

IMPORTANCE OF SOVEREIGN RETAIL SUKUK FOR ENERGY INFRASTRUCTURE, IN VIEW OF INCREASED SHARIAH AWARENESS IN UZBEKISTAN

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Abstract

The Objective of this paper is to review such complex issues in Uzbekistan as Infrastructure Financing of the Energy sector projects on one hand, and the recent escalating foreign debt on the other hand and propose the applicable and beneficial financing solution. The implementation of the sovereign domestic retail Sukuk in the country is assumed to benefit in facilitating the complex problems under the environment of the increased Shariah awareness of people of Uzbekistan. The paper adopts qualitative approach by conducting the survey, analysis of the literature review, case studies, gathering valid data and documents from official websites. As households and individuals buy Sukuk it will bring to better wealth distribution and increase their stable income. The Government of Uzbekistan may find this research useful for funding its infrastructure projects in energy sector as well as controlling its increasing foreign debt. To the best of the author's knowledge, this paper is the first for Uzbekistan with thorough review of the situation based on the valuable primary data. In addition, the research confirms the fact of the increased Shariah awareness of the people of Uzbekistan, which started impacting on their financial preferences to avoid dealings with conventional financing and expedite the implementation of Islamic Finance in the country.

Keywords – Sovereign Retail Sukuk, energy infrastructure, Shariah awareness, Uzbekistan

Introduction

Uzbekistan is the largest country in the Central Asia in terms of population with 35.2mln of people as of the estimate ([Statistics Committee of RUz, 2021](#)). 92.4% of population follows Islam ([Wikipedia, 2021](#)).

The financial system of the country is based on only the conventional system and, officially, the Islamic finance does not exist in the country.

The country has 45 electric power plants with a total installed capacity of 12,400 MW and a potential production capacity of 64 million MW/h. More than 80% of the total electricity generated comes from natural gas (<http://invest.gov.uz/investor/tek>).

However, this output is not being able to fully satisfy the consumers' needs. As a result, there have been consecutive and serious cut-offs of power supply to the population ([Gazeta.uz, 2021](#), [Uz.sputniknew.ru, 2021](#), [Podrobno.uz, 2021](#)).

To solve the issue of energy supply Government of Uzbekistan is trying to update its energy facilities with renewable energy sources, based on domestic & foreign investment ([Zokirov, 2019](#)). The investment plan of Uzbekistan for 2021-2023 shows that total amount of projects in construction and modernization of power generating infrastructure exceeds the USD 2Bln in this period.

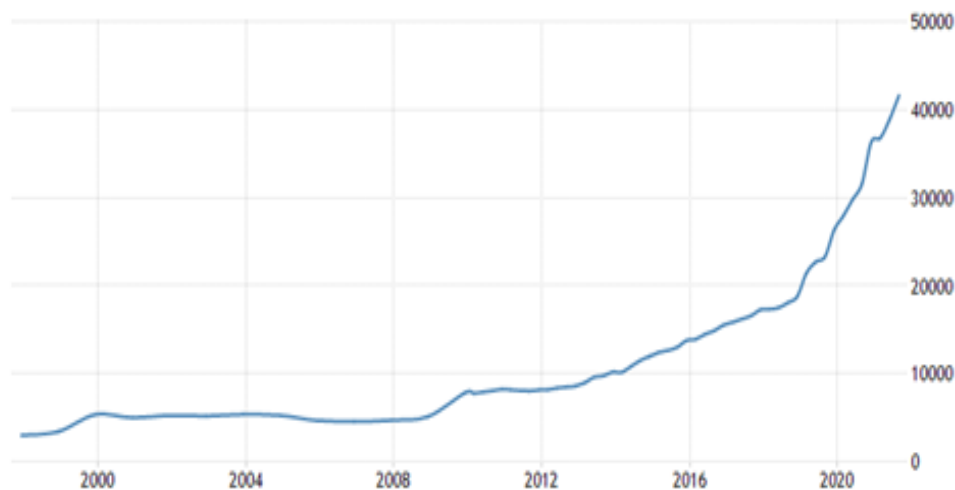
However, main source of financing is being the foreign debt which is abruptly increasing in the last years as seen in the diagram 1. For reference, it increased about 3 times in the last 5 years

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and reached USD 40bln as shown in the Diagram 1 (Spanov, 2021, Review.uz, 2021, Tradingeconomics.com, 2021).

Diagram 1: Dynamics of foreign debt in Uzbekistan



Source: Central Bank of Uzbekistan

Considering the above conditions, the research is conducted with the the aim to review energy sector issues in Uzbekistan with best alternative financing options using the internal resources rather than applying to the external debts. Such financing could have been settled by efficiently utilization of funds flow from the surplus units (Households) to the deficit unit (Government), using the Islamic Capital Markets instrument, namely Sukuk.

It would be relevant here to mention the statement of S.Safoyev, the deputy Head of Senat of Uzbekistan. He declared that citizens of Uzbekistan have USD 10bln idle money, which needs to be directed to the real sector. Here he partly blamed the Banks not to attract the idle funds from population (<https://upl.uz/economy/19675-news.html>).

In this regard, it is found useful to investigate whether the households are Shariah aware on financial issues and whether the Shariah preference impact on their financial transactions, i.e., purchase of Sukuk.

Therefore, following research questions are raised to reach the research objective: (1) How the Shariah awareness affect on implementing the Sukuk structure in Uzbekistan? (2) How the Sovereign Retail Sukuk scheme fit for fundraising of projects in Uzbekistan? Accordingly, the primary and secondary data is analyzed, based on the on-line survey, the literature review, data on official web sites, case studies, etc.

Structure of the remaining part is consisted of the Literature review, Methods of research, Discussions on findings and rounds up with the Conclusion on the whole research paper.

1. Literature Review

1.1. Review of Sukuk

1.1.1. As part of the research is to give a proposal on application of Sukuk, the relevant literature review is conducted on theoretical background of Sukuk, based on the reference to the official governing organizations, together with other researchers' work on specific Sukuk topics.

1.1.2. According to [AAOIFI](#) definition, “Sukuk are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity”. It is similar to the conventional bond, but it is an Islamic Bond, where the fundraiser raises funds and issues the certificates to the investor, based on the underlying asset or a project, which entitles the holder of the certificate on the undivided ownership in the project.

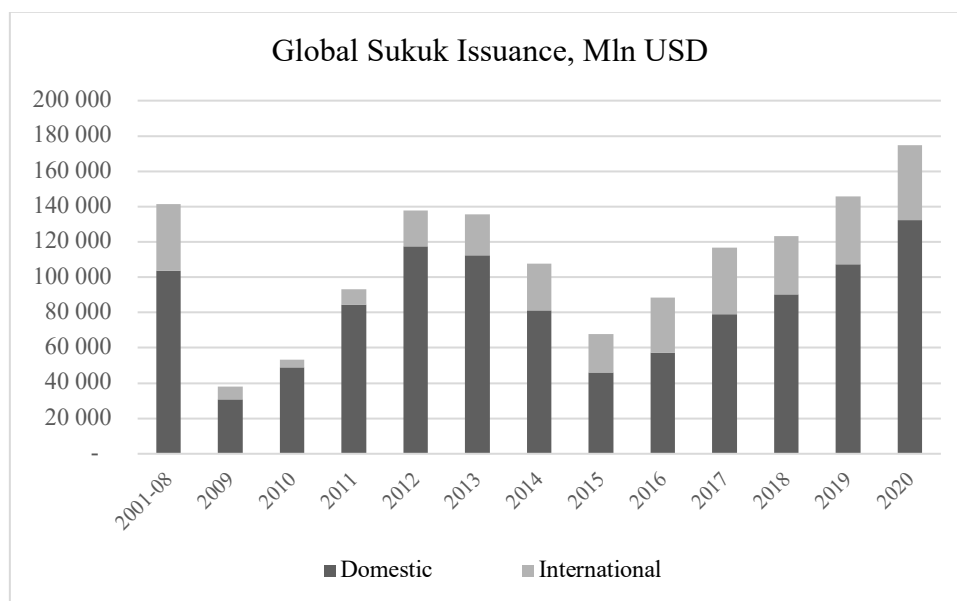
1.1.3. The common types of Sukuk are followings due the World Bank ([Ariadi et al. 2014](#)):

#	Types of Sukuk, based on	Short definition
1	Ijarah	Leasing (sale and leaseback) agreements
2	Murabahah	Trust based sale and purchase agreements
3	Mudharabah	Profit-sharing agreement between Investor and Entrepreneur
4	Musharakah	Partnership agreement between the investors
5	Salam	Forward contract, usually agricultural commodities
6	Istisna	Forward contract for manufacturing and construction objects
7	Wakalah	Agency agreement between Agent and Investor

1.1.4. The contemporary Islamic Finance started in 1970’s by establishing of the Islamic Development Bank (IDB). Due to the demand for Capital Market instruments, the Islamic Fiqh Academy of the Organization of Islamic Conference (OIC) in 1988 legitimized the Sukuk, which opened more opportunities for Shariah based financing.

1.1.5. In 1990, the 1st Sukuk was issued by Shell MDS, non-Islamic Company in Malaysia. After 10 years, in 2000, Government of Sudan issued the domestic Sukuk on Musharakah basis. In 2001, the market became global by the issuance of the international Sukuk on Ijarah basis by the Government of Bahrain ([IIFM Sukuk Reports, 2012](#)). Since 2001, the Sukuk market started to grow significantly and the total volume reached USD 174,641Mln in 2020, which is seen on the following diagram:

Diagram 2: Global Sukuk Issuance (IIFM Sukuk Reports, 2021)



1.1.6. Sukuk market is expanding worldwide, and the number of country-participants touched 37. The biggest share belongs to Malaysia with 56% of total issued Sukuk since 2001 (**appendix 1**). Though, Malaysia had stopped issuance of short term Sukuk in 2015's, which had reflected in decrease of total volumes during that time (IIFM Sukuk Reports, 2016). Out of whole global Sukuk, 77% belongs to local and the rest 23% is due the international Sukuk.

1.1.7. Despite the development, Ariadi et al., (2014) mentions on obstacles for further growth of Sukuk market as well, caused by several factors as (1) absence of standardization of Sukuk structures, (2) bankruptcy and investor protection, and (3) lacking liquidity.

1.1.8. Following table shows the comparison of the Sukuk with similar Securities.

Table 1: Comparison of Bonds, Sukuk & Shares

	Bonds	Sukuk	Shares
Nature	IOU or interest-based debt	Proportionate ownership in Shariah compliant asset, project, usufruct, etc.	Proportionate ownership in corporate
Issuers	Any issuer	Issuer in Shariah permitted activities	Any issuer
Investors	Non-Islamic investor	Any investor	Any investor
Relationship	Creditor – debtor	Based on structure	Shareholder in corporate
Underlying Assets	No asset is required for unsecured bonds and any asset for secured bonds	Sharia complied assets, mainly tangible. Minimum debts receivable is allowed.	No required
Asset related expenses	No	May be affected	No

Status	Mainly, unsecured creditor	Have recourse to asset in case of default	Junior claims than securities
Returns to Investors	Fixed coupon payments	Profit share or rent income	Dividends
Principal Repayment by Issuers	Return, irrespective whether project is profitable or not	No fixed obligation. repurchase undertaking in case of Ijarah	No, as perpetual instruments.
Utilization of Proceed	No specific requirement	Shariah compliant activity	No specific requirement
Tradability in Secondary Market	It is the sale of debt	It is sale of share in asset or project. AAOIFI allows asset based Sukuk.	It is the sale of share in company
Pricing	Based on credit rating	Based on the structure of Sukuk. For fixed income, it is similar with bond pricing	Based on Performance of corporation

1.2. Review of Sovereign Retail Sukuk and its types.

1.2.1. Sovereign Retail Sukuk is when the Government initiates the Sukuk issuance for fundraising of projects and sells the Sukuk securities among its citizens, households of the country. In other words, the fundraising is come from the retail market, i.e, rather than the corporates.

1.2.2. [Handayani & Surachman \(2017\)](#), conducts the research on types of financing and suggest the sovereign Sukuk as an alternative financing for the energy infrastructure in Indonesia.

1.2.3. According to implication [Aman et al. \(2021\)](#), Government officials need to reinforce the economic growth and financial system to develop the domestic Sukuk market.

[Tariq & Dar \(2007\)](#) state that Sukuk is a valuable instrument for financing of the public and private sectors, which is also useful investment product for the households.

1.2.4. Research conducted by [Toshmurodova & Abrorov \(2020\)](#) implies that Sukuk is important on development of economy, especially the increase of income levels of households and states that the Islamic Finance products can be used in both Muslim and non-Muslim countries.

1.2.5. According to [Sukmana \(2020\)](#), specific features of sovereign domestic retail Sukuk are (1) favorable rates, (2) tradability among people and (3) risk-free features. Domestic Sukuk is specified as institutional & retail Sukuk. Retail Sukuk, is initially acquired by individuals, usually by the online platforms and may later be sold to institutions in secondary market. [Sukmana \(2020\)](#) also defines four objectives of issuance of domestic retail Sukuk: (1) to diversify the portfolio of financial tools for the government budget; (2) to expand the scale of domestic investors; (3) to contribute towards the development of IF, (4) to support the capital market of Indonesia by converting the households from a savings-oriented into investment-oriented.

1.3. Review of the development of Sukuk in Uzbekistan.

1.3.1. Literature review shows that there are not many articles yet published on perspectives and development of Sukuk in Uzbekistan. Though, it is noted the increasing tendency of such articles in the recent years. Following articles are discussed on Sukuk development in Uzbekistan.

1.3.2. [Abrorov \(2021\)](#) conducted research on the development of Sukuk worldwide, stated on the absence of Sukuk instrument in Uzbekistan, with weak capital market and suggested implementing Sukuk for strengthening of capital markets of Uzbekistan.

1.3.3. Similarly, [Arifdjanova \(2021\)](#), concludes the importance of Sukuk in financing of the real sector of Economy, diversification of the financial instruments, increasing the competitiveness of the market, providing the wide options for the investors and suggests the importance of working out the legal base, primarily, and also build the necessary infrastructure.

1.3.4. Research by [Elmirzaev & Alikulova \(2021\)](#), finds the importance of inclusion of Islamic financial instruments into the financial markets of Uzbekistan and considers the issuance of Sukuk as a key factor for attraction of foreign investors to Uzbekistan.

1.3.5. [Imamnazarov \(2020\)](#), suggests 5 actions for Sukuk perspective: (1) Set up legal framework of Islamic Finance by legislative act; (2) Work out the Guidelines on Sukuk issuances; (3) Applying international best practice; (4) Pick up the proper infrastructure projects possibly in energy sector for international Sukuk issuance; (5) Increasing the knowledge of the industry professionals.

2. Research Methodology

2.1. Online survey is conducted to investigate the people's Shariah awereness and its impact on financial preferences in Uzbekistan, especially the people's interest towards Sukuk.

2.2. Primary data is analyzed based on the quantitative and qualitative approach. Regarding the best Sukuk structure for fundraising of projects in Uzbekistan, the secondary data is analyzed, based on the literature review, data on official web sites, case studies, etc.

2.3. Survey questions are prepared using the Google Forms platform, and sent through the Telegram, the most popular Messenger in Uzbekistan, to the various people to avoid the bias as much as possible, using the snowball technique. The initial receiver is asked to resend the survey to his/her group, including relatives, friends, workmates, classmates, etc, and even placed in some public channels. According to estimates, the survey questions were sent to more than 2,000 people and resulted in 226 responses on closed questions.

2.4. Some selective survey responses are brought down as followings:

2.4.1. What Bank services do you use?

Bank services	Usage by respondents
Never use bank accounts	9%
Saving account	9%
Loans	20%
Demand deposit account	23%
Cash operations	47%
Currency exchange	52%
Card operations	83%
Others	15%

Regarding the usage of Bank services, **biggest** share belongs to usage of **card operations** (83%) and the **smallest** percent belongs to the **Saving accounts**. As (1) card operations in Uzbekistan are interest free debit cards, and (2) Saving accounts, basically, are interest earning accounts, it signals, that people are not willing to engage in Ribavi Bank services.

2.4.2. Do you use bank financing?

Usage of bank financing?	Yes 22%	No 78%
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Majority (78%) does **not use** bank financing except Minority respondents (22%).

2.4.3. Reason of not usage of Bank financing:

Bank services	Usage by respondents
Shariah perceptions (Riba)	56%
No need	24%
High interest rates	13%
Too much bureacracy	7%
Total	100%

As it is discovered from survey, 56% of total respondents expressed that they do not use the Bank financing due to the Sharia perceptions, that is Riba. While 24% of them informed of not being necessary, 13% is high interest rates and 7% is due to bureaucracy.

This is also an evident that majority people's awareness towards the Sharia in Uzbekistan is increased enough to refuse the conventional financing.

2.4.4. If Government issues Sukuk (Islamic Bond) how much are you willing to buy?

Scenarios based on earning rates	Not buy	Buy:		Total
		UZS *1mln - 10mln	More than UZS 10mln	
If Sukuk rate < CB rate [†]	41%	37%	22%	100%
If Sukuk rate = CB rate	35%	41%	24%	100%
If Sukuk rate > CB rate	31%	38%	31%	100%

For the question whether the people would be willing to buy the Sukuk, the participant is given 3 different scenarios. As noticed, if the Sukuk rate < CB rate, 41% people would not buy Sukuk, but still the rest would buy in different amounts. When Sukuk rate > CB rate willingness to buy rises.

2.5. Case studies on Sovereign Retail Sukuk

The recent case studies are learnt for getting lessons from the international Sukuk markets.

2.5.1. Oman Sovereign Domestic Sukuk (IIFM Sukuk Reports, 2021)

Issuer	Oman Sovereign Sukuk S.A.O.
Tranches	Series 4 (S4) & Series 5 (S5)
Issue Size	(S4): OMR 208mln (\$541mln) / (S5): OMR 25mln (\$65mln)
Investor breakdown	(S4): FI, Pension Funds, Corp-s, HNWI / (S5): Retail
Issue date	11 Nov 2020 & 24 Nov 2020
Tenor	5 & 2 years
Structure	Ijarah
Mode of issue	Public
Profit rate	5.75% & 4.75% per annum
Minimum investment	RO 10,000 & RO 100
Subscription details	Over Subscribed & Fully Subscribed
Payment terms	Semi-annual
Lead arranger / Fin. advisor	Maisarah Islamic Banking Services - Bank Dhofar
Shari'ah advisor	Maisarah Islamic Banking Services - Bank Dhofar
Legal advisor	Ali Busaidy, Mansoor Jamal & Co.
Governing law	Omani

* UZS is Uzbek Soum. For reference, \$1 = UZS 11,005 as of 03.10.2022.

[†] CB is Conventional Bank.

Listing	Muscat Securities Market
Rating	Not Rated
Asset pool	Ownership in the commercial land in the Barka area

Oman started implementing Sukuk in 2015. Nevertheless, the Country could have issued 5 Sovereign Sukuk since then. In the issuance of 4th and 5th tranches of Sukuk in 2020, the Oman government included the Sovereign **retail public Sukuk** with the purpose of creating access to ordinary Omani households (investors) to capital markets (DDCAP Group, 2020).

Various countries in GCC region, Malaysia, Indonesia, Turkey, and Nigeria have been actively pursuing to favor retail investors to get engaged in Sukuk offerings. The funding mainly goes to infrastructure projects in the road, rail restorations and construction sphere (DDCAP Group, 2020)

2.5.2. Government of Indonesia Retail Sukuk (Salaam gateway, 2021)

Issuer	Government of Indonesia
Type of Sukuk	Government domestic retail Sukuk
Amount	Rupiah 27 Trln (\$1.9bln)
Date of issue	September 20, 2021
Tenor	3 years
Asset	Ijarah
Underlying assets	State owned assets and State budget for 2021
Yield	5.1%
Minimum holding period	3 months
Traded through	Online platform for Government Securities
Investor types	Self employed investors, private employees, etc

Movement of Household savings to Investment holdings such as Sukuk is rising in Indonesia, due to being familiarity of this instrument (Salaam gateway, 2021).

3. Main Results And Discussions

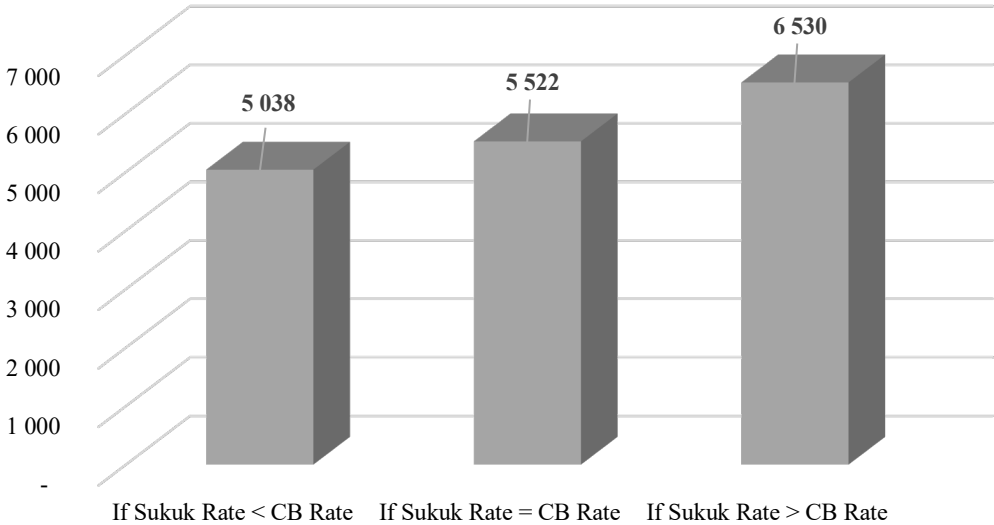
3.1. As earlier mentioned, the objective of the research is to review energy sector issues in Uzbekistan with best possible financing using the internal resources rather than applying to the external debts. Such financing could have been settled by efficiently utilization of funds flow from Households to the Government, using Sukuk, in view of the Muslim population.

3.2. In this regard, it is found useful to investigate whether the households are Shariah aware on financial issues and whether it impacts on their financial deal, i.e., purchase of Sukuk. Based on the survey, conducted with 226 respondents, it is evidenced that the Shariah awareness of the people of Uzbekistan is matured, which started impacting on financial preferences.

3.3. Survey shows that 56% respondents do not use bank loans due to Sharia (Riba) perceptions. Furthermore, it was found that majority people informed of buying Sukuk, if made available by Government.

3.4. According to the official statistics (Stat.uz, 2021), number of households in Uzbekistan reached 8.9mln. Based on the obtained survey information, we can simulate the amount of fundraising to the Government from the Households in 3 scenarios as in the following diagram. Note: The average amount of Sukuk purchase is assumed UZS 5mln for middle range Households (in survey it is UZS 1-10mln range) and UZS 20mln for the higher range Households (in survey it is more than UZS 10mln range).

Diagram 3: Simulation of Sukuk purchase, USD Mln



The simulation diagram shows that depending on the rate of earnings to its Households, the Government would have internally generated funds for the amounts of USD 5bln-USD 6.5bln on average. It is sufficient to cover the current needs of USD 2bln due the investment projects in Uzbekistan for energy sector reconstruction.

3.4.1. The overall importance for the issuance of Retail Sukuk could be listed as followings:

1. Restore of energy sector infrastructure by the internal sources in Uzbekistan
2. Satisfaction of the population’s desire for Islamic Financial products
3. Properly utilization of internal resources, as being practiced in the worldwide
4. Assist in release of burden on increasing foreign debt
5. Funds are circulated in the Country, assisting in the active money circulation
6. Additional stable income for the households
7. Increased trust between the Government and population as being united partners
8. By gaining experience, the Government may expand issuance of new types of Sukuk and other types of Islamic Finance Products, which are in line with People’s desire.

3.4.2. Based on the analysis, the issuance of the Sovereign Retail Sukuk would be most important and beneficial at present for the Government of Uzbekistan.

Conclusion and Recommendations

Uzbekistan is facing problems with shortage of energy supply, which is reflected on consecutive shut-offs of power supply to households, corporates, etc with the purpose of economizing the electric energy. To solve the issue the Government of Uzbekistan is trying to update its energy facilities with renewable energy sources, mainly, based on the foreign debts.

However, on the other hand, Uzbekistan's external debt has been increasing significantly, especially, with sharp trend in recent years. Without mentioning its positive sides on the economy, though, this burden creates a risk of (1) dependency on external world and (2) foreign currency devaluation risk, concerning its repayment with additional interest.

It is assumed that such issues could have been settled by efficiently utilization of funds flow from the surplus units (households) to the deficit unit (Government), by issuance of Sovereign Retail Sukuk, assuming the fact that the most Households in the country are Muslims.

In this regards, present research also covered the survey on the Shariah awareness of people in Uzbekistan on their financial preferences. Below are the research findings and policy recommendations:

1. The Shariah awareness of people of Uzbekistan is increased so much as it started affecting on people's financial preferences, i.e., willing to engage in Sukuk transactions.
2. The implementation of the sovereign domestic retail Sukuk in the country is assumed to benefit in facilitating the complex economic issues such as funding its infrastructure projects under the increasing external debt and promotes the social welfare.

Based on the simulation analysis, the total fundraising from the Sovereign Retail Sukuk issuance would have potential to raise USD 5.0bln – USD 6.5bln, which is significant to cover the current needs of USD 2bln due the energy infrastructure projects in Uzbekistan.

The Government of Uzbekistan may find this research useful for funding its infrastructure projects by utilizing the internal resources. By gaining experience, as the pilot project, the Government may expand the issuance of other types of Islamic Finance Products, in line with increased Shariah awareness of the people.

The development of Sukuk in the Country would ultimately assist in settlement of such social issues as electric power shut-offs and raise the trust of the population of Uzbekistan towards the Government Authorities.

As households and individuals buy retail Sukuk, it also brings to better wealth distribution and additional stable income. Additionally, it gives satisfaction for the people to use their savings for Islamic Financial products.

To the best of the author's knowledge, this paper is the first research with thorough review of the situation based on the valuable primary data for Uzbekistan. In addition, the research confirms the fact of the increased Shariah awareness of the people of Uzbekistan, which started impacting on their financial preferences.

The research paper used the primary data of 226 survey respondents, which could have been improved by increasing the number. Furthermore, this research, basically, includes two types of research: (1) academic research, where the primary data is collected and checked for the relationship of Sharia awareness on financial preferences and (2) industry research, where the issue is studied, and relevant proposal is given.

This is the huge and subtle topic, though, due to time constrain and financial limitations, research is just limited with bringing up importance of Sukuk rather than detailed approach how

to develop Sukuk framework in the country. It could give reasoning for further research in conducting of road map for development of Sukuk or Islamic Finance framework in Uzbekistan.

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Appendix 1: Global Sukuk Issuances during 2001 – 2020

Countries	# of issues	USD Mln	%
Asia & Far East			
Bangladesh	29	790	0,06%
Brunei Darussalam	195	11 830	0,83%
China	1	97	0,01%
Hong kong	5	3 196	0,22%
Indonesia	552	124 958	8,78%
Japan	3	190	0,01%
Malaysia	7 800	799 945	56,22%
Maldives	3	24	0,00%
Pakistan	117	22 792	1,60%
Singapore	16	1 498	0,11%
Sri Lanka	2	5	0,00%
Total	8 723	965 325	67,85%
GCC & MIDDLE			-
Bahrain	467	39 396	2,77%
Jordan	4	483	0,03%
Kuwait	23	5 995	0,42%
Oman	17	7 322	0,51%
Qatar	56	35 967	2,53%
Saudi Arabia	261	174 611	12,27%
United Arab Emirates	155	98 315	6,91%
Yemen	2	253	0,02%
Total	985	362 342	25,47%
AFRICA			-
Egypt	2	286	0,02%
Gambia	556	430	0,03%
Ivory Coast	2	460	0,03%
Nigeria	6	1 249	0,09%
Mali	1	285	0,02%
Morocco	1	105	0,01%
South Africa	1	500	0,04%
Senegal	2	445	0,03%
Sudan	41	20 545	1,44%
Togo	1	245	0,02%
Total	613	24 550	1,73%
Europe & Others			-
France	1	1	0,00%
Germany	3	206	0,01%
Luxembourg	3	280	0,02%
Kazakhstan	1	77	0,01%
Turkey	708	66 915	4,70%
United Kingdom	11	1 769	0,12%
USA	5	1 367	0,10%
Total	732	70 615	4,96%
Grand Total	11 053	1 422 832	100,00%

Source: IIFM Sukuk Reports, 2021