrowings for religious motives. There are some economic advantages of integrating Islamic finance which boost financial stability, increase socially responsible investments and align the Uzbekistan economy with the UN Sustainable Development Goals. This indicates immediate action in terms of legislations, banks setting up Islamic finance departments and expanding sukuk and takaful markets to achieve sustainable and inclusive economic growth, the results showed.

Keywords: Islamic finance, commercial banks, Sharia principles, murabaha, mudaraba, musharaka, sukuk, takaful, financial stability, investment.

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1. Introduction

In recent years, the integration of Islamic finance into the global financial system has emerged as a crucial aspect of modern economic development. Islamic finance, based on Sharia law, is an interest-free financial system focused on risk-sharing, real assets, and equitable distribution of wealth. Its principles, such as *murabaha*, *mudaraba*, *musharaka*, and *sukuk*, are gaining traction worldwide as an alternative to conventional finance, especially in regions with significant Muslim populations like Uzbekistan. The Role of Islamic Finance for Attracting Investment for Financial Stability, Social Justice, Sustainable Economic Growth of Uzbekistan This particular study aims to examine the development of Islamic finance within the context of Uzbekistan's commercial banks, despite being a predominantly Muslim country, it has still maintained a significant base of conventional interest-based finance. Sharia-compliance is termed to be the first driver of growth, financial inclusion, and sustainable development in Uzbekistan: and this raises the question. In particular, the effects relate to the role that Islamic finance may play in

promoting investment, small businesses and reducing financial exclusion, in Uzbekistan given its existing economic structures.

There are several theories and concepts which underpin Islamic finance, including risk-sharing, profit-and-loss sharing, and ethical investments. This helps ensure fairness, equity in economic transactions, as well as, social responsibility and sustainability. Yet as always the adapting of these ideas into the financial system of Uzbekistan has been mostly problematic not only with regard to regulation, mentality but also how appealing Islamic financial products are to the needs of the nation. While both theory and practice of Islamic finance had attracted significant attention from both academia and practitioners in the world, including empirical studies analyzing the adoption of Islamic finance in Malaysia, Saudi Arabia and Indonesia, there is a lack of empirical evidence regarding Islamic finance in Uzbekistan. This research utilizes the mixed-method approach which includes both theory and practice, as evidenced by the data obtained from commercial banks of Uzbekistan, the Islamic Development Bank (IDB) and national economy figures. Their methodology involves economic multipliers to analyze the effects of Islamic finance on level of GDP, employment, and investment flows in Uzbekistan. It also uses a comparative analysis to study the cases of other successful experiences in Islamic banking and finance in countries such as Malaysia and Turkey.

The results imply that the practice of Islamic finance can greatly improve the economic prospects of Uzbekistan through greater financial inclusion, greater diversification of investment sources and greater stability in the financial system as a whole [1]. Moreover, the findings show that Islamic financial products can open up new opportunities for small businesses, decrease dependence on loans that carry interest, and foster social justice through impartial financial practices. These implications are crucial for policymakers and financial institutions seeking to enhance economic growth and ensure a sustainable, inclusive financial system.

2. Materials and Methods

A systematic analysis was carried out in the study based on **the IMRAD** model. The following methodological approaches were used:

- a. **Theoretical Analysis:** The principles of Islamic finance, the specifics of the activities of commercial banks, and the mechanisms of financing based on Sharia law were studied.
- b. **Modeling:** The influence of the introduction of Islamic finance in the economy of Uzbekistan on macroeconomic indicators. The effect of economic multiplier method was employed to estimate the changes on gross domestic product (GDP), employment and budget revenues.
- c. **Comparative analysis:** Uzbekistan experience was compared with the experience of other countries that also have Islamic finance practice, such as Turkey, Malaysia, Pakistan and Kazakhstan.

Data the data of the Islamic Development Bank (IDB), the Institute for Economic Research (IER), Central Bank of Uzbekistan were applied for statistical analysis.

Through these methods, the impact of the introduction of Islamic finance at the micro and macroeconomic levels, new opportunities for commercial banks, and the contribution to the financial activity of the population were determined.

Literature Review

Scientific research conducted on Islamic finance deeply illuminates the theoretical and practical foundations of this direction. **Abdurakhmanova G.G. (2021)** in her work, she emphasized the need to create a regulatory framework for Islamic finance in the country and noted the importance of eliminating aspects that contradict Sharia due to the current banking system's focus on interest-bearing lending [2].

Mamatkulov B.B in his research, having analyzed the stages of introducing Islamic finance services in commercial banks of Uzbekistan, he substantiated the possibility of ensuring the diversification of banking services by adapting such instruments as murabaha, mudaraba and sukuk to national conditions [3].

Ibragimova Z.R in her research, emphasizes that Islamic financial products increase public confidence in the banking system and allow attracting savings through halal financing [4].

From foreign scientists **Usmanov R.R.** The experience of Russia has shown that the interest-free financing system, in addition to religious foundations, is a mechanism for ensuring economic stability. **Karimov A.A** and scientifically substantiated the possibility of a positive impact on the real sector by supporting small businesses through Islamic financial instruments [5][6].

At the international level, the works of **Chapra** and **Siddiqi** are recognized as fundamental studies substantiating the role of Islamic finance in ensuring economic justice, risk sharing, and social stability.

This literature leads to a general conclusion: Islamic finance is not just a religious principle, but a modern financial model that promotes economic inclusion and sustainable growth.

3. Results and Discussion

The economy of Uzbekistan has shown an average growth rate of **7.4%** over the past five years. At the same time, up to 40% of the population refuses traditional loans for religious reasons. This situation reduces the efficiency of the use of financial resources in the economy. The introduction of Islamic finance will allow this segment of the population to be involved in economic activity.

Analysis shows that through the introduction of Islamic finance, it is possible to attract savings from households in the amount of 8 billion US dollars into the banking system. An additional inflow of up to \$10 billion is also expected.

Islamic finance has a direct impact on economic growth because it is based on real assets. Empirical modelling suggests that Islamic investment instruments would add 16.3 per cent of GDP, create over 2 million new jobs and increase budget revenues by \$100 million in Uzbekistan.

The experience of Malaysia and Bangladesh corroborates these results. Consider Bangladesh, where economic growth jumped from 5.6% to 8% with the share of Islamic banks increasing from 24%.

The advent of Islamic finance generates the following strategic benefits for commercial asset banks:

Expansion of the client base (attracting a segment that has abandoned traditional loans for religious reasons);

- a. Increase in liquidity sources (new deposit and investment inflow);
- b. Financial innovations (murabaha, sukuk, takaful, social funds);
- c. Risk diversification (shared distribution of profits and losses).

Small businesses account for more than 50% of Uzbekistan's economy. For this segment, Islamic financial instruments - **mudaraba** and **musharaka** - provide investment based on partnership, not debt [7]. This does not limit small businesses to excessive interest and collateral requirements.

Murabaha and **lease** contracts create convenience in obtaining means of production and stimulate entrepreneurial activity. As a result, employment and innovation activity in the economy will increase.

More than \$1.25 billion has been attracted to renewable energy projects in Malaysia through the "green sukuk" program. Uzbekistan can also finance environmental and social projects in this direction by issuing "green" and "social" sukuk.

Since 2003, while in cooperation with Uzbekistan, Islamic Development Bank (IDB) has financed more than 212 projects, total value of which exceeds 5 billion US dollars. The projects had been carried out in infrastructure, energy, agriculture, and education sectors. Grounded to this, as a result of the institutional support from the IsDB, the Islamic finance "windows" in commercial banks started to due this. Until now Uzbekistan's share in the

IBRD capital has become 13.4 million US dollars. US dollars (0.03% of the total authorized capital of the IsDB). As of the end of the third quarter of 2025, 212 projects have been financed by the IsDB in Uzbekistan, of which 76 have been completed, and 212 are ongoing [8][9]. The total amount of funds allocated by the bank for these projects amounted to 5 billion US dollars. This indicator confirms the IDB's view of Uzbekistan as one of the leading partner countries in the region.

It should be noted that, according to statistics published by the World Bank Group, the volume of financing by the Islamic Development Bank for investment projects in the territory of Uzbekistan is 4.04 percent of the country's gross domestic product (GDP). This indicator clearly shows how important the active participation of the IsDB and its financial support are in the economic development of our republic [10]. At the same time, these figures not only reflect the scale of financial assistance, but also testify to the strengthening of Uzbekistan's cooperation with international financial institutions, in particular, with the IDB. Consequently, the role of Islamic financial institutions in the process of economic development of our country has significantly increased, and it is becoming one of the important components of national economic policy, see Figure 1.

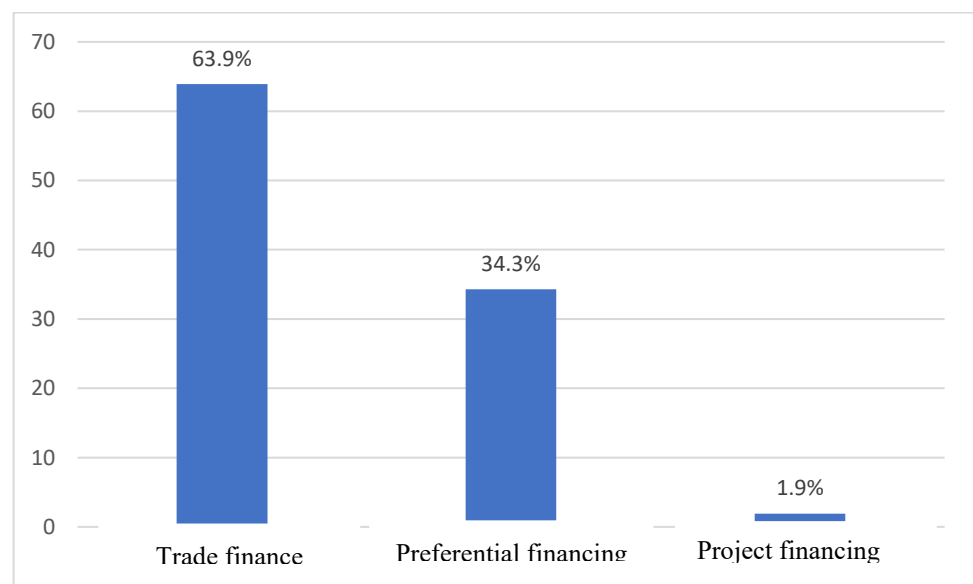


Figure 1. Financial operations of the Islamic Development Bank Group in Uzbekistan in 2003-2024

Table 1. Projects funded by Islamic Development Bank

Project name	Amount of financing, million US dollars	Purpose
Smart Education (SmartEd)	160.25	58 inclusive schools, 2,431 classrooms, laboratories, digital infrastructure, teacher training, modernization of the assessment system, creation of equal educational opportunities
Project for the Integrated Development of Rural Areas (2nd stage)	260.	In rural areas - infrastructure, roads, power grids, drinking water supply networks, social facilities (school, kindergarten, hospital), transformers, mahalla centers; 157 mahallas, 21 districts, Kashkadarya, Samarkand, Surkhandarya regions.

Reconstruction / modernization of roads (road M39 and others)	106.7	Reconstruction and expansion of the M39 road section, increasing transport efficiency, improving road communications, transport and logistics capabilities.
Early Childhood / Preschool Education Improvement Project	30.	Energy, Renewable Energy Project
Solar photovoltaic station and battery energy storage system		Energy, Renewable Energy Project
Support for small and medium-sized businesses	40.	The Murabaha principle includes loans, loan guarantees, enterprise engineering and professional development, social support, and project management.
Provision of oncology and radiology services with modern equipment	90.	Provision of oncology and radiology centers in the city of Tashkent with equipment, expansion of diagnostic services, expansion of patient care, and training of medical personnel.
Project "Modernization of infrastructure and social facilities" Karakalpakstan, Khorezm, Bukhara, Navoi regions	200.	Water supply, roads, electrical networks, power lines, social facilities (school, clinic, and other facilities).

Joint projects implemented within the framework of cooperation between the Islamic Development Bank (IDB) and Uzbekistan play an important role in the socio-economic development of the country. These projects cover various sectors and are aimed at achieving the Sustainable Development Goals, reducing regional inequality, developing human capital, and stimulating innovative economic growth, see Table 1.

First of all, initiatives aimed at the sphere of education are of particular importance. The "Smart Education (SmartEd) " project (160.25 mln. USA) is aimed at ensuring equal educational opportunities through the development of modern educational infrastructure, the creation of 58 inclusive schools and 2,431 classroom laboratories, and the modernization of the teacher training and assessment system [11]. Additionally, the "Early Childhood Education" project (30 mln. USA) will serve to improve the quality of preschool education and ensure the strengthening of human capital from the initial stage [12].

The project on "Comprehensive Development of Rural Areas" (260 million US dollars) is being implemented in the direction of territorial and infrastructural development. USA) as well as on the "Modernization of Infrastructure and Social Facilities" project (200

million. USA) is of primary importance. The purpose of these initiatives is to improve quality of life and overcome inequality between regions by enhancing transport, electricity, drinking water networks, and social facilities (schools, kindergartens, hospitals) in rural areas. Consequently, this is speeding up the process of socio-economic development in rural areas.

In the transport and logistics sector: Reconstruction and modernization of the M39 road (106.7 million US dollars). USA) reinforce the US role as a regional transit hub. The implementation of the project will enhance economic integration: Operationalisation of international transport corridors will create new trade flows and increase logistical potential aimed at facilitating the most sustainable integrated transportation services for the road transport sector.

The project on "Solar Photovoltaic Station and Battery Energy Storage System" will be used to promote the utilization of renewable energy sources in the energy sector. This initiative is significant not only in terms of energy security but also in terms of environmental sustainability through the formation concept of the green economy.

In the area of healthcare, it is being implemented the project "Modernization of Oncology and Radiology Services" in Tashkent (90 million US dollars, IsDB, Tashkent city branch). USA) will ensure access to quality medical services for the population by providing modern medical equipment, expanding diagnostic and treatment capabilities, as well as improving the qualifications of medical workers.

Also, a project aimed at supporting small and medium-sized businesses (40 million US dollars) will be implemented. USA) serves to strengthen the role of the private sector in the economy by allocating credit resources to business entities based on the murabaha principle, expanding engineering and management capabilities.

In general, joint projects between the IsDB and Uzbekistan play an important role in accelerating the country's socio-economic development. They cover such strategic areas as education, healthcare, infrastructure, transport, energy, and business development, ensuring comprehensive development in accordance with the Sustainable Development Goals [13]. At the same time, these initiatives scientifically confirm the role of the IsDB for Uzbekistan not only as a financial partner, but also as a strategic partner for sustainable development.

Projects financed by the Islamic Development Bank (IsDB) in Uzbekistan are important within the framework of the country's sustainable development strategy and serve not only to accelerate economic growth, but also to ensure social justice and environmental sustainability. These projects are directly related to the UN Sustainable Development Goals (SDGs) until 2030 and ensure Uzbekistan's integration into the global development process.

1. Projects in the field of education (SDG 4: Quality Education)

The "Smart Education (SmartEd) " and "Early Education" projects are aimed at developing quality and inclusive education in the country. These initiatives will contribute to the formation of human capital by expanding digital infrastructure, introducing modern curricula, and strengthening the preschool education system. As a result, the quality of education and equal opportunities will be ensured, and the foundation will be laid for the creation of highly qualified labor resources in the future.

2. Regional Infrastructure and Rural Development (SDG-9: Industry, Innovation and Infrastructure; SDG 10: Reducing inequality)

Through the projects "Integrated Development of Rural Areas" and "Modernization of Infrastructure and Social Facilities," transport, water supply, electricity networks, educational and healthcare facilities are being modernized in rural areas. This will not only improve the quality of infrastructure, but also serve to reduce the socio-economic gap between urban and rural areas [14]. Thus, these initiatives will create a basis for regional stability and inclusive economic growth.

3. Transport and logistics projects (SDG 8: Economic growth and sustainable employment; SDG 9)

The reconstruction and modernization of the M39 highway will enhance Uzbekistan's potential as a regional transport and communication hub. This will accelerate trade flows, strengthen international integration, and increase the efficiency of the logistics system. Improving the quality of transport infrastructure directly contributes to economic growth and sustainable employment.

4. Energy and environmental sustainability (SDG 7: Affordable and clean energy; SDG-13: Climate Change Action)

The "Solar Photovoltaic Station and Energy Storage System" project will strengthen Uzbekistan's energy security through the development of renewable energy sources. At the same time, this project will contribute to reducing carbon footprints and combating the consequences of climate change by introducing the principles of a "green economy."

5. Healthcare initiatives (SDG 3: Health and well-being)

The project to modernize oncology and radiology services will expand access to quality medical services for the population. Providing modern equipment, increasing diagnostic capabilities, and training qualified personnel will improve life expectancy and quality of life.

6. Support for small and medium-sized businesses (SDG 8: Economic growth and sustainable employment)

The project, implemented based on the Murabaha principle, serves to develop entrepreneurial activity by allocating credit resources to the private sector and expanding engineering and management capabilities [15]. As a result, new jobs will be created and economic activity will increase.

In conclusion, the joint projects implemented by the IsDB and Uzbekistan are in harmony with the country's national development strategy and are fully consistent with the UN's SDG concept. These initiatives, covering education, healthcare, infrastructure, transport, energy, and entrepreneurship, serve as an important foundation for ensuring sustainable economic growth, social justice, and ecological balance in Uzbekistan. In this context, the IsDB acts not only as a financial institution, but also as a strategic partner in the global process of sustainable development.

4. Conclusion

The introduction of Islamic finance into Uzbekistan's commercial banking system has shown substantial potential to drive economic growth, increase financial inclusion, and enhance social justice by offering interest-free financial products aligned with Sharia principles. The results of the study underline the potential of Islamic finance to boost GDP, create new jobs and attract foreign direct investments, especially from segments that had previously been set aside from conventional financial markets. These implications indicate that the incorporation of Islamic finance can diversify Uzbekistan's financial landscape, support small businesses, and promote sustainable development. To investigate the impact of Islamic finance on macroeconomic stability in the long-term, study the role of Islamic finance in financial literacy, and assess the regulatory regime needed for the development and integration of Islamic banking in Uzbekistan.

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