

**EXPERTS' VIEWS ON THE IMPACT AND THE PROSPECTS OF ISLAMIC BANKING AND FINANCE IN THE REPUBLIC OF TAJIKISTAN**

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<b>Abstract</b>	<p><i>It is in the national interest to make the Republic of Tajikistan (the RT) one of the prominent financial markets in the Commonwealth of Independent States (CIS) consistent with the core values of the local society, environmentally friendly, and closely aligned with morals, ethics, and social responsibilities. The country's main law on Islamic Banking (IB) was enacted in 2014, and subsequently, the CB introduced 16 instructions, procedures, charts of account, and recommendations for the country's smooth implementation and development of the IB industry. The first full-fledged IB was established in 2019 and two Islamic Banking Window (IBW) in 2020. Hence, the IB industry in the country is still at a nascent stage, and with the recent development of the IB industry, this study aims to explore experts' opinions on the impact and prospects of IBF in the RT. Using qualitative research methodologies, semi-structured interviews were conducted with local and international experts who were familiar with the local industry. The findings reveal that IBF has a positive impact and promising prospects for the country's overall economy, including economic growth, sustainable development, and financial stability. IBF also promotes financial inclusion, addresses sector financing demands, and fulfills the religious needs of the populace. IBF can provide a resilient banking model that operates effectively, alongside conventional banking. Additionally, IBF is poised to foster economic development, enhance social welfare, and fill up the gap in the country's financial intermediary. Findings from this study serve as a cornerstone for future exploration of the IBF industry's impact while offering valuable insights into the country's evolving landscape of Islamic finance.</i></p> <p><b>Keywords:</b> <i>Islamic banking and finance, Impact and Prospects, sustainable development, the Republic of Tajikistan.</i></p>
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## INTRODUCTION

Islamic banking and finance (IBF) is growing tremendously globally in Muslim and non-Muslim countries, covering over eighty (80) jurisdictions. While the world has faced a global pandemic caused by COVID-19, despite a slight decrease, IBF continued to develop alongside the recovery of the global economy. The industry has grown rigorously and reached 1,871 Islamic Financial Institutions (IFIs) worldwide in 2022. Moreover, the global IBF industry increased its assets by 11% to US\$4.5 trillion, and 72 % of its total assets are held by Islamic banking (IB). The industry's spectacular growth has continued by 163% since 2012, showing a stable upward trend, and it is expected by 2027 to grow to US\$6.7 trillion (ICD, 2023). In this regard, the Commonwealth of Independent States (CIS) remains an untapped industry for Islamic finance consumers, with considerable potential to grow in

the region. The IBF industry is considered relevant to the region due to certain factors, such as its demographic structure, which stands out with a majority Muslim population, the religious-oriented nature of the populace, and the suitability of IBF's products with their economic activities that depend on agriculture and manufacturing. (ADB, 2015; Boboev, 2019; World Bank, 2022).

Despite the remarkable global expansions of the IBF, several members of the Organization of Islamic Cooperation (OIC) in the CIS, such as the Republic of Tajikistan (the RT) were relatively late to adopt this unique financial system. The motivation to establish IBF in the RT can be traced back to 2008-2009, when consistent resilience was seen in the performances of IFIs, which faced the global financial crisis with an impressive report on their average assets. Hence, to develop the country's economy, in November 2011, the country cooperated with the Islamic Development Bank (IsDB) and signed an agreement for technical assistance (Wolters, 2013). Through this cooperation, regulatory authorities were exposed to IBF practice, where a close collaboration has been placed between the RT and Malaysia since 2013, engaging with Malaysian-affiliated institutions, such as the Foundation of Zaid Ibrahim & Co (ZICO) and the International Shari'ah Research Academy for Islamic Finance (ISRA). Hereafter, the Tajik regulators have taken positive initiatives to introduce new legislation that is enforceable in the IBF industry. The government's position on this issue was marked in 2014, and its practical expression can be considered adopting the "Law of the Republic of Tajikistan on Islamic Banking Activities" (ADB-IFSB, 2015; ISRA, 2019; ZICO, 2024).

The IBF industry is still in its early stages of development in the CIS, with financing totaling around \$500 million as of September 2023. Despite a favorable regulatory regime, challenges like taxation, accounting, and low banking service penetration remain. The region's banking systems are relatively small due to economic structures and low welfare levels. While the IB shows promise, its growth will be gradual, potentially reaching a 5% market share in the next five years, particularly the RT showing promising potential (Asia-Plus, 2024). The RT has emphasized the importance and the role of IB in several programs and strategies, such as: 1) the Mid-term Development Program of the RT for 2021-2025 (MtDP, 2016); 2) the National Development Strategy of the RT for the period up to 2030 (NDS, 2016); and 3) the National Financial Inclusion Strategy of the RT for the period 2022-2026 (NFIS, 2022). Hence, these programs and strategies are vital to determining IBF's legal and organizational structure in the RT, with a special focus on the IB business. Moreover, recently the RT was recognized as one of the fastest-growing IBF markets, with the biggest rise in assets at 84%, signaling the growth of new markets and the plateauing of the sector in the more mature jurisdictions. The growth is mainly attributed to the IB, Islamic funds, and Sukuk (ICD, 2023).

The country needs to improve the performance of the agriculture sector and broaden its industrial bases and services to sustain high growth. The government can play a decisive role in prioritizing investment and enhancing the weak private sector; absorbing external shocks and maintaining macroeconomic stability requires managing healthy foreign reserves, creating sufficient jobs, and inducing productive investments (ADB, 2015). Since the RT heavily depends on the agriculture and mining sector, the country needs to deepen its industrial base and improve the performance of agriculture and services to achieve its goals. This issue is the main challenge to becoming a modern and industrial economy, generating more private investments, diversifying exports, and creating non-farm employment opportunities. Most importantly, the business environment and conditions should be improved. The country can diversify its industrial development and accelerate the structural transformation through crop farming, animal farming, textile and garments, and precious mining metals. A dynamic industrial sector that can generate sufficient employment opportunities is vital for future growth in the country. Hence, it is expected that the IBF industry has the potential to attract new players to the local financial market and boost economic development, which helps to bridge the gap in financial intermediation. The IBF is poised to enhance the local financial market by offering flexible and efficient

products, thereby supporting the country's economic development. Key industries such as mining, agriculture, and manufacturing require partners who can provide value beyond simple lending. Traditional interest-based lending often stifles healthy market activities and diminishes real economic transactions. To foster growth, banks are proposed to transition from mere intermediaries to intrapreneurs, leveraging Shari'ah-compliant financial instruments like partnership agreements, Salam, and Istisna contracts. The success of these products hinges on the commitment of all stakeholders and a thorough assessment of industry response. Unlike conventional financial solutions, these Islamic financial products are designed to stimulate real economic activities. For this transition to be effective, banks must embrace greater risk, employ skilled professionals, and deepen their market knowledge. This shift will not only align financial practices with ethical standards but also enhance the overall economic landscape of the RT.

This study explores experts' opinions on the impact and prospects of IBF industry in the RT. It is organized into several sections to ensure the smooth delivery of ideas and discussion. After the introductory section, a literature review is followed by a presentation to indicate important previous research. In the third section, the details of research methodologies are provided. Before the conclusion, findings, and discussion are placed under the fourth section.

## **LITERATURE REVIEW**

The researcher examined numerous studies, research, and articles on the impact and prospects of IBF at their initial stages. Various studies have been conducted worldwide about the introduction of IB in many Muslim and non-Muslim countries. However, the researcher did not find sufficient materials on IB introduction in the RT or CIS. In addition, most of the previous research was conducted during the pre-introduction period of IBF in the CIS and from a quantitative perspective. Unfortunately, only a few studies have been conducted about IBF in the country on the level of awareness of the populace. There is insufficient information about Islamic Banks (IBs) and their issues, challenges, products, and services. Besides, a few service providers and a handful of products are available in the country. This research focuses on the post-introduction period on the impact and prospects from a qualitative perspective. Hence, to make the outcomes more relevant to RT's situation while reviewing the literature, the researcher focuses on the impact and prospects of the IBs: (i) where Muslims are a minority, (ii) where IBs are still in the infancy stages, and (iii) where IBs are operating under secular regimes. On some occasions, the researcher highlights the Malaysian experience in addition to the most prominent worldwide experiences and depends on it as a benchmark. Due to the relevancy, some archaic materials were used in comprehending potential impact and prospects in the initial stages in other countries, linking it to the RT's context.

The review of studies from different countries showed significant benefits of IBF on the entire economy. Implementing IBF will not only have a positive impact in the period of turbulence in the financial system but can also play an alternative banking model alongside traditional banking in the country. It may enhance the financial sector, and solve, and remedy the country's banking problems to achieve long-term sustainable economic growth. There is a long-run equilibrium relationship between economic growth and the IBF. In promoting economic growth in Malaysia, the development of IBF is one of the essential options to be taken into consideration. Supporting the industry and providing a conducive environment will enhance the country's economic growth in the long term. Furthermore, continuous efforts are required to make significant contributions to the Malaysian economy to promote the IBF's development (Majid and Kassim, 2015; Kassim, 2016). In another study, Hachicha and Ben Amar (2015) tested the impact of IBF on Malaysia's economic growth from 2000 to 2011. The researchers found that the effect of various Islamic financial indicators was less significant on economic growth in the long run compared to its impact in the short run. Because of marginalizing the PLS-based instruments and rigorously engaging with non-participatory activities, which have a short-term effect on economic

growth, IBs did not play their prominent role effectively as financial intermediaries to channel the savings to long-term projects. The researchers concluded that the impact of IBF on Malaysia's economic growth is ambiguous. Furthermore, the study suggested strengthening the size of PLS-based instruments in the Malaysian financial sector.

Although IBs have a short history compared to the Conventional Financial Institutions' (CFIs) practices, unexpectedly, the IBs performed well and attained high growth in the financial sector in the countries that were practicing IBF. Comparing the performance of IBs and CFIs in Pakistan for 2006-2012, IBs performed better than the CFIs and contributed more to the country's financial stability. IBs had higher income diversity, higher investment-to-asset ratios, and higher profitability ratios, which positively affected the financial system's stability. Furthermore, creating a healthy competitive environment for the banking industry enhances financial soundness (Rashid et al., 2017). Baber (2018) examined the potential of Islamic finance to prevent future financial crises and act as a viable alternative to the Conventional Financial System (CFS). He claimed that IBF is more secure than the CFS and it can reduce the severity of financial crises. The principle of IBF contributes towards padding from future risks, and this cohesion impact ensures financial stability. The performance of IBF in the pre-crisis period and during the first year following the crisis eruption proved its flexibility, which was much better than its conventional sector. Nevertheless, their profitability suffered when the crisis hit most real economic sectors.

IB industry in the CIS is still in its early stages, with limited reach and infrastructure. The sector lacks widespread Shari'ah-compliant products and services. The growing Muslim population and the demand for ethical and Shari'ah-compliant financial services are significant drivers of Islamic finance in the region. IB industry is seen as a way to enhance economic diversification, promote sustainable development, and improve financial inclusion. Opportunities for growth lie in strategic partnerships through collaborations with international IFIs and industry experts to enhance knowledge, build capacity, and accelerate the sector's development. Additionally, there is substantial potential for developing innovative Shari'ah-compliant financial products tailored to the local market's needs, including Sukuk, Islamic bonds, and equity-based financing. IB can play a crucial role in enhancing financial inclusion, particularly in underserved and rural areas, by providing ethical and accessible financial services. The RT is actively working on developing regulatory frameworks for Islamic finance, drawing lessons from other countries and aligning with international standards. With an increasing interest in ethical finance, the RT's IB sector is expected to grow, with the establishment of IBs and the introduction of Shari'ah-compliant products. The expansion of Islamic finance in the RT is anticipated to contribute to sustainable economic growth, enhance social welfare, and address financial needs in line with the values of the local population (Asia-Plus, 2024).

The S&P Global Ratings (2024) report notes that Islamic finance is still at an early stage of development in six countries of the former Soviet Union with predominantly Muslim populations – Azerbaijan, Kazakhstan, Kyrgyzstan, the RT, Turkmenistan, and Uzbekistan. However, simply having a Muslim population is not enough to develop the growing Islamic finance industry. Even in countries where the authorities have created significant regulatory frameworks, the level of penetration of such banking products among the population remains quite low. The low level of penetration can likely be explained by several factors, including the relative complexity of the financial product, the low level of wealth of the population, and the likely secular heritage of the republics. The rapid growth of IB industry in the RT and Kyrgyzstan reportedly suggests that IBs can compete with traditional ones. As a result, the development of IB is hampered not only by factors specific to this sector but also by the insufficient level of penetration of banking services among the population of these countries. Although the majority of the population is Muslim, Shari'ah principles reportedly do not influence the judicial systems of the mentioned six countries, unlike Muslim countries in the Middle East, where Shari'ah influences individual legal norms.

Moody's has emphasized the significant potential impact of IB on RT's financial growth. As the global IBF industry experiences strong growth, RT's adoption of IB practices could facilitate financial inclusion, support infrastructure development, and attract foreign investments, particularly from Muslim-majority countries and regions like the Middle East and Asia-Pacific. IB's emphasis on risk-sharing and ethical investments aligns well with RT's goals of economic development, particularly in financing large-scale infrastructure projects. Furthermore, with IBF expanding globally, RT could benefit from tapping into this growing market, boosting sectors such as real estate, SMEs, and renewable energy. By adopting Shari'ah-compliant financial practices, RT could position itself as an attractive destination for Islamic investors, fostering long-term financial stability and growth. The broader IBF market, particularly in CAR the Middle East, continues to grow despite challenges like currency volatility and regulatory issues. RT's proximity to these markets presents opportunities to integrate further into global IBF networks (Moody's, 2024).

According to the Asian Development Bank (ADB), the RT has a lot of untapped potential to promote financial inclusion through the development of Islamic finance. If Islamic finance is developed in the country, it could positively impact banking penetration by expanding the range of market players. Moreover, it could provide a way for Muslims who opt out of using products offered by traditional financial institutions to access Shari'ah-compliant financial products and services. This, in turn, could help to bridge the financial gap and promote financial inclusion in the country (ADB, 2015; NFIS, 2022). However, some external factors, such as the majority of Muslim and religious-oriented communities in the RT, may further influence the growth of IBF in the country. The religious factors should be considered when analyzing the improvement of the banking sector and the need of the populace to use alternative financing models aligned with their beliefs. Considering that most of the populace (96.8%) follows the religion of Islam, one cannot deny that an indefinite number of the populace may be financially excluded because of their religious beliefs. Besides, the country's religious awareness has increased over time, with 58% of the surveyed populace stating that they abide by Islamic teachings (Ali et al., 2013; Barotzoda et al., 2017; Boboев, 2019;). Hence, there is a need to develop a set of special products to meet the needs of the populace who avoided using the conventional financial system, as 12 percent of the adult populace did not have a banking account due to religious reasons (Findex, 2021; NFIS, 2022).

### **The Economy of the Country**

The financial sector recovered from the 2016 banking crisis, and the quality of the credit portfolio improved. The profitability of the banking sector showed an improvement; the level of dollarization declined from 64 percent in 2015 to 53 percent in 2019. In 2019, the economy recorded strong growth; however, due to the outbreak of COVID-19 and some external issues, it indicated much lower growth in 2020. The expectations for 2023 and 2024 indicate that GDP growth will be 6.5% and 7%, respectively (ADB, 2024; World Bank, 2020). Since 1997, the RT has seen strong economic growth, averaging over 7.1%. The reduction in poverty from 32% in 2009 to around 12.4% in 2022 is attributed to robust growth, increased wages, and remittances from abroad. However, heavy reliance on remittances, lack of economic diversity, and high risk of debt distress make it susceptible to external shocks. Approximately one-third of the annual GDP comes from remittances. Although the public debt is manageable, the risk of debt distress remains high. The country has potential for growth due to its youthful and expanding population, water and hydropower resources, and progress in sectors such as agriculture, mineral resources, tourism, and more. The RT aims to double or triple domestic incomes by 2030, necessitating a new growth model centered on a dynamic private sector. This shift requires the implementation of structural reforms, improved public sector efficiency and transparency, and enhanced investment climate, energy sector, trade connectivity, and access to finance. Given the RT's susceptibility to climate risks, it is crucial to enhance environmental resilience through mitigation and adaptation efforts (World Bank, 2024).

The GDP grew above 12.1 billion USD in 2023. Since 2000, GDP growth has averaged about 8 percent annually, and the inflation rate fell from 40 percent in 2001 to 6 percent in 2014. GDP per capita has continually grown in the last two decades, from 138 dollars in the year 2000 to 1189 dollars in the year 2023. Depending on the agriculture sector is considered a drawback to the economy because it causes low productivity and absorbs 66% of the working force. However, the economy has exceeded expectations by 8.0 percent in 2022, despite regional instability and the high base effect caused by the post-COVID rebound of 2021. Fortunately, the adverse spillover effects from Russia's invasion of Ukraine did not happen, and strong financial inflows fuelled household income growth and liquidity throughout the RT. The appreciation of the Russian Ruble and strong labor demand also boosted the economy. Investment played a crucial role, with public and private investments contributing to growth in the energy, education, transport, and mining sectors (World Bank, 2024).

### **Industrial Basis**

Diversifying an industrial basis and establishing other stable growth drivers can reduce the vulnerability to economic shocks. Efficient export industries can attract productive investment, boost foreign exchange reserves, and generate employment opportunities to absorb external shocks and maintain macroeconomic stability. Hence, the RT needs to improve its business environment and increase the quality of its infrastructure. The country needs to explore suitable business and investment opportunities to sustain high economic growth in the long term. While improving the quality of current products, other exportable products must be diversified (UN, 2016). In 2022, the RT ranked as the 144th largest economy in the world based on its GDP in current US dollars, 142nd in total exports, and 135th in total imports. It was also the 167th largest economy in terms of GDP per capita and the 108th most complex economy according to the economic complexity index (ECI). The RT's major exports included gold (\$644m), precious metals (\$249m), raw cotton (\$212m), copper ore (\$203m), and raw aluminum (\$174m), with the main export destinations being Kazakhstan, Switzerland, China, Turkey, and Uzbekistan. On the other hand, the country's primary imports were refined petroleum (\$625m), wheat (\$312m), cars (\$203m), petroleum gas (\$161m), and raw iron bars (\$143M), with the majority of imports coming from China, Russia, Kazakhstan, Uzbekistan, and Turkey (OEC, 2022).

### **Agriculture Sector**

The RT has a large reserve of fresh water, various minerals, and favorable conditions for cultivation. Opportunities to develop ecological tourism and environmentally friendly food products (National Review, 2017). The country is landlocked in mountainous terrain; only 35 percent of its surface area (142,600 km<sup>2</sup>) is suitable for agriculture, and less than 7 percent is arable land (IMC Worldwide, 2017). However, in 2019 the contribution of the agriculture sector to the GDB was 22.6 percent. Half of the populace depends on agriculture, three-quarters of the population resides in rural areas, and two-thirds of peasants are women. Various significant agrarian reforms have been implemented by the government (TAJSTAT, 2020; USAID, 2020). In the past, the country was a major producer of vegetables and fruits; it also produced cotton, silk, and grain for export to CIS markets (UN, 2016). It is crucial to cooperate with public and private partners to implement solutions by facilitating strategic partnerships, resources, and expertise (ICD, 2018). The NDS 2030 sets a target to increase domestic income by 3.5 times and reduce poverty by half by 2030. Such targets are achievable if more opportunities are provided to the private sector to invest, create jobs, and contribute to the economy (World Bank, 2020; NDS, 2016).

## **Development Islamic Financial Sector**

In 2017, the Central Bank (CB) established the IB supervision department to facilitate the development of the IB in the country. In September 2019, the Sohibkorbank OJSC was converted to the Tawhidbank OJSC to become the first Islamic bank in the country. In February 2020, two MFIs - CJSC MDO Humo and MLF IMON - received licenses to carry out Islamic Banking Window (IBW). To ensure the operation of IBs meets the requirements of the existing laws and the principles of Islamic Law, the CB introduced 16 instructions, procedures, charts of account, and recommendations for the country's smooth implementation and development of the IB industry (NBT, 2020; NBT, 2024).

### **1. Full-Fledge IB: Tawhidbank**

The bank was established as a Sohibkorbank in August 1999 as a joint-stock commercial bank providing support for entrepreneurial activities. In May 2002, the bank was reorganized into OJSC "Sohibkorbank". Since its establishment, the bank has played an active and vital role in the country's financial market. The bank demonstrates positive performance and indicators and has five branches and 58 banking services across the country. Currently, more than 340 specialists are working at the bank. The bank is included in the top 10 biggest banks and has a presence almost in all regions across the country (Tawhidbank, 2019). In 2018, Sohibkorbank approached the Islamic Corporation for the Development of the Private Sector (ICD) to provide technical guidance in transforming from CFI to IB operations. Since then, ICD has been guiding the bank in its transformation journey, addressing issues in Shari'ah Governance (SG), IT solutions, product development, accounting, legal support, treasury, marketing, and risk management (ICD, 2018). Since a large fraction of the populace remains unbanked; Tawhidbank aims to increase financial inclusion, mobilize capital for development and assist the unbanked population. Achieving this endeavour requires the strong commitment and support of the NBT and ICD. In July 2019, it was renamed OJSC "Tawhidbank," and in September 2019, it obtained its license to operate as the first full-fledged IB in the RT (I-FIKR, 2019; NBT, 2019).

According to the NBT regulations, establishing the Committee of Islamic Financial Services (CIFS) is a prerequisite to operating as an IB in the country, and financial institutions cannot function as IBs if there is no such committee in its organizational and administrative structure. Hence, the Tawhidbank complying with the requirements of this legislation has established the CIFS consisting of three members. The head of the committee is responsible for ensuring productive work and monitoring the implementation of decisions adopted by the general meeting of shareholders (Tawhidbank, 2020).

### **2. Islamic Banking Window (IBW)**

#### **HUMO**

The company was officially registered in 2004 as one of the first microfinance institutions in the RT. In 2008, Humo became a microcredit deposit organization. It has a broad geographic scope of activities in more than 40 districts and provides micro-financial services to poor people in the country. During its presence in the micro-financial market, the company opened 16 branches, 36 cash service centers, five cash settlement centers, and 34 customer service points. Mainly, the company's services are directed towards the rural populace; it acquires 77% of the lending portfolio. Special attention is given to women, where 45% of active clients are women. Enhancing women's role in the family is one of the company's priorities and supports SMEs and the agriculture sector. Humo was granted five-diamond awards for the high level of transparency of the microfinance organization (Humo, 2020). In February 2020, the company was granted a license by NBT to offer IBW in the country (NBT, 2020).

## **IMON**

Since 1999, IMON International had a presence in the financial market in the RT, and its activities have been started as an international project with the financial support of the US Agency for International Development (USAID). In July 2005, after adopting the law of microfinance in the country, the Microcredit Fund "IMON" was established and started its operation with an active portfolio of more than three million dollars and 2630 customers. To expand the scope of activities, the company needed to increase the number of its clients and have a solid basis to attract foreign investments, and in 2008, the founders decided to establish a commercial micro-lending organization, "IMON International." After its successful transformation, the fund was able to attract foreign investments, which contributed to the organization's expansion and achievement of success. The active portfolio of the organization reached 30 million dollars, with 15182 customers. In 2013, the organization obtained a license from the NBT to operate as a microcredit deposit organization. After obtaining the license, the number of clients increased to 70826, and over 100 million dollars were received. Over the period, the organization became one of the largest financial institutions in the country (IMON, 2020). In February 2020, the company was licensed by NBT to offer IBW exclusively in the national currency (Asia-Plus, 2020; NBT, 2020).

## **Other IFIs: ASR Leasing**

Asr Leasing Company was established in 2013 as the first Islamic leasing institution in the RT. Together with a group of local and foreign investors, namely, Barakat Microcredit Deposit Organization, ICD, Ijarah Management Company (IMC), and Eurasia Group AG, the paid-up capital has increased to four million dollars (ASR Leasing, 2020; ICD, 2018). The company is one of the largest and fastest-growing companies in the leasing sector in the country and is planning to offer Shari'ah-compliant leasing products all over CIS. As the pioneer of the first Islamic finance provider, the company will have first-mover advantage in RT's financial market. Recently, it was granted a Shari'ah-compliant certificate as a rental-based Islamic finance product by AlHuda CIBE (AlHuda, 2020).

## **RESEARCH METHODOLOGY**

This study investigates the impact and prospects of IBF in the RT by gathering insights from local and international experts who are actively working in IBF industry, such as bankers, practitioners, and Shari'ah advisors. A qualitative research approach was chosen, by employing semi-structured interviews with experts who are working in the IBF industry. This technique aims to generate rich, first-hand data and often uncovers surprising evidence that might not surface through other data collection methods. Semi-structured interviews strike a balance between the flexibility of unstructured interviews and the focus of structured interviews, allowing for in-depth exploration of the topic while still guiding the conversation with predetermined questions (Daymon & Holloway, 2011). For the purpose of this research eleven (11) interviews were conducted. The researcher carefully assessed the participants' backgrounds, taking into account their seniority in the IBF sector and their knowledge of the local financial market. Most participants had been engaged in IBF projects in the country, and some had been assisting regulatory authorities for approximately a decade. As recommended by Saunders et al. (2016), in selecting participants the study used purposive sampling to identify senior experts and practitioners familiar with the IB industry in the region. The interviews yielded valuable insights, making the study results relevant for future research in other countries where Islamic finance is growing or prevalent.

In addition to interviews, a library research method was employed to review existing studies on the impact and prospects of the IBF industry, particularly in the context of local financial markets. Library research involves the systematic collection, analysis, and interpretation of data from library resources, including academic journals, books, newspapers, magazines, and digital materials. This method, also known as secondary or

desktop research, relies on existing data rather than generating new data (George, 2008). The combination of semi-structured interviews and library research is essential for this study. While the interviews provide primary, firsthand data from experts, the library research offers a secondary perspective, grounding the primary data within the context of existing knowledge and research. This comprehensive methodology enables a nuanced understanding of the current state and future potential of the IBF industry in the RT.

## **FINDINGS AND DISCUSSION**

### **Economic Development**

Looking at the local financial market of the RT, it's evident that the Islamic financial market is quite small and relatively young. Only one full-fledged IB and two IBW belonging to micro-credit institutions are operational. There remains ample potential to introduce additional fully-fledged IBs and IBW services, for which the regulatory framework has already been established by the law governing IB activities. The respondents (R10-E and R11-A) described the situation as follows: IBs constitute a relatively minor segment of the global banking system, accounting for only 2% of its total size. This holds true for the RT as well. There is a single bank and a few small institutions in this context. Consequently, IBs' influence over the extent of returns offered to deposit holders is limited.

IBs need to revisit the basic principles and requirements, which are related to the real economy and aimed at assisting lower-income groups. These individuals need support from the banking sector. Additionally, the respondents (R4-A and R9-E) advised: IBs should engage in blended financing, which combines profit-making with benevolent initiatives. A portion of the financing can be allocated to Waqf (endowment) or supporting segments of society in need. This allows IBs to promote financial inclusion, contribute to the prosperity of the entire country, and still achieve acceptable profits.

In order to contribute to society and economic development, the regulators also need to revisit the basic principles and requirements of IB, which are related to the real economy and aimed at assisting high-net-worth individuals and lower-income groups. These individuals need support from the banking sector. IB carries an extra burden in fulfilling its tasks, but it is a reality that must be faced. If the IBs fail to fulfill this mission and vision, they will not be able to achieve mainstream recognition. In relation to economic development, the R1 and R10-E gave a focus on IBF contribution towards the agriculture sector via certain distinguished banking products: "We have Islamic transactions like Salam, Muzara'ah, and Musaqah, which are mainly based on agriculture and developing the agriculture sector. This underscores the importance for IB in the RT to conduct a thorough analysis of the local market, identifying its needs and potentials, and then develop or introduce products and services accordingly. Once firmly established within the country, IBs can consider expansion, growth, and potential collaborations with other countries". Although the Islamic financial market is relatively small and young, it is crucial to be part of the mainstream and aim to contribute to the prosperity of the entire economy.

Furthermore, R1 suggested for more innovative products to be introduced in the RT in attracting investors and customers in improving economic development. For an example, the potentials of the microfinance instrument to be employed in financing the agro-sector: "Additionally, RT's banks should explore the possibility of offering microfinance schemes and consider agriculture as a potential sector to focus on. The RT has an agriculture-based economy, making it a suitable area for development". Islamic microfinance products will not only benefit the operations of the institutions but also positively impact the well-being of the clients and reduce the risk of borrowing and the vulnerability of the poor (Abul Hassan, 2015; Abul Hassan, 2016).

The regulatory improvement of IBF can contribute to the development of the local economy and attract more foreign investments, if a win-win situation is created. The R1 opined: "Malaysia serves as an example where Sukuk issuance is utilized to address societal and welfare needs. IBs need to convince the regulatory side that they can contribute in the same way if given the opportunity. It is crucial for IBs to create a win-win situation for both

the regulatory and banking sides in order to convince them". Additionally, the R6 stated that, "Firstly, you can explain to the population that even countries like the UK and Hong Kong have issued sovereign Sukuk. They have done so in order to provide alternative asset classes that benefit both investors and the country as a whole. Therefore, by introducing IBF, one of the key commercial business arguments would be attracting investors who are specifically interested in Shariah-compliant business practices".

Besides, the sustainable development schemes of IB and other factors can motivate depositors to choose IB services instead of the CFIIs (Pitchay et al. 2020). Closing this gap requires careful analysis of the benefits and finding ways to unlock them. This involves conducting a gap analysis and working with economic agencies to develop a middle path that connects the banking sector with the real economy and aligns with policies to drive economic growth. The R9 opined that: "Political stability is essential for economic improvement, which, in turn, leads to increased incomes for the population. By improving the economy, we can address the issue of financial inclusion, which is currently a challenge in your country". Additionally, the R10 stated: "When discussing sectors that have yet to be adequately served, particularly in the context of the RT, it becomes evident that IFIs have predominantly focused on the commercial sector. They have not extended their services to rural areas, the agriculture sector, or even the industrial sectors. Their operational scope has mainly encompassed consumer financing, exemplified by their funding of household items and cars through Murabahah".

The majority of scholars and researchers hold the opinion that Musharakah contracts are a fair and appropriate instrument of IBs, which consider both parties' contributions, and the profit and losses will be shared accordingly. It offers tremendous benefits to the customers and the community. Hence, IBs shall step out of their comfort zone and actively participate in the businesses as partners (Abdul Rahman et al., 2020). The R4 advised to adopt reasonable financing approaches: "So, this is where banks should adopt responsible financing practices. It involves considering ESG factors, aligning with sustainable development goals, and developing long-term plans for the country or society. It also entails segmenting depositors and ensuring a balanced approach between profit and ethical, value-based responsibilities".

### **Prospective Sectors**

The countries that adopted IB have enjoyed various benefits, such as profit and loss-sharing dealings, interest-free loans, and economic growth (Nasser and Muhammed, 2013). If the authorities believe in the IB system, IBs can ultimately assist and contribute to society's well-being and the welfare of their customers. IBs demonstrate loyalty to their customers, which is not commonly found in the CFS (Sethi and Acharya, 2018). The R5 suggested focusing on trade finance as a prospective sector for the IFIs to contribute: "The best approach for the bank is to venture into trade finance, where the terms are very short, and the potential returns are more significant, especially in international trade finance. Currently, IBs have a relatively small involvement in trade finance, but efforts are being made to increase participation to improve profits and match the shorter time frames with the liability side".

As advised by the R1 and R11 respondents, the IFIs need to differentiate themselves in the financial market and give a special focus on the populace's needs and beliefs in order to be trusted: "The uniqueness of IBs lies in their dual perspective of seeking economic profit while adhering to Shari'ah values. This inherently compels IB shareholders and authorities to involve the entire society in benefiting from banking products and services. This approach is rooted in both economic considerations and the principles of Aqidah and Shari'ah. Both dimensions compel IBs to actively contribute to financial inclusion". Furthermore, "a critical aspect involves ensuring the absence of Dharar – harm throughout this process. Vigilance in this regard safeguards against unintended negative consequences. These are pivotal aspects that, if adhered to by the bank, instill confidence in their ability to cultivate trust, especially within the religiously motivated segment of society".

Hence, to maximize the reach, it is crucial to tap into the untapped communities and capture their attention. IBs should tailor their marketing efforts to resonate with this audience, highlighting the unique features and benefits of IB that align with their values. IBs should offer attractive value propositions and services that appeal to customers like any other bank. IBs can attract customers and build loyalty by providing competitive products and services. It is also vital to prioritize strong corporate and Shari'ah governance practices and avoid any negative headlines that could erode trust and undermine the efforts of IBs. Maintaining a positive reputation is essential for long-term success and fostering customer confidence, as the R6 opined: "CFIs, due to their significant size and wide range of financial services and products, may sometimes offer more competitive deals compared to IBs. This advantage can pose a challenge to the growth of IBs, especially in terms of limited resources and market share. However, IBs can mitigate this challenge by consistently focusing on enhancing financial literacy and promoting their unique value propositions within the community. By emphasizing the distinctive benefits of IB, such as ethical principles and Shari'ah-compliance, IBs can maintain their position and attract customers despite the competition from CFIs. Continuous efforts to educate the public about IB and its advantages will contribute to the sustainable growth and success of the IB sector".

### **Financial Inclusion**

IBs must facilitate their products and services to reach a wider customer base, thereby promoting financial inclusion. It is the responsibility of IBs to not only serve those customers who already have access but also to offer more facilities, banking products, and services to society as a whole. The primary goal should be ensuring that the majority of the population can access and benefit from banking products and services. In this regard, the R8 stated: "Certainly, IBs must contribute to financial inclusion. This is of paramount importance in the present landscape, evident from the multitude of global events where discussions on financial inclusion are commonplace. It is imperative that IBs actively engage in this sphere. Their perspective should extend worldwide, accompanied by a comprehension of the significance of this endeavor. Therefore, it becomes necessary for them to designate a responsible individual to oversee matters related to financial inclusion". However, the CB must provide a level playing field, only then can IFIs can champion financial inclusion, which will benefit the country. So, it requires change - a shift in mindset, a paradigm shift; all of this is necessary to make it happen. The R9 stressed that: "Because it's part of our ideology, we must promote financial inclusion. Therefore, to achieve this goal, you need to cooperate with Ministry of Finance and CB. However, IBs also play a vital role in assisting with financial inclusion. Making financial inclusion a priority must be at the top of your agenda, but it requires significant changes in the entire system".

Islamic finance can contribute positively to three dimensions, such as enhancing financial inclusion, especially a large portion of Muslim communities are financially unserved. Provide risk-sharing products and asset-backed financing, supporting SMEs and investments in public infrastructures. Due to the prohibition of speculation, Islamic finance may pose fewer systematic risks than conventional finance. The IFIs are an excellent platform to achieve financial inclusion and support economic development. Moreover, Islamic finance can employ funds from other Islamic institutions, such as Waqf and Zakat, to have a broader impact on financial inclusion. The R3 suggested close collaboration of IFIs and governmental bodies to increase financial inclusion in the country: "Individuals who are poor or in need can open bank accounts with IBs, and the Zakah funds they receive can be channeled through the bank. Additionally, the Zakah authority may provide support for individuals engaged in business. Currently, there is a disconnect between our Islamic safety net and the financial system. It would be beneficial for banks to collaborate with religious authorities, as they possess the necessary infrastructure. By combining efforts, we can effectively collect and disburse Zakah and Sadaqah funds". This indicates a positive correlation between savings and financial inclusion. Hence, a rise in the population's savings level will increase the banked population and financial inclusion. There are some

opportunities to improve poor Muslim communities' economic conditions through innovative approaches.

### **Impact**

To have a positive impact on the economy and the society, IBs should actively participate in the ongoing digitalization efforts and prepare for the future. By embracing digitalization, IBs can expand their reach and cater to specific sectors such as agriculture. IBs can extend their services to farmers, remote businessmen, and traders in rural areas by leveraging digital platforms and technology. Digitalization offers a unique opportunity to bridge the geographical gap and provide financial services to underserved communities. By adopting digital technologies, IBs remain relevant and accessible in the evolving financial landscape. Embracing digitalization is essential to prevent being left behind in the industry's progress, as the R6 stressed: "The discussion around digitalized financial services has gained significant momentum, and it is widely recognized that digitalization plays a crucial role in promoting financial inclusion. IBs should actively embrace this trend and recognize the importance of digital financial services. Many banks are shifting their focus from traditional brick-and-mortar infrastructure to enhanced digitalization and innovative digital structures. By leveraging technology and digital platforms, IBs can expand their reach, improve accessibility, and provide convenient and inclusive financial services to a broader customer base. Embracing digitalization offers opportunities for IBs to stay competitive and meet the evolving needs of customers in today's digital age".

Furthermore, the R9 opined: "Digitalization is of utmost importance in today's world, and you cannot ignore its significance. The banking industry is rapidly adopting digitalization, and this means that we are offering digital banking services, particularly focusing on the bottom segment of society. By incorporating criteria such as FinTech, digitalization, value-based intermediation, and equity-based sharing, you will attract more people". Even the essential drivers for realizing financial inclusion, particularly for women, low-income earners, and the poor in rural areas, are robust technology, microcredit services (Shinkafi et al., 2019).

The R3 stressed that the IFIs must adhere the moral and ethical aspects of their operations, perceive their customers beyond mere profit sources, and ensure that their services contribute positively to societal well-being: "IBs should emphasize the moral and ethical aspects of their operations. Given the conservative nature of society in a country like RT, highlighting the ethical values aligned with Islamic principles can attract individuals to the IB sector". Furthermore, the R11 opined: "While fundamentally a business entity, the institution must perceive its customers beyond mere profit sources, recognizing them as integral components of society. This perspective should drive the institution to ensure that its services contribute positively to societal well-being. Conducting business, while financially profitable and legitimate, falls short if the rendered services inadvertently inflict harm upon society. A case in point is a tobacco factory or shop that sells cigarettes to customers, capitalizing on demand and reaping profits. However, this enterprise contributes solely to societal detriment. Being ethically legitimate is insufficient; active participation in societal betterment is imperative".

Another important aspect involves fostering a concept of mutual cooperation within the framework of the IFIs' business operations. Similarly, the R2 opined that in order to contribute to the welfare and development of society the IFIs should not neglect the role of Waqf, Zakat, and other charitable initiatives: "One of the sectors IBs should focus on, not only in the RT but also in other countries, is the sector of Waqf, Zakat, and other charitable initiatives. If IBs choose to prioritize these sectors and develop them effectively, they can make significant contributions to social development and support". Besides, the circulation of wealth is one of the essential objectives of Islam for society. Islam acknowledges the importance of circulating wealth and sets certain principles to ensure that wealth does not circulate and is concentrated among the privileged where the benefits are restricted within a small portion of society. The gap between rich and poor should be restricted as much as

possible. Besides, Zakat is a vital mechanism for redistributing wealth and prohibiting Riba consumption from achieving societal equality (Ibrahim et al., 2014; Bella and Al-Fayoumi, 2016). The R4 opined in this regard: "From a religious perspective, hoarding money at home without utilizing it in the economy is considered Canz and is prohibited. By doing so, you deprive society of benefiting from your funds as they remain under your pillow. Instead, depositing them in a guaranteed account may not yield significant profits for you individually, but it benefits the country and the overall economy by circulating the funds and facilitating economic activity".

Moreover, IFIs should not solely focus on maximizing profit. They should strive to add value to society by supporting start-up companies and SMEs with genuine projects that contribute to the economy. While it may not yield as high a profit as in normal conditions, it is important to recognize that profit is not just monetary gains. The R3 opined: "The SME sector is an important area for Islamic finance to explore. However, there is significant work to be done in this regard. Once a comprehensive framework and system are established, it has the potential to operate effectively. Therefore, it is crucial for us to focus on SMEs as well. The challenge for IBs lies in the fact that many of them are competing within the same market segment as conventional banks". Furthermore, the R8 added: "IFIs should expand their focus to encompass SMEs and the retail sector, as their current emphasis is primarily on collaborating with corporate entities. Although corporate banking holds the potential for substantial profits, these institutions should also extend their services to SMEs and retail customers".

Finally, the impact and performance of the IBF during the crisis eruption could be viable proof that IBs can face future crises more effectively. Moreover, many Islamic scholars, such as Taqi Usmani, Umar Chapra, Abbas Mirakhor, and others, argued that IFS is drifting away from Islamic principles and its theoretical norms. Although IBF is not practiced as it should be, it proven its stability and flexibility (Belwal and Al Maqbali, 2019). Hence, it could perform much better and be more resilient if it is practiced according to authentic Islamic principles. IBF has witnessed astonishing growth and proved itself to be a reliable option on which to depend to prevent future financial crises.

## **CONCLUSION**

The RT is a Muslim-majority country located in the CIS, where IFIs recently established. The country was listed among the countries with the most significant increases in Islamic finance assets and the main growth driver. Also, the country was considered one of the fastest-growing markets in the CIS. Accordingly, the purpose of this research is to explore the impact and prospects of the IBF in the country. The results showed a positive impact and promising prospects of IBF on the entire economy as a whole, such as economic growth, sustainable development, financial stability, promotion of financial inclusion, sector financing demands, and fulfilling the religious needs of the populace. Besides, the Islamic finance approach is more friendly to the environment, and this issue is tightly related to morals, ethics, and social responsibilities.

Hence, it is expected that IBF will not only have a positive impact in the period of turbulence in the financial system but can also play an alternative banking model alongside traditional banking in the country. Also, it may enhance the financial sector in the RT to achieve long-term sustainable economic growth. In addition, IBF would enhance social welfare, and fill the gap of a financial intermediary in the country. It can also help generate real competition in the financial market. Moreover, a bright future awaits the industry if it practices appropriately according to Islamic principles rather than mimicking CFI's financial instruments. Despite the supposed advantages of IB and the presence of a Muslim majority in the RT, IB remains limited.

The findings also signify that practitioners must avoid conventional banking practices to make a real impact and prosper rigorously in the country. The market players need to closely collaborate with the authorities since the industry needs tremendous efforts and continuous support to prosper rigorously. Hence, looking at IBF from an economic

perspective, embracing this unique system, and understanding the impact and prospects of IB in the RT is necessary. Finally, it must be highlighted that the study has been limited to the qualitative and library research methods, future studies may explore other methods to assess the impact and prospects of IFIs in the local economy.

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