

**THE DIRECTION OF ISLAMIC BANKING  
DEVELOPMENT IN PAKISTAN FROM  
FINANCIAL EXPERTS OPINION**

**GUL GHUTAI**

**UNIVERSITI SAINS MALAYSIA**

**2021**

**THE DIRECTION OF ISLAMIC BANKING  
DEVELOPMENT IN PAKISTAN FROM  
FINANCIAL EXPERTS OPINION**

by

**GUL GHUTAI**

**Thesis submitted in fulfillment of the requirements  
for the degree of  
Doctor of Philosophy**

**October 2021**

## ACKNOWLEDGEMENT

I extend my sincere and humble gratitude to Almighty Allah (SWT) for His blessings and enriched me as a researcher and a random person; This study cannot be completed unless I thank Almighty Allah (SWT) for giving us Islam as a complete code of life and blessed our lives with the enlighten Shariah of Prophet Muhammad (SAW), is the greatest source of guidance for all Muslim Ummah and thus needs to be revived in our national lives too. The life of Prophet Muhammad (SAW) inspires all the Muslim world for being the most humblest person upon the earth who has provided socio-economic and socio-political frameworks to uplift the under privileged masses of the world economically with dignity, honor and spirituality. I am very thankful to Almighty Allah (SWT) for acquainted my research journey with the dynamic, professional and cooperative supervisors, Dr.Azreen Hamiza Abdul Aziz and Dr. Zakaria Bahari; I am very thankful to Dr Azreen Hamiza for her leadership skills that helped me to lead my research in a quick and focused manner. Her kindness and understanding yet empathetic nature has always inspired me. I am also very thankful to Dr. Zakaria Bahari for his visionary skills has up-graded my rational thinking, particularly in writing research papers.

## TABLE OF CONTENTS

<b>ACKNOWLEDGEMENT</b> .....	<b>ii</b>
<b>TABLE OF CONTENTS</b> .....	<b>iii</b>
<b>LIST OF TABLES</b> .....	<b>ix</b>
<b>LIST OF FIGURES</b> .....	<b>x</b>
<b>LIST OF ABBREVIATIONS</b> .....	<b>xi</b>
<b>ABSTRAK</b> .....	<b>xiii</b>
<b>ABSTRACT</b> .....	<b>xv</b>
<b>CHAPTER 1 INTRODUCTION</b> .....	<b>1</b>
1.1 Introduction .....	1
1.2 Background of Study .....	1
1.2.1 Performance of Islamic Finance industry globally and in context of Pakistan with respect to Development Indicators .....	2
1.2.2 The Banking sector in Pakistan.....	8
1.2.3 Economic Issues in Pakistan .....	14
1.2.4 Pakistan’s Banking Sector’s Efficiency and Performance.....	17
1.2.5 Adoptability of Economic Policies in Compliance to Islamic Shariah.....	20
1.2.6 The Stance upon Riba in Islam and Ideology of Pakistan .....	22
1.3 Problem Statement .....	27
1.4 Objectives of Study .....	32
1.5 Research Questions .....	32
1.6 Operational Definition .....	34
1.6.1 Development .....	34
1.6.2 Islamic Banking .....	35
1.6.3 Financial Experts.....	36
1.6.4 Direction.....	37

1.7	Significance of Study .....	37
1.8	Scope and Limitation of Study.....	38
1.8.1	Limitation of study .....	39
1.8.1(a)	Limitation of method .....	39
1.8.1(b)	Limitation of Subject .....	39
1.8.1(c)	Limitation of location .....	40
1.9	Organization of Thesis .....	40
1.10	Summary of the Chapter .....	41
	<b>CHAPTER 2 LITERATURE REVIEW .....</b>	<b>42</b>
2.1	Introduction .....	42
2.2	Past Research .....	42
2.2.1	Development of Islamic Finance .....	43
2.2.2	Development of Islamic Banking in Muslim world.....	46
2.2.3	Development of Islamic Banking in non-Muslim countries .....	53
2.2.4	Development of Islamic Banking in South Asian Countries .....	54
2.2.5	Development of Islamic Banking in Pakistan.....	56
2.2.6	Financial Intermediation Theory.....	62
2.2.7	Theory of Islamic Financial Intermediation.....	64
2.2.8	Economic and Social Welfare.....	71
2.2.9	Analysis of Previous studies .....	75
2.3	Literature review about Pakistan.....	76
2.4	Analysis of Literature Review .....	119
2.5	Conceptual Framework .....	123
2.6	Summary of the Chapter .....	129
	<b>CHAPTER 3 RESEARCH METHODOLOGY .....</b>	<b>131</b>
3.1	Introduction .....	131
3.2	Research Design.....	131

3.3	Data Collection.....	133
3.3.1	Research Instrument.....	134
3.3.2	Sample Size and Justification of Informants.....	138
3.3.3	Validity and Reliability .....	145
3.3.4	Pilot Study.....	147
3.4	Data Analysis .....	150
3.4.1	Atlas.ti Software.....	153
3.5	Research Procedure.....	154
3.5.1	Procedure of Research Implementation .....	155
3.6	Summary of the Chapter .....	156
	<b>CHAPTER 4 DISCUSSION AND DATA ANALYSIS .....</b>	<b>157</b>
4.1	The existing stage of development of Islamic Banking industry in Pakistan .....	157
4.2	Further incorporation of Islamic banks in Pakistan by Islamic Banking division of SBP .....	161
4.2.1	Islamic banking industry in Pakistan flourished in 2002.....	166
4.3	Enactment towards interest free banking in province passed by any provincial assembly.....	170
4.4	Immediate steps to be undertaken by State and its representative institutions to promote complete interest free banking in Pakistan .....	175
4.4.1	Possibility of breaking down the heavy chains of interest-backed banking channels effectively in Islamic Republic of Pakistan .....	182
4.4.2	Contribution of Interest free banking upon the well-being of residents of Pakistan.....	185
4.4.3	Protecting Islamic Banking industry in Pakistan legally and regulatory to establish Interest free economic setup in Pakistan .....	189
4.4.4	The effect of enactment of law or legislative framework upon development of Islamic Banking sector in Pakistan .....	192
4.4.5	Strength and demerits of Islamic banking industry of Pakistan as compared to Islamic banking industry in Muslim world.....	194

4.4.6	The role of educational institutes in the development of Islamic banking in Pakistan .....	194
4.5	Factors in past contributed to hinder complete transformation of Shariah compliant banking in Pakistan .....	197
4.5.1	The status of Interest based Conventional Banking in Pakistan in context of Islamic Identity and Ideology of Pakistan .....	201
4.5.2	The inauguration of State Bank of Pakistan (1948) to date the possibility of legally protecting Islamic Banking industry in Pakistan .....	205
4.6	The contemporary practices towards development of Islamic banking in Pakistan to be the only mode of full fledged banking in Pakistan.....	207
4.6.1	The extent of using equity financing by Islamic banking industry in Pakistan as compared to debt financing.....	213
4.6.2	The effect of financial crisis upon Islamic Banks and conventional banks of Pakistan.....	216
4.6.3	Status of Council of Islamic Ideology in challenging the existing interest-based banking practices in Pakistan .....	219
4.6.4	The possibility of Islamic banking as the only mode of banking industry in future .....	222
4.6.5	Conventional banks towards Islamic windows than Islamic subsidiaries.....	225
4.6.6	The status of SBP-Islamic division if share of Islamic banking crosses more than 80%.....	227
4.6.7	SBP- Islamic division is operative in other cities of Pakistan .....	228
4.6.8	The response of Chairman CII upon the resolution presented by Abdul Akbar Chitrali.....	228
4.6.9	Negligence in applying interest free financial affairs in Pakistan (Negligence in context of negligence in pursuit of government / political parties / residents of Pakistan / intellectuals / academicians / policy makers / state representative institutions). .....	228
4.6.10	Constraints towards development of legal and regulatory framework towards interest free banking.....	229
4.6.11	Expediting development in Islamic banking industry.....	229
4.6.12	Status of constitution of Pakistan.....	229

4.6.13	Constitution declares about Islamic way of life.....	230
4.6.14	The response of students towards degree programs of Islamic business and Finance.....	230
4.6.15	Meezan bank's progress in upcoming 10-15 years strategically .....	231
4.6.16	Inclination of Dr. Hafeez shaikh as former representation of IMF towards Islamic banking and financial setup in Pakistan .....	231
4.6.17	UK is sponsoring Pakistan's National Inclusion Financial Plan.....	232
4.7	Analysis and Results .....	232
4.7.1	To determine the Status of Development of Islamic Banking in Pakistan .....	234
4.7.2	To analyze the development of Islamic Banking in Pakistan with respect to financial experts' opinion. ....	236
4.7.3	To conclude the Development of Islamic banking in Pakistan.....	242
4.8	Summary of the chapter .....	247
<b>CHAPTER 5 CONCLUSION .....</b>		<b>250</b>
5.1	Introduction .....	250
5.2	Main Findings and Summary .....	250
5.3	Implications and the policies of the Study .....	262
5.3.1	Theoretical implications.....	262
5.3.2	Empirical Implications .....	264
5.4	Contribution of the Research .....	265
5.4.1	Theoretical Contribution .....	265
5.4.2	Empirical Contribution.....	266
5.5	Future Research Suggestions .....	267
5.5.1	Qualitative Studies .....	268
5.5.2	Quantitative Studies .....	268
5.6	Summary of the Chapter .....	268



<b>REFERENCES.....</b>	<b>269</b>
<b>APPENDICES</b>	

## LIST OF TABLES

		<b>Page</b>
Table 1.1	Islamic finance development indicators with respect to aggregate performance of countries for the year-2018.....	4
Table 1.2	Five main indicators for Islamic Finance Development Indicator as weighted indices and sub indicators of quantitative development indicator.....	5
Table 1.3	Islamic Finance Country Index.....	6
Table 1.4	Total Islamic Banking branches in Pakistan.....	9
Table 1.5	Total Banks in Pakistan .....	10
Table 1.6	Summary of Research Objectives and Research Questions .....	33
Table 3.1	Assigned groups to financial informants of the study. ....	137
Table 3.2	List of interview informants participated to assess development of Islamic banking in Pakistan. ....	139
Table 3.3	List of Informants selected for face Validity .....	146
Table 3.4	The questions asked from face validity informants to assess face validity of interview guide. ....	147
Table 3.5	List of informants selected for pilot testing.....	148
Table 3.6	The questions suggested for modification in interview guide. ....	149
Table 3.7	The relationship between research objectives, research Questions, data collection and data analysis.....	154
Table 5.1	Shows that research objectives, research questions and findings of the study are synchronized. ....	259

## LIST OF FIGURES

	<b>Page</b>
Figure 2.1	Conceptual framework regarding development of Islamic banking in Pakistan..... 123
Figure 3.1	Shows the flow of research through Phases 1-3. .... 155
Figure 4.1	Council of Islamic Ideology vs Government Willingness..... 249

## LIST OF ABBREVIATIONS

“n.d”	No Date
BOJ	Bank of Japan
BOK	Bank of Khyber
CII	Council of Islamic Ideology
COMCEC	Committee for Economic and Commercial Cooperation
CPEC	China Pakistan Economic Corridor
FSC	Federal Shariat Court
Govt	Government
HBL	Habib Bank Limited
IB	Islamic Banking
IBA	Institute of Business Administration
IBF	Islamic banking and finance
IDA	International Development Agency
IFCI	Islamic Finance Country Index
IFI’s	Islamic Financial Institutions
IFSB	Islamic Financial Services Board
IMF	International Monetary Funds
IMS	Institute of Management Sciences
Kpk	Khyber Pakhtunkhwa
LUMS	Lahore University of Management Sciences
MCB	Muslim Commercial Bank
MMA	Mutahida Majlis-e-Amal
NFIP	National Financial Inclusion Plan
PBUH	Peace Be Upon Him
Pk	Pakistan

RS	Rupees
SAB	Shariat Appellant Bench
SAWW	Sallallahu alaihi wa Alaihi wassalam
SBP	State Bank of Pakistan
SECP	Security and Exchange Commission of Pakistan
SESRIC	Statistical, Economic and Social Research and Training Centre for Islamic Countries
SWT	Subhanahu wa taa'Allah
UBL	United Bank Limited
UK	United Kingdom
USA	United states of America
USD	United States Dollar
VBI	Value Based Intermediation
ZIRP	Zero Interest Rate Policy
ZTBL	Zarai Taraqiyati Bank Limited

**HALATUJU PERKEMBANGAN PERBANKAN ISLAM DI PAKISTAN  
DARIPADA PANDANGAN PAKAR KEWANGAN**

**ABSTRAK**

Perkembangan dalam industri perbankan Islam mmenggambarkan persekitaran yang menyokong kerajaan untuk mendorong pertumbuhan pasaran aset serta menyediakan infrastruktur yang mencukupi untuk memudahkan pendatang baru. Selain itu, ia bermatlamat untuk meningkatkan pengukuran melalui pengawal seliaan dalam entiti perbankan Islam untuk mencapai kesejahteraan sosio-ekonomi rakyat. Sejak tahun 2002, industri perbankan Islam di Pakistan beroperasi selari dengan perbankan konvensional. Kewujudan perbankan konvensional di Pakistan yang beroperasi mempunyai pertentangan dengan ideologi negara Islam. Walau bagaimanapun, usaha kepada Islamisasi penyediaan kewangan telah lama bermula kerana kewajipan agama dan perlembagaan. Namun demikian sehingga kini perbankan tanpa faedah belum dikembangkan sebagai satu-satunya kaedah perbankan penuh di Pakistan. Oleh itu, tiga objektif kajian telah ditetapkan, untuk menentukan status perkembangan perbankan Islam di Pakistan, menganalisis perkembangan perbankan Islam di Pakistan berdasarkan pendapat pakar kewangan dan merumuskan perkembangan perbankan Islam di Pakistan. Metodologi penyelidikan kualitatif dilaksanakan sepanjang kajian ini dan kerangka konseptual dibina dengan menerapkan paradigma induktif sementara instrumen temu bual semi berstruktur telah digunakan untuk mewakili pendapat pakar kewangan sebagai informan untuk menilai arah perkembangan perbankan Islam di Pakistan. Analisis data telah dilaksanakan dengan menggunakan pendekatan deduktif melalui analisis kandungan konseptual untuk

merumuskan keseriusan badan-badan pemerintahan terhadap perkembangan penyediaan perbankan Islam yang patuh syariah di Pakistan sebagai satu-satunya mod perbankan penuh. Kajian ini menunjukkan bahawa perkembangan perbankan Islam berada pada tahap pertumbuhan awal dan belum mencapai kepentingan sistematik sebanyak 15%. Oleh itu, akibat ketidakpatuhan kerajaan, perkembangan perbankan tanpa kadar faedah di Pakistan telah terganggu akibat tiadanya integrasi antara perundangan dan peraturan untuk memandu proses perkembangan ini ke peringkat seterusnya. Kajian ini juga merumuskan bahawa '*Council of Islamic Ideology*' adalah satu-satunya organisasi berkanun yang boleh mengesyorkan undang-undang berkaitan dengan perkembangan perbankan Islam di Pakistan dan membawa ke arah berlakunya undang-undang yang menentang kepentingan Pakistan kepada parlimen.

# **THE DIRECTION OF ISLAMIC BANKING DEVELOPMENT IN PAKISTAN FROM FINANCIAL EXPERTS OPINION**

## **ABSTRACT**

The development in the industry of Islamic Banking reflects the supportive yet enabling environment provided by Government to promote growth in the market share of assets while providing sufficient infrastructure for facilitating new entrants. Also, by targeting improvement measures through regulators in existing Islamic banking entities to achieve socio-economic wellbeing of the masses. Since 2002, the industry of Islamic Banking in Pakistan is operating parallel to conventional banking setup. The existence of conventional banking setup losses its legitimacy to be operative in Pakistan as it goes against the Islamic ideology of the Country. However, efforts towards Islamization of financial setup started since long ago due to religious and constitutional obligations but to date interest free banking has not been developed as the only full fledged mode of banking in Pakistan. Thus, Three specific objectives of the study are, to determine the status of development of Islamic banking in Pakistan, to analyse the development of Islamic banking in Pakistan with respect to financial experts' opinion and to conclude the development of Islamic banking in Pakistan. The qualitative research methodology is pursued throughout the study and conceptual framework is built by adopting inductive paradigm while semi structured in dept interview instrument has been used to represent financial experts' opinions as interview informants to assess the direction of Islamic banking development in Pakistan. However, the analysis has been carried by using deductive approach through conceptual content analysis to unveil the seriousness of governing bodies towards



development of shariah compliant Islamic banking setup in Pakistan as only full fledged mode of banking. The study reveals that the direction of Islamic banking development is at initial growth stage and has not yet achieved systematic importance of 15%. Thus, due to negligence of Government the development of interest free banking in Pakistan has been undermined for not incorporating proper legislation and legal framework to lead the development to next level. This study also reveals that ‘Council of Islamic Ideology’ is the only statutory policy organization to recommend legislation in regard to development of Islamic banking in Pakistan and towards enactment of laws against interest in Pakistan to parliament.

# CHAPTER 1

## INTRODUCTION

### 1.1 Introduction

Muslim countries in the world are trying their best to accommodate Shariah compliant financial dealings. That is why financial institutions are established by Islamic countries through its financial regulatory agencies in facilitating Muslim residents of their respective economies. Likewise, efforts towards Islamization of Pakistan's financial system has initiated since post 1970's. Hence the need arises to analyze Pakistan's achievements in regard to progress and development in context to Islamize financial sector needs to be undertaken. However, the important lessons learned with respect to achievement, failure towards addressing financial sector particularly banking sector would be served in becoming a reality in Pakistan.

Following subtopics of discussion in this chapter includes background of study followed by the problem statement, objectives of study, research questions, and operational definition of terms, scope and limitation of study, significance of study and organization of study.

### 1.2 Background of Study

The background of study entails different sub themes revolving around discussing the main theme of Pakistan's development towards Islamization of its Banking sector particularly. The sub themes include:-Performance of Islamic Finance industry globally and in context of Pakistan with respect to Development Indicators; The banking sector in Pakistan, the economic issues in Pakistan, Pakistan's banking

sector's efficiency and performance, adoptability of Economic Policies in Compliance to Islamic Shariah and the stance upon riba in Islam and ideology of Pakistan.

### **1.2.1 Performance of Islamic Finance industry globally and in context of Pakistan with respect to Development Indicators**

In today's era, developing economies as well as developed economies are in dire need to find sustainable yet effective solutions for financial problems. Whereas, developing countries are trying their best to solve their budget deficits and trade imbalances along with other macroeconomic problems through interest based economic regimes. Thus, throughout the world, interest based economic regimes are prevailing.

While Islam prohibits Riba (interest) to promote socio economic justice. Therefore, many Muslim majority countries started to disregard interest-based banking operations post 1970 such as Pakistan, Iran, Malaysia, Indonesia and Saudi Arabia. Such economies pursuing interest free alternative within the economies have shown strong resilience and less volatility due to presence of Shariah compliant Islamic banking when global financial crisis evoked which was mainly due to interest rates.

Islamic Shariah considers riba (interest) as *haram* (forbidden) for all Muslims. There is unanimous agreement regarding forbiddance of riba for all Muslim and thus no room of confusion is left for using interest in Islamic countries particularly. However, total Assets of Islamic finance industry comprised of more than US\$ 2.44 trillion in 2019 which was of worth US\$ 2.19 trillion in 2018<sup>1</sup> IFSI (2020). The largest sector representing 71% for having assets of US\$ 1.72 trillion in the development of

---

<sup>1</sup> While it was expected since 2016 that assets of Islamic finance industry will cross US\$ 3 trillion in 2020.

Islamic finance industry globally consists of Islamic Banking. Growth in the assets of Islamic finance industry since 2012 has been increased 6% to Dollar value of 2.44 Trillion Reuters (2018). However, Ten Islamic countries representing more than 94% assets of Islamic finance industry are Bangladesh, Bahrain, Indonesia, Iran, Kuwait, Malaysia, Qatar, Saudi Arabia, Turkey and UAE examined by SESRIC (2018).

Development indicators are used to measure the overall development in Islamic finance industry in the world. These indicators of development used to assess progress, rankings and profiles of various Islamic finance markets includes quantitative development, governance, corporate social responsibility, knowledge and awareness. The first factor of Islamic finance development indicator is Quantitative Development Indicator which identifies countries' as well as financial institutions adoption to economic conditions respectively. While the remaining four indicators are the role of Government (Governance indicator), Corporate Social Responsibility Indicator, Knowledge Indicator and Awareness Indicator reported by Kapital (2019).

However, the five sub-indicators of quantitative development indicator are Islamic Banks, Takaful, Other IFI's, Sukuk and Funds. Whereas, sub-indicators related to Governance are Regulations, Shariah Governance and Corporate Governance; the sub-indicators of Corporate Social responsibility comprised of CSR-funds and CSR-activities; the sub indicators of Knowledge are Education and Research; and the sub-indicators of Awareness include Seminars, Conferences and News assessed by Reuters (2018). In terms of quantitative development, the top five countries rankings comprised of Malaysia<sup>2</sup>, Iran, Saudi Arabia, Kuwait and Bahrain. Whereas, sub indicators of quantitative development are categorizing into five sectors that is Islamic

---

<sup>2</sup> Islamic Banking in Malaysia will cover half of banking industry in 2030.

Banking Takaful, Sukuk, Islamic funds and other Islamic financial institutions (investment companies and micro finance organizations) respectively.

Table 1.1 Islamic finance development indicators with respect to aggregate performance of countries for the year-2018

<b>S/No</b>	<b>Islamic Finance Development Indicator</b>	<b>Country Wise Performance globally-2018</b>
1	Quantitative Development Indicator	Malaysia, Iran, Saudi Arabia, Kuwait, Bahrain
2	Governance Indicator	Bahrain, Malaysia, Oman, Pakistan, Kuwait
3	Corporate Social Responsibility	Jordon, Saudi Arabia, UAE, Qatar, Kuwait
4	Knowledge	Malaysia, Indonesia, Pakistan, Jordon, UAE
5	Awareness	Malaysia, Bahrain, UAE, Pakistan, Oman

As far as Islamic Banking as subset of development indicator of Islamic finance reveals that Sudan, Bahrain and Iran ranked as top three countries. In takaful, Saudi Arabia, Iran and Bangladesh ranks as top three countries. In developing other Islamic financial institutions comprised as top three countries are Iran, Kuwait and Malaysia. For Sukuk top three countries reflecting development includes Malaysia, United States of America and Saudi Arabia. Top three countries in maintaining Islamic funds includes Malaysia, Iran and Saudi Arabia (Reuters, 2018).

Table 1.2 Five main indicators for Islamic Finance Development Indicator as weighted indices and sub indicators of quantitative development indicator.

Islamic Finance Development Indicator	Top rank Countries in developing Islamic Finance Markets with respect to Quantitative Development Indicator (2018)	Sub-Indicators of Quantitative Development	Top performer Countries with respect to Sub-indices of Quantitative development Globally
Quantitative Development	Malaysia, Iran, Saudi Arabia, Kuwait and Bahrain	Islamic Banking	Sudan, Bahrain, Iran
		Takaful	Saudi Arabia, Iran, Bangladesh
		Sukuk	Malaysia, United States of America
		Islamic Funds	Malaysia, Iran, Saudi Arabia
		Other Institutions	Iran, Kuwait, Malaysia

Source: Reuters (2018)

Islamic Finance country index reveals the performance in regard to development indicators rank wise with respect to 2017, 2018 and 2019 respectively. Islamic Finance country index in 2019 with respect to Islamic banking and finance industry (IBF) has ranked Malaysia as second by achieving the score of 81.05 while through past consecutive three years (2016, 2017, and 2018) Malaysia had been at top. However, Indonesia has improved its ranking from 6<sup>th</sup> to top rank and has scored highest of 81.93. Similarly, Sudan has improved its ranking from 11<sup>th</sup> rank in 2018 by attaining 5<sup>th</sup> position in 2019. Brunei Darussalam has also improved its position from 14<sup>th</sup> (2018) to 6<sup>th</sup> in 2019. Similarly, Bangladesh has improved its ranking from 10<sup>th</sup> previously to 8<sup>th</sup> rank in 2019. However, the rank of Pakistan has increased from 7<sup>th</sup> score to 10<sup>th</sup> score in 2019 by scoring 36.88 in 2019 which was previously 24.01 in 2018. Morocco has significantly improved its position from 48<sup>th</sup> rank (2018) to 19<sup>th</sup> position in 2019 by making its IBF market amongst top 20 with respect to Islamic

Banking and Finance markets. By adherence to regulatory development, extended Government support backed by political support, halal tourism, defined mechanism of Zakah collection and further distribution, waqf based sukuk and private sector has helped Bank Syariah Mandiri (BSM) to contribute in making Indonesia as top performer in regard to IBF market in 2019. Despite of the fact that Indonesia is the country of largest Muslim population (269.54 Million) as well as GDP (US\$ 3,243 Billion) (IFCI, 2019). Indonesia is pursuing a master plan to transform its economy into Shariah based economy from 2019 until 2024 (IFSI, 2020).

Table 1.3 Islamic Finance Country Index

Islamic Finance Country Index	Countries Performance Rank wise		
	2017	2018	2019
Indonesia	7 <sup>th</sup>	6 <sup>th</sup>	1 <sup>st</sup>
Malaysia	1 <sup>st</sup>	1 <sup>st</sup>	2 <sup>nd</sup>
Iran	2 <sup>nd</sup>	2 <sup>nd</sup>	3 <sup>rd</sup>
Saudi Arabia	3 <sup>rd</sup>	3 <sup>rd</sup>	4 <sup>th</sup>
Sudan	11 <sup>th</sup>	11 <sup>th</sup>	5 <sup>th</sup>
Brunei Darussalam	15 <sup>th</sup>	14 <sup>th</sup>	6 <sup>th</sup>
United Arab Emirates	4 <sup>th</sup>	4 <sup>th</sup>	7 <sup>th</sup>
Bangladesh	10 <sup>th</sup>	10 <sup>th</sup>	8 <sup>th</sup>
Kuwait	5 <sup>th</sup>	5 <sup>th</sup>	9 <sup>th</sup>
Pakistan	6 <sup>th</sup>	7 <sup>th</sup>	10 <sup>th</sup>

Source: Reuters (2020)

As the top contributor in Islamic finance industry is Islamic banking industry, worth USD 1.77 trillion in fourth quarter of 2019. There are 13 countries where Islamic banking industry has achieved systematic importance which is depicted by the total number of Islamic banking assets achieved more than 15% of total banking industry in a country. Iran and Sudan contribute 100% share of Islamic banking domestically,

Saudi Arabia and Brunei shares more than 50% share by holding up to 69% and 63%. The contribution of Malaysia and Kuwait in Islamic banking assets locally holds 28.4% and 48%. Bangladesh market share in banking industry is 25.3%, Qatar market share is 26% and Jordan 16.2%. Palestine holds 15.5%. these 13 countries are holding more than 91.4% total Islamic banking assets globally (IFSI, 2020). Moreover, the share of Pakistan's Islamic banking assets globally represents 1.1% according to third quarter of 2019. Also, Pakistan has not yet achieved systematic importance (IFSI, 2020).

The assets of Islamic Finance have been grown significantly by passing over US\$ 2 Trillion in 2019 (Shaikh, 2019). Thus, top ten countries with respect to IFCI as per 2019 in the world are Indonesia, Malaysia, Iran, Saudi Arabia, Sudan, Brunei Darussalam, United Arab Emirates, Bangladesh, Kuwait, Pakistan respectively (IFCI, 2019).

Islamic banking has contributed 76%<sup>3</sup> in development of Islamic finance industry while Sukuk had represented 19.5% assets of Islamic finance industry, Islamic funds represented 3.3% and Takaful has represented 1.3% of Islamic finance industry in 2018 (SESRIC, 2018). However, the industry of Islamic Finance in Pakistan has shown significant growth over past years while Islamic Banking as dominant contributor has achieved 14.8% of total banking sector which is expected to be 20% in 2020 (Siddiqui, 2018).

Eight Countries such as Bangladesh, Brunei Darussalam, Sudan, Malaysia, Saudi Arabia, Iran, Kuwait, and United Arab Emirates has shown exceptional

---

<sup>3</sup> While share of Islamic banking in development of Islamic finance industry contributed 72.4% in the end of 2019 whereas Islamic capital market contributed 26.5% (Sukuk 22.3% plus Islamic funds 4.2%) and takaful contributed 1.1% (IFSI, 2020).



performance since 2011 till 2019 with respect to global Islamic financial service sector. However, Indonesia has made highly exceptional performance in representing global Islamic financial service industry since 2011 till 2019. While, Pakistan and Bahrain are showing significant improvement in IBF score since 2011 till 2019 score with respect to Global Islamic financial service industry (IFCI, 2019).

### **1.2.2 The Banking sector in Pakistan**

In Pakistan, Islamic Banking segment operates parallel to conventional Banking. Islamic Banking operates according to interest free Islamic principles of Shariah which is based upon equity financing and debt financing. Whereas, Conventional Banking operates according to modern yet secular based international banking principles undertaking interest based financial dealings. Islamic banks in Pakistan operates upon Islamic Shariah while conventional banks are operating upon interest while both types of banking are operative within the same economy of Pakistan since 2002. It is the need of time to understand the reasons due to which central bank of Pakistan cannot transform conventional banking setup without interest in Pakistan. The interest free phenomenon according to Islamic Shariah can be carried out by satisfying two integral financial prohibitions that are to circumvent any surplus or inconsistency in sense of any discrepancy on the loan or principle amount. Secondly by avoiding any conditional contract or gharar based contract in terms of ambiguity (habib, Mohieldin, Verbeek, & Aboulmagd, 2015). Although Islamic banking has been re launched in Pakistan in 2002, many conventional banks are having Islamic banking branches in Pakistan (Salman & Nawaz, 2018). However, total Islamic branches hold by conventional banks in Pakistan are 1530 and total Islamic banking branches held

by full fledged Islamic Banks are 1744. Thus, total Islamic banking branches in Pakistan are 3,274 which were previously 2,913 (SBP, 2020).

Table 1.4 Total Islamic Banking branches in Pakistan

<b>Total Islamic Banking Branches in Pakistan</b>	<b>Year-2020</b>
Islamic Banking Branches Held by Conventional Banks	1,530
Islamic Banking Branches held by Full fledged Islamic Banks	1,744
Total Islamic Banking branch network in Pakistan	3,274

Source: SBP, (2020)

State Bank of Pakistan in September 2003 has introduced separate department for Islamic banking in SBP for the promotion and development of Islamic Banking in Pakistan (Khan & Ijaz, 2014). Since 2002 to 2010, deposits of Islamic banks have shown increase with the rate of 59.6% per annum as compared to banking sector's average 16.1% in same time frame. Whereas, in 2006 to 2008 Islamic banking sector in Pakistan has evidenced 100% increase in market share from 2.5% to attaining 5% respectively (Awan, 2009). Islamic Banking in Pakistan has grown more than 16% with respect to overall Banking industry in Pakistan and is expected that Islamic Banking in Pakistan will make 20 to 25% till the end of 2023 (Siddiqui, 2019). However, It is expected that in 2020 the branch network of Islamic banking will exceed 3,300 branches throughout Pakistan (Siddiqui, 2018).

The State bank of Pakistan has allowed Islamic banks to promote interest free banking as a fair chance basis to grow within the economy of dual banking system where conventional banks also operates (Akram, Rafique, & Alam, 2011). While the prime purpose of The State bank of Pakistan in 1948 was based to promote Shariah

based banking and research (Ghutai & Bahari, 2020). However, according to supreme court of Pakistan's judgment against Riba on 14<sup>th</sup> Ramadan 1420 (22<sup>nd</sup> December,1999), it clearly stated that interest is banned in Pakistan in whatever name or form it may take place (Ghutai & Bahari, 2019). Thus, Pakistan as a first Muslim country officially declared that conventional bank's dealing on interest basis is Riba which is considered as prohibited according to Quran therefore it should be abolished in certain steps from economy (Usmani, 2002). In Pakistan 55 banks are operating including 10 development financial institutions out of which only 5 banks are operating as full fledge Islamic banks while non development Financial institutions operating in Pakistan are 42 (SBP, n.d.-b).

Table 1.5 Total Banks in Pakistan

Total Banks in Pakistan		Total Islamic Banks	
Full Fledge Islamic Banks	5	Full Fledge Islamic Banks	5
Commercial Banks	15	Branches of IB's of conventional Banks	17
Specialized banks	3		
Micro finance banks	11		
Foreign Banks	4		
Developmental financial institutions	9		
Total financial institutions in Pakistan	47	Total Islamic Banks	22

Source: SBP, (2020)

Out of these 47 banks only 22 banks providing interest free banking in compliance to Islamic Shariah (SBP, 2020). The specialized banks as well as public owned banks providing interest-based banking services in Pakistan raises a question mark upon seriousness of Government and policy makers to legitimize complete Shariah based financial setup in Pakistan. According to the study conducted in 2018

by SBP, the 76% people of Pakistan have shown their preference towards Islamic banking services rather than conventional banking. The 88.41% respondents representing population having bank accounts has identified interest-based banking against Islamic Shariah. The same views are expressed by 93% respondents of population having no bank accounts in Pakistan, shows increased demand for Islamic banks and potential towards untapped market share in future (Ayesha, 2018). In 2002 SBP has incorporated Meezan bank as first full fledge Islamic bank in Pakistan. In 2005, SBP has incorporated Bank Islami Pakistan Limited as second full fledge Islamic Bank in pursual of Islamic banking policy 2003. Third full fledge Islamic bank in Pakistan incorporated as Dubai Islamic bank Pakistan limited which started its operations in Pakistan in 2006. Burj Bank limited commenced its operations in 2007 as forth full fledge Islamic Bank which was incorporated in 2006 by SBP. Al Baraka Bank Pakistan limited started its operations as fifth full fledge Islamic Bank in 2010 (Khan & Ijaz, 2014).

The Government's decision to maintain interest based economic system in the country will violate the divine decree upon Riba which as a consequence is leading the nation towards constant war against divine powers (Ghutai & Bahari, 2020). In March 2019, Islamic banking institutions in Pakistan market share per asset has been represented by 15% and also covered up 15.6% deposit share with respect to overall banking industry deposits. The growth in the assets of Islamic banking industry shows 4.9% since last year. The branches of Islamic banking industry operate throughout 113 districts of Pakistan through Islamic banking 2869 branch networks (SBP, 2019a). Islamic banking industry operates in compliance to Islamic Shariah and selected by large number of market participants as a result of faith and religious obligations (Aziz

& Afaq, 2018)<sup>4</sup>. However, the founder of Pakistan in opening ceremony of SBP in 1948 stated that as a practicing Muslims and a nation there is a need to develop economic system based upon Islamic principles of equality of manhood and social justice (Cheema, 2006). All financial as well as economic dealings must not be based upon practices of exploitation, injustice and moral hazards towards other human beings. Pakistan had taken initiative to Islamize its banking structure since 1948 but to date only holding 9<sup>th</sup> position towards promotion and development of Islamic banking in Pakistan (Shaukat, 2017b). However, the rest of the Islamic countries had taken initiatives to introduce Islamic banking later than Pakistan in their regimes. Nevertheless, are holding significant position in development and progress of Islamic banking such as Malaysia, United Arab Emirates, Iran, Saudi Arabia, Bahrain etc. Whereas, in Malaysia, Islamic banking started practically in 1983 and today holding 33% of total assets of banking industry in its country as well as targets Islamic banking industry's assets to represents 40% of overall banking industry assets in Malaysia in 2020 (Singh & Shen, 2019). What are the reasons that Malaysia stood as a leader for developing Islamic financial services globally according to Thomson router's for so many years? (Amiruddin, 2019). Seeking answers to such question will help to address development gaps with respect to Islamic banking in Pakistan so that Pakistan can also serve its constitutional responsibility of eradication of interest from its economic setup. However, Islamic Banking is not a new phenomenon now. Muslim countries as well as non-Muslim developed countries such as United States of America, United Kingdom and Sweden have adopted Islamic Banking in their premises. The industry of Islamic banking in Muslim world is growing consistently due to the fact that majority of Muslims supports interest free banking. However, Islamic banking

---

<sup>4</sup> The deposits of Meezan bank as the first Islamic bank incorporated in Pakistan in 2002 has crossed Rupees 1 trillion in deposits on 10<sup>th</sup> June, 2020 due to faith and trust of residents of Pakistan.

industry has witnessed a growth rate of 12.7% globally in 2019. The return on equity for Islamic banks in USA and Europe has been increased to 11.67% and 6.6% as compared to conventional banks of the same economy in 2019 (IFSI, 2020).

Pakistan in 1950's has initiated setting up the foundation of modern Islamic bank and since late 1970 it is trying to introduce Shariah compliant financial solutions of the country by shifting national banks into Shariah compliant banks (Hunt, 2007). Population of Pakistan is more than 200 million people but still only 13% population is using banking services including Islamic banking segment of population. Whereas, majority of population excluded financially constitutes 65% are considering Islamic banking within Pakistan's economy is non-compliant to Shariah (Ayesha, 2018). Almost 93% people<sup>5</sup> are ready to forgo any profit through banking channels if it is based upon interest and due to interest factor; they avoid to use any banking channel. While 75% of population promotes Islamic banking channels by dealing with Islamic banks in order to avoid interest even if the level of services as given by conventional banking channels is different (Junaid & Siddiqui, 2020). The total percentage of population having bank accounts in Pakistan is only 18% comprising 3% of females (Shaikh, 2018). In Pakistan conventional banking operates parallel to Islamic banking setup. The validity of dual banking setup in Pakistan with respect to Shariah in context of financial experts' opinion will help to undertake this research at further levels. The economic activity in a country will excelled by adopting interest free policy as it reduces not only borrowing cost but also increases investments which increases employment as well as consumption opportunities (Turk, 2016). The expletive of regulating interest based economic activities in deviation from divine guidance

---

<sup>5</sup> The study was conducted by SBP sponsored by UK in regard to Islamic banking by the title "Knowledge, attitude and practice".

deprives the market participants from the *Barakah*-blessings of economic transactions taking place within the economy and as a result economic ills and troubles in society is propagated (Ghutai & Bahari, 2019). Debt around the world has been raised 3 times larger than the size of global economy (Tiftik & Mahmood, 2019). The economic growth in Pakistan is still depressed due to higher interest rates of 13.25%<sup>6</sup> announced by State Bank of Pakistan due to which growth in real GDP is expected to be 2.9% during first half of year 2020, which was 3.3% in 2019. While the real GDP in 2018 had been 5.5 % (Moody's, 2020).

State bank of Pakistan has established Islamic banking set up parallel to the conventional banking system as a step towards interest free economy since 2001. Nevertheless, certain measures were taken towards Islamization of banking and financial system in late 1977 (SBP, 2002a). However, since the inception of Islamic banking to date, conventional banking as interest-based banking is still operative in the economy of Pakistan.

### **1.2.3 Economic Issues in Pakistan**

Conventional Economic system prevalent in modern world is failed to address human, economic and financial crisis (Foster, 2019a). These laws are based upon man made concepts and rely mainly upon exploitation in the form of interest (Riba), speculation, Gambling factors in one way or the other way. The conventional Economics contradicts divine orders while operates upon the basis of such measures to solve economic problems, has given rise to other economic and financial ills in the

---

<sup>6</sup> Pakistan on 17<sup>th</sup> March, 2020, in order to offset the effect of Covid-19 has reduced its benchmark interest rate into 12.5% whereas, on 24<sup>th</sup> March,2020 has reduced interest rate further to 11% (Economics, 2020a). Whereas, on 16<sup>th</sup> April 2020 has reduced interest rate into 9%. (Font change to TNR)

economy (Ascarya, 2017). Current economic system prevailing in modern world has enslaved countries through their interest based debts and imposes a severe question mark upon employment and output levels in their respective countries (Shabbir, 2016). However, Muslims on other hand are fortunate enough for having Islamic economic system which traces back to 1400 years back. Islamic economic system still not only be applicable in today's world but is also capable to solve economic, social, moral, spiritual and financial problems of the world. As it prohibits Riba due to its attributes of exploitation and Zulm-oppression (Ahmadi, 2016).

The solutions of worldly and humanistic problems lies in the guiding principle of Islam (Saiti & Abdullah, 2016). Islam condemns exploitation of any kind against any other fellow human being. For Muslims, the warnings regarding Riba based dealings or economic activities as revealed in Quran and Hadith which is a supreme constitution for Muslims to adhere to. Nevertheless, it also has been guided through Islamic Shariah towards the implementation of Riba free economy. Keeping in view the discretion regarding riba in Islamic Shariah question arises that what justifications do Muslim countries holds particularly Islamic Republic of Pakistan, with respect to its Islamic ideology for existing and prevailing Riba based economic and financial system needs to be evaluated.

Constitution of Pakistan clearly and explicitly states that State will enable residents of Pakistan to practice their individual and collective life according to Islamic Shariah where ultimate authority belongs to only Almighty Allah (Constitution, 1973). The reason in context of Pakistan's monetary authorities for not serving the nation to practice their financial dealings without Riba needs to be analyzed. The Pakistan Finance Minister each year declared the percentages of interest rates during each fiscal



year. While article 38(f) of Pakistan's constitution declares that state needs to eradicate interest as early as possible (Constitution, 1973). Likewise, State bank of Pakistan policy rate per annum is 13.25 % (SBP, 2019a). Pakistan is an Islamic country that has opened a declaration of policy rates in lieu of Quran and Sunnah is instigating the need to evaluate financial experts' opinion to realize the root because hindering ban of riba based financial dealings in Pakistan.

The status of the country is an Islamic republic of Pakistan and had independence on the name of Islamic ideology and majority of its population is consisting Muslims (Ghutai & Bahari, 2020). The foundation of Pakistan as an independent country was based upon Islamic identity and Muslim unity (Akbar, 2015). The constitution of Pakistan 1973 stated that no law shall be considered compatible or superior than the teachings of Quran and Sunnah (Mehdi, 2013).

Pakistan since its inception is facing problems in one way or the other way. However, since last few decades, it is always subjected to economic and financial problems. Such as poverty, low standards of living, poor healthcare system, poor infrastructure, budget deficit, trade gap, gap in saving and investment, terrorism, natural disasters, poor yet outdated educational system and reform structures are contributing highly in making Pakistan's economy dangerously imbalanced (Rizvi, 2015). Pakistan's economic problems started since then Pakistan has taken foreign loans in 1951 for stimulating growth in Pakistan's economy and to meet budget deficit. Although it started since very early years of independence but the mountain of loans has trapped the country badly (Zafar, 2009). The practice of relying upon foreign debt started in 1951, then every government tried to avail foreign debt as a culture and symbol of the best governance due to which Pakistan has been indebted in terms of

foreign debt of USD 80 Billion by June 2017. Every year Pakistan faces budget deficit problem and to offset this problem takes massive loans (Chaudhary & Abbas, 2017).

Pakistan's problems are mainly due to countries dependence upon interest based foreign loans to handle its economic affairs. This is mainly due to adherence to Riba based economic system which is against Islamic principles of shariah and Islamic ideology of Pakistan as well. However, Islamic financial system is supposed to be based upon real economic activity and condemns Riba while tiding risk with reward to promotes equitable distribution of wealth (Riazuddin, 2017). There is a dire need to make quick reforms for paying off existing foreign debt and also to structure effective economic policies in compliance to Islamic principles of Shariah. For 70 years of dependence upon interest-based debt in solving economic problems has not left any valuable mark for the country on globe instead miseries of country's are increased. Pakistan is still not yet succeeded to implement its economic, social, legal, cultural, financial, educational systems according to parameters of Islam to preserve and strengthen the underlying foundation of Islamic ideology of Pakistan. The legitimacy of conventional banks becomes void in Pakistan because according to legal verdict given by Islamic scholars that establishment of conventional banks, dealing with them are haram because it is based upon interest stated by (Kahf, 2002)

#### **1.2.4 Pakistan's Banking Sector's Efficiency and Performance**

Global financial crisis did not affect operational performance and efficiency of commercial banking channels in Pakistan because of their less dependence, integration and interconnectedness with United States of America's financial system (Chaudhary & Abbas, 2017). The performance of Islamic banking sector was relatively much better in efficiency and performance (Phulpoto, Shah, & Shaikh, 2012).

The reason for survival of Islamic banking sector in Pakistan as well as around the world during global financial crisis lies in the fact that Islamic banks operating upon the guiding principles of Islam. Thus, avoiding interest-based dealings, gambling factors, short selling concepts and its financing is based upon equity and debt-based instruments. It encourages involvement of all market participants through profit and loss sharing basis, which opposes conventional banks debt financing as Islamic banks financial products are backed by assets and thus increased stability during market crisis is maintained (Pappas, Ongena, Izzeldin, & Fuertes, 2017). State Bank of Pakistan SBP has reported that Islamic Banking in Pakistan has not been affected directly due to global financial crisis (Anwar, 2012b).

The Central Banks of developed countries since 2008 with the failure of capitalism itself using lower zero bound policy (Foster, 2019b). Japan has used interest rate at zero percent for first time in 1999 to fight deflation and to uplift its economy ((Nishad, 2018). United Kingdom since 2009 had been using interest rate near zero percent that is at 0.5% till 2013<sup>7</sup> and the central Bank of United States of America is using lower bound interest rate policy by using interest rates of 0.25% from 2008 till 2013<sup>8</sup> according to (Pettinger, 2013) but fluctuating interest does not help them because interest as an exploitation tool still exists.

Since financial crisis of 2008 different central banks are using interest rate to zero policy rates but below zero percent interest rates are used by the central banks of European countries like Denmark, Sweden and Switzerland. Since global financial

---

<sup>7</sup> Bank of England has cut off interest from 0.75 to 0.50 % on 11<sup>th</sup> march 2020 to offset the effects of Covid-19.

<sup>8</sup> Federal Reserve Bank has cut off its interest rate near to zero that is ranging between 0.25% to zero present in an attempt to mitigate the effects of Covid-19 upon economy of US on 16<sup>th</sup> march 2020. (FONT – TNR)

crisis, Swedish Central Bank uses -0.5 interest rates as in 2016 (Eggertsson, Juelsrud, Summers, & Wold, 2019). However, interest rate above zero, near zero or below zero is prohibited as per Shariah basis (Ghutai & Bahari, 2019). Through the last sermon of Prophet Muhammad (PBUH) during Farewell Pilgrimage 10 A.H (623 AD) it had been clearly conveyed to Muslim Ummah that all forms of Riba becomes invalid and void for you, It is only the principle amount which needs to be paid off (Ahmed, 2014). If any surplus amount is paid upon loan-based contract then this extra amount upon loan would be considered as riba (Iqbal, 2006). That is the main reason in regard to developed countries are not achieving desired results to stabilize their economies as the underlying foundation of their economies are based upon secularism and nothing is helpful without solid foundation of divine laws (Ghutai & Bahari, 2019). Islamic finance helps to reduce inflation by promoting stake in risk of loss and profit through ethically permissible business ventures under Shariah supervision therefore ensures stable economy which forms the basis for development (Sarwer, Ramzan, & Ahmad, 2013). Islamic banking has not or even very lesser extent affected by financial crisis because it had shown significant growth during financial crisis (Ebrahim, 2011).

The history of Islamic finance is as old as divine religions are to date (Uddin, 2015). All divine books have guided human beings to carryout economic activities without interest so that wellbeing of humans can be assured.

Pakistan is offering Asia's highest interest rate 13.25% in its territory since new elected government in Pakistan in 2018, has vowed to make Pakistan as an exemplary welfare state of Madina. What are the reasons of Pakistan's Islamization<sup>9</sup>

---

<sup>9</sup> The word Islamization has appeared as state policy to govern state's affairs according to Musawat-e-Muhammadi (Islamic socialism) during zulfiqar Ali Bhutto regime (1970-1977), later on this phrase was used in Zia-ul-Haq regime (1977-1988) in regard to implementation of Nizam-e-Mustafa (PBUH) in Pakistan.

of banking sector has failed since 1950's and then again failed in 1970's. Attempts to Islamize banking sector in Pakistan had taken place in 1970's (Ariff, 1988b) while in 1978 in Luxemburg, Islamic finance house started operating as Islamic Bank successfully (Emin & Alexandra, 2015). However, since 2002 to date why only 5 full-fledged Islamic banks have only been incorporated in Pakistan to date needs to be analyzed with respect to the viewpoints of financial experts.

### **1.2.5 Adoptability of Economic Policies in Compliance to Islamic Shariah**

All economic activities carried by risk sharing factors ensures the wellbeing of all market participants particularly and society generally. Without risk sharing factor the vulnerability of conventional financial institutions relying upon debt financing is reinvested by the repetition of financial crisis (Maghrebi & Mirakhor, 2015). The interest, riba or usury is prohibited upon Muslims of the world according to Islamic Shariah because lending upon interest does not produce any new wealth or value in the economy (Kahf, 2013). However, there is firm zero percent interest or without interest in Islam but if any rate is set above zero rate then it will give rise to usurious rate of interest (Qureshi, 1974). The involvement of economic participants through conventional banking setup on the basis of risk sharing principles, without any interest and gharar is possible (Ghutai & Bahari, 2019). Because, Islamic economics philosophy lies upon without riba and is based upon the distribution of wealth amid market participants as a reward for taking risk hence, discourages wealth in few hands through interest-based earnings and wealth hoardings (Imran, 2002). Islamic banking refers to without interest and not zero return (Sharawy, 2000). Return upon investment is the reward for participation of sharing risk among market participants for carrying out economic activities. The philosophical underpinning of interest free

phenomenon kept the logic of condemning injustice, exploitation and oppression against human beings flourished by capitalism (Ghutai & Bahari, 2019). Riba is condemned because it increases gap in poverty as 60% of resources in the world are accumulated and used by 20% of world's rich people (Arif, Hussaini, & Azzem, 2012). In Sudan Since 1991, Islamic banking is the only mode of financing applied by central bank of Sudan (Ebrahim, 2011). In Sudan, government has regulated various laws in order to regulate Islamic banking as the only form of banking in 1990's (Alharbi, 2015). In Sudan, Faisal Islamic Bank had been established in 1977 which has paved the way to Islamize all banks in Sudan due to government firm support and demand of people of Sudan. Moreover, within three years government had incorporated five Islamic banks in Sudan in 1980. The success of Islamic banks in Sudanese economy, government successfully Islamize all banking sector<sup>10</sup>. Within twenty years in 1997, there were 29 Islamic banks. This all happened due to central bank of Sudan stood as a leader to make Islamization of Banking of Sudan a reality in Sudan (Mohsin, 2005).

The basic problem of Pakistan like all other developing or underdeveloped countries is foreign debt against interest. The debt of third world has been realized as the biggest barrier towards development of human. Due to their serious indebtedness towards rich countries has raised many other problems for third world countries. The debt has handicapped sustainable development of human, as well as affected security, political and economic stabilities of these countries owing debt of rich countries (Shah, 2007). This vicious debt trap with interest has blocked the eminent success of Pakistan. Interest upon debt is the root cause of all economic problems in Pakistan (Ghutai & Bahari, 2020).

---

<sup>10</sup> And today Government of Sudan is holding 41% of the banks in Sudan whether completely or partly owned (IFSB, 2018).

As United States of America is the backbone of worldwide economics, exchange rates and financial arrangements due to which any change in US interest rates also affects other countries. As Pakistan's international transactions mostly carried out in US dollars therefore the economy of Pakistan is unprotected due to the movement in US currency. Similarly, with the rise in interest rate in US will also increase the value of Pakistan's external debt and also the cost of debt servicing even if no fresh loan has been taken by the country. Whereas if interest rates are low in united states then to attract foreign investors Pakistan needs to increase interest rates high along with risk premium (Zaidi, 2018).

#### **1.2.6 The Stance upon Riba in Islam and Ideology of Pakistan**

The Quran is revealed upon last Prophet Muhammad (PBUH) has revealed the decree of Almighty Allah (SWT) with respect to riba, interest or usury in whatever name is clearly declared prohibited upon Muslims. The Shariah of Prophet Muhammad (PBUH) clearly condemns riba and the declaration of prohibition of riba for Muslims is applicable since then no matter where ever they are. There is no exception for any Muslim in regard to divine decree.

Riba as a mechanism or element or anything whether arises due to additional payment upon loan or arises as discrepancy thereupon due to mutual understanding or agreement (Ghutai & Bahari, 2019). However, riba does not arises only in lending but also through trade or investment while exchanging items of same kind (Tahir, 1999). The Prophet Muhammad PBUH has stated that obviously riba arises in lending (Bhatti, n.d.). There is complete agreement among Muslims towards prohibition of riba in Islamic Shariah throughout the world. Thus, in this context interest-based debt

through conventional banking legitimacy in Islamic ideological economy of Pakistan became void completely.

The vision of Pakistan as an independent country and Islamic ideological state was presented by Iqbal in 1930 (Saeed, 2002). The founding father of Pakistan as first Governor-General of Pakistan ordered State Bank of Pakistan in 1948 to align banking practices with respect to Islamic ideals of social and economic way of life (Mujahid, 2001). The foundation of Pakistan is based upon Islam and for that millions of people had sacrificed their life, abandoned homes and established businesses for the sake of living in Islamic ideological State of Pakistan. The constitution of Pakistan 1973 Article 38(f) clearly declares that the interest (riba) must be abolished as early as possible. Moreover, the State will help to facilitate the residents of Pakistan to understand the meaning of life according to Quran and Sunnah of Prophet Muhammad PBUH (Haq, 2017). The newly elected Prime minister of Pakistan declared that my inspiration is to make Pakistan in accordance to first Islamic state of medina built by holy Prophet Muhammad (PBUH) (Farzana, 2018).

As far as Islamic identity and faith is concerned, abolishment of Riba and exploitation from financial and economic activities with respect to state of Pakistan is the need of time. The demand by the residents of Pakistan towards Islamic Banking is very high since 2002 the industry is growing very fast (Ayyub, n.d.). The Faysal bank of Pakistan is going to open 200 branches within 2 years to satisfy demand for shariah compliant deposits and has switched forty regular banks branches into shariah compliant banks this year. Such remarkable progress moves opposite with respect to decline in banks in the world (Mangi, 2019). In Islam, interest is prohibited as it affects the society by giving rise to poverty, unlawful activities, inadequate distribution of



wealth and widens inequality in consumers purchasing power, charging time value of money on lending is interest and interest is haram in Islam (Ahmed, Siddiqui, & Immamuddin, 2013); (Ghutai & Bahari, 2019). Though financial transactions are crucial for economic development but *riba* is not vital for undertaking banking activities rather Islamic jurisprudence approves many alternate forms of contracts which can help Muslims to avoid interest and can be adopted by banks (Alharbi, 2015). At the very beginning of Islamic history, the Muslims have developed a financial system without interest. They successfully carried out business transactions on profit and loss basis through *Mudarabah*, *Musharakah* instruments and without interest-based loans to fulfill consumers' needs (Chapra & Khan, 2000). Traditional banking operations based upon lending on interest in Muslim countries started in the time of western colonization (Habib et al., 2015). The preamble of constitution of Islamic republic of Pakistan 1973 is the objective resolution of 1949 which declares that official religion of Pakistan is Islam and no law would be pursued if in conflict with the injunction of Quran and Sunnah of Prophet Muhammad (PBUH) (Mukhtar, 2016).

State Bank of Pakistan has taken steps towards establishment of Islamic banking system within the country in response to Federal Shariat Court Judgment against Interest in 1999. Thus, has obligated every conventional bank to open its respective branches in Islamic mode of banking (Ghutai & Bahari, 2019). So that with the passage of time conventional mode of banking which functions parallel to Islamic banking industry in the country can switch to Islamic banking system because conventional mode of banking is solely based upon interest-based factors and it is the violation of divine orders against *riba* (SBP, 2002b).