

Prohibition of Interest and Initiative of Islamic Banking: A Historical Review of Pakistan

Syed M. Abdul Rehman Shah (Ph.D.)*¹ Muhammad Irfan**

* Basic Sciences & Humanities Department, University of Engineering & Technology (UET), Taxila, Pakistan

** Basic Sciences & Humanities Department, UET, Taxila, Pakistan

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Abstract: The constitution of Pakistan has disowned the interest-based transactions because of the conceptual foundation of Riba-prohibition as per the tenets of Quran and Sunnah. Since the Objectives Resolution in 1949, people of Pakistan have denied any transaction that keeps them on war against Allah Almighty and Beloved Prophet (PBUH). Over the time, legislative assemblies, courts, regulatory bodies, academia, and Islamic NGOs have worked to introduce Islamic economic system over the decades till the FSC's verdict on Riba on April 28, 2022 and initiative of Islamic banking system in 2002 under supervision of Islamic banking division of State Bank of Pakistan. Currently in Pakistan, market share of Islamic banking assets and deposits to the overall banking industry stood at 19.5 percent (PKR 6,781 billion) and 20.5 percent (PKR 4,856 billion), respectively by end of June 2022. We present historical background of Riba elimination and initiative of Islamic banking practices in context of Pakistan. This study provides a short background and current trends of Islamic banking market. Further, some important issues are also explored in context of Islamic banking institutions. Similarly, it would be beneficial for academicians, investors and policy makers to move forward in domain of Islamic banking and finance with conceptual and constitutional support in Pakistan.

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¹ Corresponding author's email: a.rehman@uettaxila.edu.pk

1. Introduction

Religions predestined not to deal with any type of Usury, Ribit and Riba due to exploitation of needy people of society. Interest (Modern Name) is named Riba (in Quran), Usury (in Medieval Latin language with Christian context) and Ribit (in Hebrew language with Jewish context).¹ In the Shariāh, Ribā is the excess that is without a (lawful) counter-value and is stipulated in reciprocal exchange (bay). This conforms that an exchange of marketable wealth with marketable wealth is allowed only. Thus, an excess without any marketable value is contrary to what is required by reciprocal exchange in a valid contract. It is, therefore, ḥarām (void) according to Islamic law. Its stipulation in reciprocal exchange renders the exchange invalid (fāsīd), like the stipulation of wine or other prohibited things as payment (al-Sarakhsi, 2018).² Similarly, Karim (2010) has recorded that the condemnations are evidenced in religious literature of Buddhism, Judaism, Christianity, and Islam. Over the time, many nations from ancient Greece to ancient Rome have outlawed the interest-based loans from society. Eventually, the Roman Empire raised the barrier and allowed interest-based loans with restricted interest rates, though the Catholic Church in medieval Europe strictly nullified the charging of all interests at any rate in transactions.³

¹- Abdul-Rahman, Yahia. "The Art of Islamic Banking and Finance: Tools and Techniques for Community-Based Banking", (New Jersey: John Wiley & Sons, Inc., Hoboken, 2011)18-19.

²- Al-Sarakhsi, *Money Exchange, Loans, and Riba: A translation of Kitab al-Sarf from Kitab al-Mabsut*, translated by Imran Ahsan Khan Nyazee, (Islamabad: Advanced Legal Studies Institute, 2018), 112-113.

³- Karim, S. A. "The Islamic Moral Economy: A Study of Islamic Money and Financial Instruments". *Open Access Library Journal* 49, no. 1 (2010): 37-63.

Riba has been declared *Haram* in Quran⁴ and Sunnah. Similarly, the constitution of Pakistan has declared that no law contradicting to the Quran and Sunnah can be implemented in the country.⁵ *Riba* (Arabic: الربوا) can be roughly translated as unjust, exploitative gains made in trade or business under Islamic law. Interest is an effortless profit, free from compensation, free of exchange (Chapra, 1996). Further, Abdul Rehman Yousari has defined that *Riba* is stipulated additional increment while borrowing or lending money, it may be paid in kind or in money. It will go under definition of *Riba* whether it is imposed by the lender as a condition or given voluntarily by the borrower.⁶ Similarly, Justice (R) Taqi Usmai has defined *Riba-ul-Quran* as a loan contract for an additional amount over the principal amount.⁷ Islamic principles are for all times and ages till the day of judgment, so there is no room to say that *Riba* prohibition was related to a specific time and era of Holy Prophet (PBUH). *Riba* was nullified when individuals were exploiting others and today financial institutions are playing financial intermediation role exploiting the customers at a larger scale than in the past, so there is need of the day to eradicate *Riba* from society. These divine rules of the Qur'an and the Prophet Muhammad (PBUH)'s traditions are organized as alternate modes of finance in Islamic

⁴- Al Quran 2: 275.

⁵- Muft Taqī 'Uṣmānī, An introduction to Islamic finance. (Karachi: *Idaratul Ma'arif*. 1998). p. 23.

⁶- Ahmad, Abdel-Rahman Yousri. "Riba, Its Economic Rationale and Implications". Institute of Islamic Banking and Insurance. Retrieved 08 October 2019. See https://www.academia.edu/723631/PROHIBITION_OF_RIBA_INTEREST_IN_ISLAM_ITS_ECONOMIC_RATIONALE_AND_IMPLICATIONS.

Accessed on 2-12-2022

⁷- Usmai, Taqi, "The Historic Judgement on Riba by the Supreme Court of Pakistan", (Karachi: Idrah tul Maarif, 1999), para 242.

economic system.⁸ In modern world, Islamic banking is borrowing contract vehicles from the same literature of Islamic law of business contracts. These contracts are fulfilling the requirements of modern world in compliance with defined rules of Shari'ah.⁹

In case of Pakistan, there is need to document the historical perspective of the prohibition of interest as context to the initiative of Islamic banking. We have found a sound historical background of our homeland to adopt economic order of Islam. In same reflection, Islamic economic thoughts are constitutionalized over different time periods. Although, some institutions were initiated over the decade of 1980s through presidential orders of President General Zia ul Haq. In 2002, State Bank of Pakistan (SBP) established Islamic Banking Department (IBP) to supervise the operations of Islamic banking industry in Pakistan. Interestingly, current market share of Islamic banking assets and deposits to the overall banking industry stood at 13.6 percent and 14.7 percent, respectively by end September 2018. We mention some issues in Islamic banking at different perspectives. This study is equally important for academicians and practitioners to work for the objectives of this historical struggle in achieving the higher intents of *Shariāh*.

In first section, we introduce the subject matter of manuscript. In second section, this study presents the historical review of constitutional reforms, the role of regulatory authorities and research models of academicians to eliminate Riba in Pakistan. In third section, we document about how State Bank of Pakistan (SBP) took an initiative

⁸- Karim, S. A. "The Islamic Moral Economy: A Study of Islamic Money and Financial Instruments". *Open Access Library Journal* 49, no. 1 (2010): 37-63.

⁹- Siddiqi, Mohammad N. "Islamic banking and finance in theory and practice: A survey of state of the art." *Islamic economic studies* 13, no. 2 (2006): 21-45.

of Islamic banking on practical basis in 2002 and what is performance of Islamic banking industry till the day. We explain issues in existing Islamic banking system of Pakistan in section 4. Finally, we concluded the subject in section 5.

2. Historical Review of Riba-Elimination in Pakistan

Pakistan came into existence on the basis of Islamic ideology in 1947. On 1st July 1948, Quaid-e-Azam, Muhammad Ali Jinnah on the occasion of inauguration of State Bank of Pakistan (SBP) declared to establish the financial system of country in accordance with Islamic economic system in the following words:

“I shall watch with keenness the work of your Research Organization in evolving banking practices compatible with Islamic ideas of social and economic life. The adoption of Western economic theory and practice will not help us in achieving our goal of creating a happy and contented people. We must work our destiny in our own way and present to the world an economic system based on true Islamic concept of equality of manhood and social justice. We will thereby be fulfilling our mission as Muslims and giving to humanity the message of peace which alone can save and secure the welfare, happiness and prosperity of mankind.”¹⁰

Initially, the research on Islamic economic and financial system was conducted by Shari’ah scholars both from Pakistan and abroad. In the Research Department of SBP, an Islamic Economic Division was established in the 1950s to undertake the research agenda on Islamic economic system. It also worked as a secretariat to Council of Islamic

¹⁰- Islamic Banking Department, State Bank of Pakistan, See <https://www.sbp.org.pk/IB/index.asp>, Accessed on 23-11-2022.

Ideology (CII) for research collaboration. Onwards, there were consumed efforts to eliminate *Riba* from economy in late 1970s on theoretical conceptual models.¹¹ In era of President General Zia-ul-Haq, an agenda of economic reforms was promoted and several noteworthy and practical steps of Modarb'ah companies, PLS accounts and Zakat-o-Usahr system were taken from 1980 to 1986. Accordingly, numerous laws were changed, and new presidential ordinances were enacted to Islamize the economy in which SBP played an important role.¹² By July 1979, President Zia's Government declared some interest-free institutions to replace the existing interest-based system. Example of these are the House Building Finance Corporation (HBFC), the National Investment Trust (NIT), and the Investment Corporation of Pakistan (ICP) which were initiated based on the concept of profit-loss sharing to enhance further as alternate to existing system. Further, there were established about seven thousand profit-loss sharing counters in commercial banks of country in 1980.¹³

Similarly, Council of Islamic Ideology (CII) contributed the most significant intellectual-cum-operational blueprint to eliminate the *Riba (Interest)* from a modern interest-based economy through Panel of Islamic Scholars, Economists and Bankers in 1980. Furthermore, an International Conference on Islamic Economics was held at Islamabad,

¹¹- Ayub, Muhammad. "Understanding Islamic Finance", (England: *John Wiley & Sons Ltd*: West Sussex, 2010). p. 212.

¹²- Shah, Syed Muhammad Abdul Rehman, and Abdul Rashid. "The credit supply channel of monetary policy transmission mechanism: an empirical investigation of islamic banks in Pakistan Versus Malaysia." *Journal of Islamic Monetary Economics and Finance* 5, no. 1 (2019): 21-36.

¹³- Mehboob, Aurangzaib "Islamization of Economy" *Islamic Studies* 6. no. 1 (2002), 682-686.

Pakistan in 1983.¹⁴ A sizable number of books, monographs, research papers and proposals were produced containing innovative ideas and fruitful discussions as proceedings of these conferences and seminars. Further, International Institute of Islamic Economics (IIIE) of International Islamic University Islamabad, Pakistan contributed in Islamic economic knowledge stream through a tremendous contribution titled "IIIE's Blueprint of Islamic Financial System (1999)" on the issue of monetary policy of an Islamic economy. This blueprint outlines institutional framework, role of central bank, policy instruments and possible choices for monetary management in an Islamic economic framework."

In November 1991, the interest-based practices of banks were declared un-Islamic by the Federal Shari'at Court (FSC) but it was suspended later on appeal to the Supreme Court's Shari'at Appellate Bench till orders of the court. Justice (R) Taqi Usmani wrote final draft mentioning that all types of prevailing interest in government institutions and commercial banks falls under the definition of Riba that is clearly prohibited by Holy Quran.¹⁵

In December 1999, the Shari'at Appellate Bench presented its judgment with the instructions that interest-based laws would cease to have any legal effect by June 30, 2001 and then the deadline was forwarded to June 30, 2002. A commercial bank came forward with a review petition; the Supreme Court's Shari'at Appellate Bench moved aside its previous verdicts in June 2002 and directed back the case FSC to reconsider its

¹⁴- Choudhry, N., & Mirakhor, A. "Indirect instruments of monetary control in an Islamic Financial System" *Islamic Economic Studies* 4. no. 2, (1997), 27-66.

¹⁵- Mufti, Usmai, Taqi, "The Historic Judgement on Riba by the Supreme Court of Pakistan", (Karachi: Idrah tul Maarif, 1999), para 242.

ruling, which had declared interest or 'Riba' unacceptable. The apex court also directed the FSC to ask from contemporary Islamic jurists from the Muslim world. The case had been pending before the FSC for the 16 years. Again in 2013, the FSC initiated preliminary proceedings of the hearing of case through taking the point of view of two jurist consultants, Dr. Muhammad Tahir Mansoori (International Islamic University Islamabad) and Muhammad Ayub (Riphah International University, Islamabad). In addition, the FSC had worked out a questionnaire regarding the issue and sent it to Dr. Sami Ibrahim Suwailem (Saudi Arabia), Dr. Wahba Zuhaili (Syria), Dr. Ajeel Jassem al Nashmi (Kuwait) and Dr. Ali Mohiuddin Al Qaradaghi (Qatar) to know their point of view on the issue. On October 29, 2015, SBP has informed the FSC that there is not an explicit definition of "Interest" or "Riba" in the Constitution. FSC went on the hearing of Riba Case on March 13, 2017 in Islamabad. Mr. Qaisar Imam Advocate defined the Riba confidently to satisfy on different questions posed by honorable judges.¹⁶

Since March 2017, the matter was pending through floating a questionnaire among scholars to discuss the matter thoroughly. However, the points in questionnaire on terms "Riba" and "interest" is nothing more but a restart of the fundamental questions that the apex judiciary had already defined at various stages since 1992."

3. Latest Judgment of the FSC of Pakistan,

On 28th April 2022 the FSC has declared that Riba is strictly prohibited in all its forms in Islamic law, and it includes commercial interest of

¹⁶ The NEWS Pakistan, 26 March 2017. P. 6.

banks and other financial institutions on the long-awaited Riba case. Thus all products and services of interest-based banking are void in Islamic law clearly. One can expect the FSC's judgement has settled the disputes on definition of "Riba" and "Commercial Interest" and will contribute significantly for Islamic economic system in homeland of us. In the para 155 of the same judgement same judgment the following words are sign of hope:

"One of the goals of the Islamic state is to have an equitable economic system, free from exploitation and speculation. The Islamic economic system is an equitable, asset-based and risk sharing economic system. It promotes and encourages circulation of money in the society. It discourages accumulation of wealth in few hands. Islamic economic and finance system is based on real economic activity" (FSC, 2022).¹⁷

The FSC (2022) has also directed the government to amend the existing interest bearing-legislations by 31st December, 2022 and interest should be eliminated from country's economy completely by the end of 2027. Although, the SBP welcomed the FSC's judgement on Riba (interest) case, however, it approached to the Supreme Court for guidance about the FSC's judgement on Riba (interest) case.

"After a detailed review of the judgment and based upon the advice of our chief legal adviser and external counsel, we have sought guidance from the honorable Shariat Appellate Bench of the Supreme Court in terms of its implementation and practicalities involved" (SBP, 2022).

As the prime custodian the financial and monetary framework of the country, the SBP is deeply dedicated to ensure the regulatory

¹⁷- Federal Shari'at Court (FSC) Judgment on Shar'ī'at Petition No.30-L of 1991 & All other 81 connected matters relating to riba/Interest. (2022). Federal Shari'at Court (FSC), Islamabad, Pakistan.

framework in compliance with Islamic law at one side and to protect the stability and security of monetary framework as part of the international financial system. In this context, the SBP has been always persisted in stimulating Islamic banking and financial markets in the country. The SBP is one of the few regulators, which developed and implemented the comprehensive legal, regulatory, and Shariah Governance frameworks (SGFs).

On 9th November 2022, Current Finance Minister of Pakistan; Muhammed Ishaq Dar announced that SBP and National Bank of Pakistan (NBP) will withdraw their petitions from the Supreme Court against the FSC's judgment of Federal Shariat Court. He also said that they are committed to implement the FSC's judgment with true sense to eliminate Riba from banking system and economy as well.

4. The SBP's Initiative of Islamic Banking in Pakistan

Pakistan as an Islamic ideological state has not been an exception to adopt Islamic banking and finance rather it has been playing the role at the top front in the promotion of Islamic economic thoughts and practices. Since inception, Islamic republic of Pakistan has been a founding member of international Islamic financial institutions (IIFIs). On these platforms, Pakistan played a vital role to develop the legal covers, the regulatory bodies, supervisory infrastructure, and Shariah compliance framework for interest-free Islamic financial institutions (IFIs). Similarly, Pakistan has hosted a chain of Islamic economics conferences and other intellectual forums to promote the industry of Islamic banking and finance. This opportunity created a good strength of Islamic scholars who has been explored the diversified perspectives of Islamic economic thoughts and practices.

In the meantime, the government decided to promote Islamic banking in a gradual manner as a parallel and compatible system. The Commission for Transformation of Financial System was established in SBP in response to the Supreme Court's judgment on Riba on December 23, 1999. They have approved the essentials of Islamic financial modes including *Musharak'ah*, *Mudarab'ah*, *Murabha'ah*, *Musawam'ah*, *Ijar'ah*, *Salam* and *Istisn'ah*. Further, Shari'ah Board of SBP has approved these Islamic modes and recommended the guidelines for Islamic banking business to be circulated to Islamic banks.¹⁸ The initiative to Islamic Banking in country was relaunched since 2001 to shift the existing interest based conventional system to interest-free economy.¹⁹ This initiative was taken through a market driven and flexible approach, in a phased manner step by step without creating any disruptions in existing system. Moreover, it aims to develop a broad harmonized financial system in Pakistan to enable all people of society to access financial services fulfilling their requirements. In 2002, the SBP established Islamic Banking Department (IBP) to supervise the operations of Islamic banking industry in Pakistan.²⁰

In this context to achieve the objectives, the SBP presented a strategy to promote Islamic banking and finance in country. The SBP has launched the strategic plan in 2013 to promote Islamic banking industry of

¹⁸- Instructions for Profit & Loss Distribution and Pool Management for Islamic Banking Institutions (IBIs), Islamic Banking Department, Karachi: State Bank of Pakistan, 2001), See <https://www.sbp.org.pk/IB/index.asp> , Accessed on 28-12-2022.

¹⁹ - M. Ashraf Janjua, "History of the State Bank of Pakistan, (Karachi: State Bank of Pakistan. Volume III (1977-88) and IV 1988-2003) p. 12-14.

²⁰- Shah. M. A. R., Raza K., & Alazhari M. A. An Introduction to Monetary Policy Framework in Pakistan: Instruments, Objectives, and Mechanism. (Pakistan Journal of Economic Studies (PJES), 1(2), 111-129., Available at SSRN: <https://ssrn.com/abstract=3991703> Accessed on 18-12-2022.

Pakistan with a task to convert the 20% of domestic banking into Islamic banking by 2018.²¹ In December 2013, the Government of Pakistan has constituted a steering committee for the promotion of Islamic finance. The steering committee has worked on strategic areas including legal, regulatory and taxation reforms, liquidity management, Islamic capital market and capacity building. Moreover, the Government of Pakistan in collaboration with other corporate institutes, have initiated to target the local and international sukuk markets to meet the credit requirements of the economy. Moreover, the central bank has recently issued a revised Shari'ah Governance Framework in 2015.

The Government of Pakistan through the Ministry of Finance, the SBP, the stock exchange markets and Security and Exchange Commission of Pakistan (SECP) are continuously in collaboration with Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB), the International Islamic Financial Market (IIFM), and Islamic Research and Training Institute (IRTI) of Islamic Development Bank (IDB) to achieve the higher objectives of Islamic economic system.²² The cooperation with other central banks and institutions of other Islamic countries have also played a pivotal role in enhancement of innovative Islamic economic thoughts and in development of Islamic banking institutions at both local and at the global level.²³

²¹- Strategic Plan of Islamic Banking 2014-2018 (Karachi: State Bank of Pakistan. 2013), See <https://www.sbp.org.pk/IB/index.asp> , Accessed on 28-12-2022.

²²- "Handbook of Islamic Banking Products & Services" Islamic Banking Department, (Karachi: State Bank of Pakistan) See <https://www.sbp.org.pk/IB/index.asp> , Accessed on 13-11-2022.

²³- Shah, Syed Muhammad Abdul Rehman, Muhammad Umar Farooq, and Muhammad Akmal. "Embracing Islamic banking as a new engine toward

The rapid growth of the Islamic banking industry recorded in the overall banking industry assets and deposits at 19.5 % and 20.5 %, respectively by end June, 2022. While, we can see the financing of Islamic banking industry in advances of overall industry reached to 27.2 % by end June, 2022 as compared to 24 % in June, 2021. On balance sheet, the assets are witnessed at PKR 6,781 billion in 2nd quarter of 2022, whereas it was recorded PKR 4,797 billion in same quarter of 2021. Similarly, the deposits are witnessed at PKR 4856 billion in 2nd quarter of 2022, which were recorded PKR 3822 billion in 2nd quarter of 2021 (see, for instance, Table 1). There are working 22 Islamic banking institutions with 14 % increase in Islamic banking branches. In the same industry, profit before tax is registered at PKR 73.4 billion by the end of 1st half of 2022 and it was found PKR 42.6 billion in same period of 2021. Similarly, return on assets (ROA) before tax and return on equity (ROE) before tax have also been improved at 2.4 billion and 42.6 billion, respectively.²⁴

economic growth." In *Contemporary Issues in Islamic Social Finance*, pp. 169-184. Routledge, 2021.

²⁴ Islamic Banking Bulletin March-June 2022

Table 1: Industry Progress and Market Share in Pakistan (Amount in Rs. Billion)

Particulars	Period			Yearly Growth (%)			Share in Overall Banking Industry (%)		
	Jun-21	Mar-22	Jun-22	Jun-21	Mar-22	Jun-22	Jun-21	Mar-22	Jun-22
Assets	4,797	5,945	6,781	32.0	35.5	41.4	17.0	19.4	19.5
Deposits	3,822	4,246	4,856	29.7	22.8	27.1	18.7	20.0	20.5
Investments (net)	1,363	2,202	2,672	51.6	63.7	96.1	9.6	14.3	15.0
Financing (net)	2,118	2,692	2,961	24.7	37.8	39.8	24.0	26.0	27.2
Number of Islamic Banking Institutions	22	22	22	-	-	-	-	-	-
Number of Branches*	3,583	3,983	4,086	9.4	13.7	14.0	-	-	-
Number of Islamic Banking Windows	1,562	1,418	1,463	12.1	(11.1)	(6.3)	-	-	-

* including sub-branches

Source: SBP Islamic Banking Bulletin, June 2022

The network of Islamic banks comprises of 22 Islamic banking institutions as per statistics of June 2022. There are five full-fledged Islamic banks, and seventeen conventional banks have standalone branches of Islamic banking. Overall, the branch network of Islamic banks comprises of 4086 branches in 129 districts on landscape of Pakistan. Encouragingly, the rapid growth of Islamic banking industry during the last decade indicates a bright future perspective for the industry. It includes the development of Islamic capital markets, Islamic money market instruments, Islamic mutual funds and Takaful (Islamic insurance) companies etc. Presently, there are operating 5 Takaful operators in the industry and about 30 Islamic mutual funds in Islamic financial market.²⁵

In context of above discussion, we can say that Islamic banking industry is playing an important role through supplying credit to economy. The contractual nature of Islamic banking is fundamentally

²⁵ Ibid

different, it requires to be dealt separately especially from perspective of prudential regulations, supervisory authorities, monetary policy, and financial markets.²⁶ The development of Islamic banking industry depends on the conducive environment supported by the regulatory authorities of government. This study provides a short background and current trends of Islamic banking market. It also supports the existence of Islamic banking and fiancé as reflection of Pakistan's ideology of Islam.

5. Issues in Existing Islamic Banking System of Pakistan

Despite Muslim-majority in Pakistan, Islamic banking and finance is facing some issues which are related to growth, creditworthiness, regulatory framework, capacity building, and political position of country. Once level of awareness increases there is surety shift to double digit growth of Islamic banking assets. This awareness campaign is necessary for bank staff and general public to enhance the agenda of Islamic banking and finance.²⁷

As for creditworthiness in Islamic banking is mainly related to Shari'ah compliance risk. There are some investment decisions of Islamic banks that are based upon "Hiy'al-حیل-". contradicting to the objectives of Shari'ah. Some of these controversial contracts like bay-al-inah (عینه بیع), bay-al-wafa (الوفا بیع), tawarruq (تورق), commodity murabh'ah (مرابحه) are widely used in market for liquidity management. Similarly, some other

²⁶- Chapra, M. U. "Monetary management in an Islamic economy." *Islamic economic studies* 4, no. 1 (1996), 1-35.

²⁷- Ahmed, Rukhsar, Kamran Siddiqui, and Immamuddin Mufti. "Islamic banking in Pakistan-problems and prospects." *Asian Journal of Research in Banking and Finance* 3, no. 7 (2013): 42-72.

products sale plus lease back sukuk, commodity murabh'ah, currency salam are also basic drivers nullifying the essence of Shari'ah.²⁸ Indeed, participatory contracts; Mudarb'ah and Mushark'ah modes of Investment are ideal one for sound Islamic economic system and long-time utilization of capital but Islamic banking institutions are not rushing to adopt these two modes due to lack of commitment of practitioners and entrepreneur.²⁹ Further, there are not systemic analysis and research on participatory contracts to earn confidence of expected participants. Interestingly, this arrangement will endorse agenda of economic growth through employment and capital formation.³⁰

Islamic banks face a lot of obstacles because of regulatory authorities who regulate them equally along with conventional banks in line with same prudential regulations. For instance, capital adequacy ratio (CAR) is acquired by central bank on basis of risk exposure of banks. The risk exposure of Islamic banks is totally different as their investment account are based upon profit and loss sharing (PLS)

²⁸- Siddique, M. A. Practice of running Musharkah in Pakistani Islamic banks: An analytical study in the light of Shariah principles. *Fikr-O-Nazar* 54, no.4, (2017). 53-110.

²⁹- Shah, Muhammad Abdul Rehman, Governing Principals of Shari'ah: A Study of Islamic Business Transactions for Contemporary Practices. Shah, S. M. A. R., & Rashid, A. Governing Principals of Shari'ah: A Study of Islamic Business Transactions for Contemporary Practices. *Al-Azhāar*, Special Edition 1, no. 2, (2015) 158-170, Available at SSRN: <https://ssrn.com/abstract=3663039> , Accessed on 8-9-2022.

³⁰- Nosheen & Rashid, A. "Business orientation, efficiency, and credit quality across business cycle: Islamic versus conventional banking. Are there any lessons for Europe and Baltic states?" *Baltic Journal of Economics* 19, no 1, (2019), 105-135.

arrangement of Modarb'ah contract.³¹ Similarly, monetary authorities use Karachi Inter Bank Offered Rate (KIBOR) to control credit supply of both types of banks in same economy. In case of Pakistan, there are noted monetary policy puzzles empirically.³² Likewise, pricing of Ijar'ah and Diminishing Mushark'ah (DM) products on KIBOR base is also another issue for credibility of the operations of Islamic financial institutions (IFIs).³³

Finally, another neglected aspect of Islamic finance is research and development (R&D) in literature and products. Further, Shah *et. al.*, (2020) have explored that Islamic financial industry also requires producing competent scholars who can propose growth-oriented Islamic economic models³⁴ and may face challenges of modern financial world in light of *Shari'ah*.

6. Conclusion

Interest-based transactions are strictly prohibited in *Shari'ah*. In context of Pakistan, we have presented the historical review of struggle to move to Riba-free economy, the role of regulatory authorities, courts, and research models of academicians to eliminate Riba. Recently on

³¹- Rehman Shah, M. A., A. Rashid, and M. Khaleequzzaman. "Determinants of Financial Leverage in Islamic Banks." *Islamic Finance, Risk-Sharing and Macroeconomic Stability* (2019): 121-149.

³²- Shah, S. M. A. R., & Rashid, A. "The Credit Supply Channel of Monetary Policy transmission Mechanism: An Empirical Investigation of Islamic Banks in Pakistan Versus Malaysia." *Journal of Islamic Monetary Economics and Finance*5, no. 1, (2019), 21-36.

³³- Rashid, Abdul, and Mamoona Riaz. "Are Islamic banks really different from conventional banks? An investigation using classification techniques." *Journal of Islamic Business and Management* 8, no. 1 (2018), 37-52.

³⁴- Shah, Syed Muhammad Abdul Rehman, and Kashif Raza. "The Role of Islamic Finance in Achieving Economic Growth: An Econometric Analysis of Pakistan." *Enhancing Financial Inclusion through Islamic Finance, Volume II* (2020): 241-258.

April 28, 2022, the FSC's judgement on Riba (interest) case is also hope to eradicate all types of Riba from economy for sake of economic justice in line with the objectives of shari'ah. The SBP took an initiative of Islamic banking on practical basis in 2002, presented successfully an alternate to citizens to invest in Shari'ah compliance way. Overall, we can say that it a great achievement that Islamic ideology in constitutionalized, then institutionalized in form of Islamic financial institutions in supervision of SPB and SECP. Yet, Islamic banking are facing some issues which require to settle down in regulatory and Shari'ah matrix. However, there is need to present a more comprehensive model of Islamic economic system applicable to all regulatory segments compatible to modern practices. We can say Islamic banking is as initiative in practice, yet the dreams of forefathers while achieving Pakistan are waiting to be converted into reality and Islamic economic system is at top of them.

We recommend for academicians to explore the Islamic economic system in conceptual framework. Policy makers are also responsible to get benefits from Islamic economic knowledge stream while devising policy stances. Last, but not least, Islamic economic system is rich area of research for future researchers with underpinned foundation of Islamic ideology. Especially, government of Pakistan is responsible to meet the deadlines as instructed by the FSC's judgement on Riba (interest) case (as of 28 April, 2022).

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5. Al-Sarakhsi, Money Exchange, Loans, and Riba: A translation of Kitab al-Sarf from Kitab al-Mabsut, translated by Imran Ahsan Khan Nyazee, 2018, (Islamabad: Advanced Legal Studies Institute)
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