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Islamic Banking and Finance in Pakistan: Growth Trends, Outlook, and Strategic Imperatives

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Abstract
This study examines the landscape of Islamic Banking and Finance (IBF) in Pakistan, focusing on its recent growth trends and future outlook. The sector has experienced remarkable expansion, with the State Bank of Pakistan (SBP) aiming to establish a sustainable and globally integrated Islamic Banking System (IBS). This vision includes offering innovative, Shariah-compliant financial products to achieve equitable economic growth. Currently, Islamic Banks (IBs) in Pakistan provide diverse financing options, including Murabaha, Musawamah, Mudaraba, Musharaka, Ijarah, Salam, Istisna, Wakala, and Islamic Export Refinance. Each mode is tailored to meet customers' financial needs while adhering to Islamic law. The study concludes that the outlook for Islamic banking is highly promising, but realizing its full potential requires strategic initiatives. Raising awareness is a key priority, with proposed measures such as the Islamic Banking Awareness Program, Islamic Banking Bulletin, video conferences, business review meetings, and quarterly engagements with Islamic Banking Institutions (IBIs). The National Institute of Banking & Finance (NIBAF) plays a crucial role in these efforts by providing educational and training programs to support IBF growth. Additionally, expanding the reach of Islamic banking is essential for its sustained success. Growth strategies include increasing branch networks and extending services into Microfinance, Agricultural Finance, and Small and Medium Enterprise (SME) Finance. By broadening its scope, Islamic banking can enhance financial inclusion and contribute significantly to Pakistan’s economic development. These steps will strengthen IBF’s position, ensuring its continued integration into the global financial system.
Keywords: Islamic Banking and Finance, Pakistan, State Bank of Pakistan, Shariah Principles, Financial Products

1. INTRODUCTION
The banking system is a cornerstone of a country's financial stability. It is imperative for the banking infrastructure to be robust, efficient, and fair to facilitate economic productivity and equity. Empirical studies affirm that well-regulated banking systems enhance macroeconomic resilience and promote inclusive financial access, especially in developing economies like Pakistan (Awan & Sohail, 2018; Ahmad, 2018). A sound banking infrastructure underpins capital allocation, investment stimulation, and risk mitigation, ultimately supporting sustainable growth and economic justice (Emodi, 2019; Khan & Zahra, 2019). While Islamic banking and traditional banking share similar fundamental objectives in promoting financial services and enhancing economic growth, their operational methodologies distinguish them significantly. The primary distinction between Islamic banking and traditional banking lies in their approaches to achieving their objectives. Islamic banking operates on trade-based contracts that comply with Shariah law, which prohibits interest (Riba). This means that Islamic banking does not involve interest payments, and there is no fixed rate of return on financial products. Instead, it relies on profit-and-loss sharing schemes, trade financing, and lease-based transactions that are designed to be equitable and risk-sharing. Conversely, traditional banking systems are based on interest-based contracts. In this model, banks lend money at a fixed or variable interest rate, generating profits through the difference between the interest paid to depositors and the interest received from borrowers. Prior research notes that while this model has historically driven financial expansion, it raises concerns over income inequality and financial exclusion (Manzoor & Agha, 2018; Muhieddine, 2018). This fundamental difference highlights the ethical and operational divergence between Islamic and traditional banking, with the former offering a faith-based alternative

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that avoids interest, promoting risk-sharing and ethical financial practices (Okurut & Mbulawa, 2018; Khan & Ali, 2018).

An Islamic Bank (IB) is a financial institution committed to the principles and economic standards of Islam within the banking sector. According to the Islamic Banking Act (IBA) of 1983 in Malaysia, an Islamic Bank is defined as a sector engaged in Islamic Banking activities. Specifically, Islamic financial business is characterized as banking operations that do not involve any element disapproved by Islam. A widely recognized definition of an Islamic Bank is a financial institution whose statutes, rules, and procedures are expressly designed to adhere to the principles of Islamic Sharia (Law). This includes a clear prohibition on the receipt and payment of interest (Riba) in any of its transactions. Islamic Banks operate on a system of profit-and-loss sharing, asset-backed financing, and ethical investment, ensuring that all activities are in harmony with Islamic ethical standards. This framework distinguishes Islamic banking from conventional banking, which relies on interest-based transactions, making Islamic Banks a unique component of the global financial system.

Within the Islamic banking community, two fundamental principles are paramount. First, there is a strict prohibition against the charging or acceptance of interest (Riba) in any form. This principle is rooted in the Islamic ethical system, which considers the practice of charging interest as exploitative and unjust. Instead of interest, Islamic banking relies on profit-sharing arrangements, lease agreements, and trade-based financing that align with Islamic law. Second, all banking activities must adhere to the moral and ethical code of Islamic teachings. This encompasses not only the financial transactions themselves but also the nature of the investments and the overall conduct of the bank. Investments in businesses that are considered Haram (forbidden), such as those dealing in alcohol, gambling, and non-halal food products, are strictly avoided. Moreover, Islamic banking emphasizes social justice, transparency, and the welfare of the community, ensuring that financial practices contribute positively to society and do not harm individuals or the environment. These two central issues highlight the distinctive nature of Islamic banking, setting it apart from conventional banking systems by integrating financial services with the ethical and moral values of Islam.

1.1.RIBA

The term "Riba" in Islamic finance refers to "increase" or "addition." It occurs when the amount of a loan or the quantity of a commodity exchanged is increased or augmented without providing a comparable counter value or remuneration to the borrower. This can happen when the same type of commodity or item is transacted, and an increment is made to its exchange value. However, if the difference in value is based on distinct types, qualities, or values of items being exchanged, then the transaction is not considered interest-based.

The prohibition of Riba in Islamic finance is rooted in several rationales, including:

- Economic Justice: Riba is viewed as unjust because it allows one party to benefit unfairly at the expense of another. It creates an unequal distribution of wealth and perpetuates economic disparity.
- Social Welfare: Riba can lead to exploitation and financial hardship for borrowers, particularly those who are economically disadvantaged. Prohibiting Riba promotes social welfare by ensuring fair and equitable financial transactions.
- Risk Sharing: Islamic finance emphasizes the concept of risk-sharing, where both parties share in the risks and rewards of a transaction. Riba undermines this principle by guaranteeing a fixed return to the lender, regardless of the outcome of the investment or transaction.
- Preservation of Property Rights: Riba is seen as a violation of property rights because it allows lenders to profit without contributing to the productive use of their wealth. Islamic finance seeks to preserve property rights by promoting productive investment and entrepreneurship.

The prohibition of Riba in Islamic finance is based on principles of justice, fairness, and economic equity. By adhering to this prohibition, Islamic financial institutions aim to create a financial system that is more inclusive, transparent, and conducive to sustainable economic development.

1.2.GHARAR

The literal meaning of "Gharar" in Islamic finance is "unqualified and unquantified uncertainty," "chance," or "risk." Gharar refers to the presence of ambiguity or uncertainty in a sale or contract. It is viewed as a form of ignorance where the parties involved are unaware of crucial details or risks associated with the transaction.

In Islamic finance, Gharar is considered problematic because it can lead to disputes and unfair outcomes. To invalidate a contract, Gharar must be specifically shown to conflict with the principles of fair trade. However, not all forms of Gharar are prohibited; those that are beneficial for the public or serve a legitimate purpose may be tolerated.

1.3.ZULM

The literal meaning of "Zulm" in Islamic ethics encompasses injustice, inequality, exploitation, and wrongful acts. It refers to actions where individuals exploit the rights of others or fail to fulfill their duties towards them. Zulm also extends to engaging in activities that are prohibited (haram) under Sharia law, such as consuming alcoholic beverages and non-halal poultry or meat. In Islamic teachings, Zulm is condemned as it disrupts the balance and harmony within society and violates the rights of individuals. It is considered a grave sin and is incompatible with the principles of justice and fairness emphasized in Islam. By prohibiting Zulm, Islamic ethics seek to promote social cohesion, equality, and respect for the rights and dignity of all individuals, fostering a society built on principles of compassion, righteousness, and integrity.

1.4.PROHIBITION OF INTEREST IN VERSES OF QURAN

The interest is prohibited in Islamic ways of banking as it is also obvious from Quran. *In Quran, Allah said that:*

“O you who believe! Do not devour Riba multiplying it over and keep your duty to Allah that you may prosper” (3:130).

“Those who charge usury (riba’/interest) are in the same position as those controlled by the devil’s influence. This is because they claim that usury is the same as commerce. However, God permits commerce and prohibits usury. Thus, whoever heeds this commandment from his Lordand refrains from usury, he may keep his past earnings and his judgmentrests with God. As for those who persist in usury, they will incur Hell,wherein they abide forever.” (2:274) “Who is he that will lend unto Allaha goodly loan, that He may double it for him or his may be a rich rewar”(57:11)

“Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the Devil; this is because they say: Trade is like interest. While God has permitted trade and forbidden interest. Hence those who have received admonition from their Lord and desist may have what has already passed, their case being entrusted to God; but those who revert shall be the inhabitancies of the fire and abide therein forever.” “O you who believe! Fear God, and give up what remains of your demand for usury, if ye are indeed believers”

2. LITERATURE REVIEW

Akram et al. (2011) conducted a study on the growth, development stages, and prospects of Islamic banking in Pakistan. The study highlighted the increasing awareness and preference for Islamic banking among individuals in the country, as Pakistan is predominantly Muslim. Understanding the basics of Islamic banking is considered essential due to this cultural context. The authors examined the growth and performance of Islamic banking by analyzing data from the financial years 2003 to 2010. They focused on key growth indicators such as assets, deposits, sources, and uses of funds. The study evaluated performance indicators to assess the progress and effectiveness of the Islamic banking system. During the study period, Islamic banking experienced rapid market share growth within the banking sector, indicating its increasing popularity among consumers. The State Bank of Pakistan (SBP) played a significant role in promoting the growth of Islamic banking by implementing strategic initiatives. The study indicated that current growth trends suggested Islamic banking would continue to expand its market share in the future, becoming a significant player in Pakistan's banking sector. The study noted substantial increases in deposits and support facilities for Islamic banking over the past decade, indicating growing confidence and participation in Islamic financial products. Additionally, Islamic banks have been expanding their branch networks to reach more customers. However, the study also observed competition from traditional banks entering the Islamic banking sector. Traditional banks have begun establishing Islamic banking branches alongside their conventional banking operations to cater to the needs of Islamic finance customers. This competition reflects the growing demand for Sharia-compliant banking services in Pakistan and highlights the importance of Islamic banking as a competitive segment within the broader financial industry.

Hasin et al. (2010) conducted a study on the importance of Islamic banks in the monetary transmission mechanism in Malaysia. The study explored how monetary policy affects the real economy through various channels, including bank lending. Malaysia operates under a dual banking system comprising both conventional and Islamic banking, with the latter featuring interest-free financing. The primary aim of the study was to empirically examine the significance of Islamic banks' funding in transmitting monetary policy effects to the real economy. The researchers utilized an autoregressive distributed lag (ARDL) bound testing approach and growth accounting method, analyzing quarterly data from 1991:Q1 to 2010:Q4. The findings of the study revealed that Islamic banking serves as an important channel for financial transmission in Malaysia. Islamic funding plays a crucial role in redistributing monetary policy shocks to different sectors of the economy. Despite operating within a dual banking system, Islamic banking is not immune to interest rate and economic conditions. The study highlighted that Islamic banking operations are influenced by interest rates, although their mode of operation is distinct from conventional banks. The authors concluded that Islamic banking should be considered as an alternative or complementary channel for financial transmission when formulating monetary policy. The study emphasized that Islamic funding channels exhibit responsiveness to monetary policy shocks, providing a quicker transmission mechanism compared to traditional lending channels. Therefore, the central bank should take into account Islamic funding channels when designing monetary policy measures to ensure effective transmission and economic stabilization.

Husain (2004) identified six sets of challenges that hinder the progress of the Islamic finance sector. Despite its notable growth in recent years, the Islamic financial services industry is still in its early stages and requires careful nurturing and development to make a significant impact in global financial markets. The study highlighted the establishment of institutions such as the Islamic Financial Services Board (IFSB), Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and International Islamic Financial Market (IIFM) as promising steps toward addressing the industry's constraints and barriers in a systematic and informed manner.

In his speech, Akhtar (2004), the governor of the central bank of Malaysia, discussed the future prospects of the Islamic Financial Services Industry (IFSI). He articulated the goal of developing an Islamic financial system that serves as an intermediation process, contributing to overall wealth creation, growth, development, and greater shared prosperity. The study emphasized that the accelerated pace of globalization and liberalization has increased the demand for more sound and efficient financial systems to secure financial stability and confidence.

Akhtar (2007) offered a comprehensive overview of the trajectory and future prospects of Islamic banking, reflecting on the lessons learned from its reintroduction in Pakistan during the 1990s. With the sector poised for substantial growth, Islamic banks are anticipated to expand significantly, aiming to elevate their share from 3.5% to approximately 15% of the overall banking landscape. To achieve this ambitious target, the study advocated for collaborative initiatives between regulatory bodies such as the State Bank of Pakistan (SBP) and industry stakeholders to bolster capacity and expertise within the Islamic finance sector. Furthermore, it stressed the importance of promoting robust corporate governance practices to ensure transparency and ethical conduct within Islamic banks. Emphasizing the adoption of international standards and best practices, the study highlighted the need for liquidity management tools to instill investor confidence and effectively manage risks inherent to Islamic banking operations. Additionally, efforts to enhance understanding and capabilities in Islamic Banking Risk Management were deemed essential to navigate potential challenges. By promoting diversification and innovation within the financial industry, stakeholders can foster an environment conducive to sustained growth and stability, underscoring the collective responsibility to realize the full potential of Islamic banking and its contributions to the broader economy.

Adzim's (2008) exploration into the prospects of Islamic banking in the aftermath of the global financial crisis sheds light on a resilient sector that weathered the storm while traditional commercial banks faltered. Motivated by the remarkable stability exhibited by Islamic banks during the crisis, the study delved into the unique attributes of Islamic finance that contributed to its robustness. Notably, Islamic banks avoided the need for government intervention or recapitalization, a stark contrast to the struggles faced by many conventional banking institutions. With Islamic banks boasting financial assets exceeding $500 billion and poised to double in the next decade, the study painted a picture of sustained growth and expansion within the industry. The success stories of Islamic banking in countries like the United Kingdom, where institutions such as the Islamic Bank in Britain and Alburaq emerged as market leaders in Sharia-compliant finance, further underscored the sector's resilience and potential. Adzim's paper emphasized that the strength of Islamic finance lies in its adherence to ethical principles, eschewing the greed and fear that characterized the conventional banking system. It posited that the future of Islamic banking is bright, driven by a commitment to virtuous conduct and a steadfast dedication to serving the needs of diverse global communities. As the world grapples with the aftermath of the financial crisis, Islamic finance emerges as a beacon of stability and integrity, poised to continue its accelerated growth trajectory in the years to come.

In 2011, French Islamic banking expert and journalist Gerard al-Fin reported on the thriving state of most Islamic banks, noting their profitability and expansion despite the ongoing banking crisis that originated in the West in 2007 and continued until that time. Unlike conventional banking practices, Islamic banking appeared to be more stable due to its asset-based nature rather than being solely reliant on currency. The Institution of Islamic Banking and Insurance highlighted significant future challenges facing the Muslim banking community, including the need for increased specialization and expertise in various financial areas and the enhancement of essential financial services for Muslims and Muslim-majority countries. Standardizing banking practices and bolstering the stability of banks emerged as two key issues for the future of Islamic banking. Looking ahead, Islamic banks are expected to focus on developing and implementing newer and more diverse financial models that prioritize real production and assets over the pursuit of money as a commodity. This emphasis reflects a broader societal shift towards financial systems that align with Islamic principles and promote economic stability and prosperity within Muslim communities.

A study by El-Gamal (2010) examined the performance of Islamic banks during the global financial crisis, highlighting their stability compared to conventional banks. El-Gamal's analysis demonstrated that Islamic banks, with their asset-based financing and avoidance of interest-based transactions, were less exposed to the risks that led to the collapse of many conventional financial institutions.

Siddiqui et al. (2012) conducted a comprehensive analysis of the growth and development of Islamic banking worldwide. Their research revealed a steady increase in the number of Islamic financial institutions and the expansion of Islamic banking services beyond traditional markets, indicating growing demand and acceptance globally.

A study by Kahf (2013) delved into the challenges and opportunities facing Islamic banking in the post-crisis era. Kahf emphasized the importance of regulatory frameworks and Sharia compliance in ensuring the continued growth and stability of Islamic banking. The study also highlighted the potential for Islamic banking to promote financial inclusion and socio-economic development in Muslim-majority countries.

A report by Ernst & Young (2014) examined the emerging trends and future prospects of Islamic banking. The report identified factors driving the growth of Islamic finance, such as increasing demand from Muslim consumers, government support for Islamic banking, and the expansion of Islamic finance into new markets. It also underscored the need for innovation and adaptation to meet the evolving needs of customers and maintain competitiveness in the global financial industry.

The Islamic banking industry (IBI) has shown a higher growth rate compared to the traditional banking industry, even amidst global economic slowdowns and financial crises. This growth is evident in both local and global financial markets, with Islamic banking continually increasing its market share. In this paper, I will delve into the origins and purposes of Islamic banking, both in Pakistan and worldwide. Firstly, I will explore the genesis of Islamic banking and its fundamental objectives. Subsequently, I will provide an overview of the goods and services offered by Islamic banks and conventional banks operating in Pakistan, highlighting the distinctive features of each. Following this, I will discuss the key points of differentiation between Islamic and conventional banking systems, focusing on principles, practices, and modes of operation. Finally, I will conclude by outlining the future prospects of Islamic banking, considering its potential for sustained growth, and offer some recommendations to further strengthen and enhance the sector's performance.

3. OBJECTIVES OF ISLAMIC BANKING

The primary objective of an Islamic bank is to serve Allah and uphold the principles of Islam. Islamic financial institutions are tasked with fostering a specific corporate culture aimed at promoting collective morality and spirituality. This culture, when combined with the creation of goods and services, contributes to the advancement of the Islamic way of life. Scholars suggest that institutional values grounded in faith-based ethics significantly influence organizational conduct and stakeholder trust (Khan & Ali, 2018; Iqbal & Nasir, 2018). All staff members of Islamic banks and their interactions with clients are expected to adhere to Islamic principles, creating an environment akin to a sacred space where religious acts can be performed (Nasir, 2019; Singh & Kumar, 2018). Additionally, the State Bank of Pakistan (SBP) plays a crucial role in promoting Islamic banking in the modern world. It encourages and facilitates the application of Islamic principles and regulations in financial transactions, catering to the needs of customers who seek Sharia-compliant financing options. The SBP also regulates investment companies to ensure their activities align with Sharia principles, preventing engagement in forbidden practices. Unlike conventional banking, which primarily focuses on economic transactions and financial markets, Islamic banking incorporates moral, social, and ethical considerations into wealth creation. The ultimate goal of Islamic banking is to promote equity and fairness in society, emphasizing the importance of social responsibility alongside financial profitability.

4. ORIGIN OF ISLAMIC BANKING IN PAKISTAN

In the 1980s, Pakistan embarked on a significant initiative to Islamize its banking framework, which involved substantial revisions to the Banking Companies Ordinance of 1962 (BCO'62) and related regulations to accommodate non-interest-based financial transactions. This initiative was initiated following a formal request to the local Council of Islamic Ideology (CII) on September 29, 1977. The council was tasked with devising a blueprint for an interest-free financial system. Comprising a panel of investors and market analysts, the council submitted its report in February 1980, outlining various strategies and detailed recommendations for eliminating interest from Pakistan's financial system. This report marked a significant milestone in the efforts to Islamize the financial system in Pakistan, laying the groundwork for subsequent reforms and initiatives aimed at promoting Sharia-compliant banking practices.

Several significant developments during this period played a crucial role in the Islamization of Pakistan's financial system:

- In 1979, the National Investment Trust (NIT), Investment Corporation of Pakistan (ICP), and House Building Finance Corporation (HBFC) initiated reforms to eliminate interest from their operations.
- The investment scheme of ICP was replaced with a new system based on profit and loss sharing starting from October 1, 1980.
- HBFC, a state-run institution, ceased interest-based operations from July 1, 1979.

- Legal reforms in June 1980 allowed for the issuance of Participation Term Certificates (PTCs), a new interest-free corporate financing instrument.
- The introduction of the Modaraba Companies and Modarabas Ordinance, 1980, along with the Modaraba Companies and Modaraba Rules, 1981, paved the way for Sharia-compliant business ventures known as modarabas.
- In 1984, the Banking and Financial Services Ordinance, 1984, amended seven regulations to further facilitate Islamic banking practices.
- The Banking Tribunals Ordinance, 1984, introduced a new mechanism for the recovery of non-interest-based financing.
- Profit and Loss Sharing (PLS) deposits as a percentage of total deposits increased significantly from 9.2% at the end of 1981 to 61.6% by the end of 1985, indicating a growing acceptance and adoption of Sharia-compliant banking principles.

5. LIST OF ISLAMIC BANKS WORKING IN PAKISTAN

Total Islamic banks working in Pakistan is 309 and their branches 129 and their sub branches are 77.

6. MAJOR PRODUCTS AND SERVICES OF ISLAMIC BANKING

Indeed, Sharia-compliant Islamic finance offers a range of distinctive modes of financing tailored to adhere to Islamic principles. Here are some of the key modes:
Murabaha: A cost-plus-profit arrangement where the bank purchases the desired asset and sells it to the customer at a markup, allowing for deferred payments.
Musawamah: A general sales contract where the price is negotiated between the buyer and seller without disclosing the cost price.
Mudaraba: A partnership agreement where one party provides capital (Rab al-maal) and the other party provides expertise and labor (Mudarib), with profits shared according to a pre-agreed ratio.
Musharaka: A joint venture agreement where all partners contribute capital and share profits or losses according to their respective stakes.
Ijarah: A leasing arrangement where the bank leases an asset to the customer for a specified period in exchange for rental payments.
Salam: A forward sale contract where the buyer makes advance payment for future delivery of goods, typically agricultural products.
Istisna: A contract for the manufacture of goods, where the bank agrees to finance the production of a specific asset according to the buyer's specifications.
Wakala: A contract of agency where the bank acts as an agent on behalf of the customer for a fee, managing investments or providing services.
Islamic Export Refinance: A financing facility provided by central banks to Islamic banks to support export-oriented businesses while complying with Sharia principles.
These Sharia-compliant modes of financing ensure that transactions are conducted in accordance with Islamic principles, avoiding interest (riba) and unethical activities. Each mode serves specific purposes and can be tailored to meet the needs of diverse customers and business ventures.

7. ESSENTIALS OF ISLAMIC MODES OF FINANCING

The Sharia Board of the State Bank of Pakistan has approved the Essentials of Islamic Modes of Financing and Model Agreements, ensuring compliance with minimum Sharia standards for banks operating Islamic banking in Pakistan. These guidelines serve as general principles to be adhered to by banking institutions engaged in Islamic banking activities within the country. By endorsing these essentials, the Sharia Board aims to uphold the integrity and authenticity of Islamic finance, ensuring that banking practices align with Sharia principles and ethics. These guidelines provide a framework for Islamic banks to structure their financing activities in accordance with Islamic law, promoting transparency, fairness, and ethical conduct in financial transactions. Compliance with these standards enhances confidence among customers and stakeholders in the Islamic banking sector, fostering sustainable growth and development while maintaining the integrity of Islamic finance principles.

8.1. ESSENTIALS AND MODEL AGREEMENTS FOR ISLAMIC MODES OF FINANCING

The Commission for Transformation of the Financial System, established within the State Bank of Pakistan in compliance with the Supreme Court Judgment on Riba dated December 23, 1999, has endorsed the fundamentals of Islamic Modes of Financing. Recently established, the Sharia Board of the State Bank of Pakistan has reviewed and approved these fundamentals, recommending their dissemination to banks engaged in Islamic banking business in Pakistan as guidelines. These fundamentals are intended to serve as the basis for Prudential Regulations on Islamic Banking in the future. The Islamic Modes of Financing endorsed by the Sharia Board include:

8.2. MURABAHA

Murabaha, in Islamic finance, refers to a transaction where an individual sells goods to another party under an arrangement wherein the seller is obligated to disclose the cost of the goods, either on a cash basis or with deferred payment, along with a predetermined profit margin included in the sale price of the goods agreed to be sold. It is essential that the goods to be traded are tangible, and credit documents cannot be the subject of a Murabaha transaction. Since Murabaha involves sales transactions, it is crucial that the goods being sold exist and are owned by the seller, who must have assumed the risks of ownership before offering the commodities to the buyer/customer. Like any other sale, Murabaha requires a clear agreement and acceptance, including certainty regarding the price, place of delivery, and the date on which the price, if deferred, will be paid. These elements ensure transparency, clarity, and adherence to Islamic principles in Murabaha transactions.

In a Murabaha transaction, the roles and actions of a representative, if involved, the acquisition of goods by or for the bank, and the subsequent sale of these goods to the customer, are all independent transactions and are documented separately. However, the agreement to sell may encompass all these events and transactions and can be executed at the onset of the relationship. The representative initially purchases the goods on behalf of the bank, assuming ownership. Subsequently, the customer purchases the goods from the bank through a proposal and acceptance process. According to Shariah principles, it is sufficient for the condition of 'ownership' that the supplier from whom the bank has purchased the goods transfers ownership to the bank or representative in a manner that subjects the goods to the bank's risk. Thus, the goods remain under the bank's risk during the acquisition by the representative and their subsequent sale to the customer (the representative/buyer) and their ownership by him. The invoice provided by the supplier will be in the name of the bank, as the goods are purchased by a representative on behalf of such an agent. Ideally, payment for these goods should be made by the agent directly to the supplier. Once the sales transaction has been concluded, the selling price determined cannot be altered.

8.3. MUSAWAMAH

Musawamah is a general type of sale where the price of the goods to be traded is negotiated between the seller and the buyer with minimal reference to the cost incurred by the seller. Unlike Murabaha, there is no obligation for the seller in Musawamah to disclose their cost. However, all other conditions applicable to Murabaha remain valid for Musawamah as well. Musawamah can be an ideal mode of transaction when the seller is unable to determine the exact costs of the goods they intend to sell.

8.4. MUDARABA

Mudaraba is a fundamental concept in Islamic finance that facilitates the partnership between capital providers (Rabbulmal) and entrepreneurs or managers (Mudarib) in a business venture. Rabbulmal contributes funds or capital to the venture, while the Mudarib provides labor, expertise, and management skills. This partnership allows individuals or entities with capital but limited expertise in a particular industry to invest in businesses managed by skilled entrepreneurs. The Mudarib, as the active partner, is responsible for the day-to-day operations of the business, including decision-making, management, and risk-taking. However, the Mudarib's authority is limited to the scope of the agreement, and they are not allowed to engage in activities that are not explicitly authorized. The profits generated from the venture are shared between the Rabbulmal and the Mudarib according to a pre-agreed profit-sharing ratio, while any losses incurred are borne solely by the Rabbulmal. This partnership structure encourages entrepreneurship, risk-taking, and wealth creation while ensuring fairness and accountability in the distribution of profits and losses.

8.5. MUSHARAKA

Musharaka represents a partnership formed under an agreement by the mutual consent of the partners for the sharing of profits and losses arising from a joint venture or enterprise. Contributions come from all partners, hereinafter referred to as associates. Profits are distributed in the proportion as agreed upon in the agreement. If one or more partners choose to become non-working or silent partners, their share of the profit cannot exceed the proportion that their capital investment bears to the total capital investment in Musharaka. In the event that a Mudarib in a Shirkah arrangement also contributes their own funds to the business, they will be entitled to share the profit in relation to their own capital in addition to their share as a Mudarib according to the agreed ratio. This structure ensures fairness and equity in the distribution of profits and losses among the partners involved in the Musharaka partnership.

8.6. IJARAH (LEASING)

In Ijara or renting, the ownership of the leased asset remains with the lessor, while the lessee is granted the right to use and enjoy the asset. Assets that cannot be used without being consumed, such as money, food items, or fuel, cannot be leased. Only assets that are capable of being leased and are owned by the lessor can be rented out, and sub-leasing is only permitted with the explicit approval of the lessor. Lease rentals become due and payable only when the leased assets are handed over to the lessee. However, if any damage or loss is caused to the leased asset due to the fault or negligence of the lessee, the lessee is responsible for bearing the consequences. Additionally, any consequences arising from the non-standard use of the asset without mutual agreement will also be borne by the lessee. The lessee is also liable for all risks and consequences related to third-party liability arising from or incidental to the possession or use of the leased asset. The insurance of the leased asset must be arranged for by the lessor, and the cost of such insurance is borne by the lessor.

It is anticipated that a similar mechanism will soon be developed for Islamic Takaful to replace the current insurance system. A lease may be terminated before the expiry of its term only with the mutual consent of the parties involved. Either party may unilaterally request or offer the premature termination of the lease agreement for a fee and under agreed-upon terms, provided that the lease agreement is not contingent upon such arrangement. On the other hand, the lessor must commit to transferring the asset to the lessee upon the termination of the lease, provided that the lessee has fulfilled their obligations in full. However, there should be no assumption within the leasing process suggesting a transfer of legal ownership of leased assets in the future.

8.7. SALAM (ADVANCE PAYMENT--DEFERRED DELIVERY SALE)

Salam entails a type of sale in which the seller undertakes to deliver specific goods to the buyer at a future date in exchange for a price fully paid in advance at the time the sale agreement is concluded. Otherwise, it would be equivalent to an exchange of debt against debt, which is explicitly prohibited in Sharia. The details, quality, and quantity of the goods must not be fully determined at the time of the agreement to avoid any ambiguity that could give rise to disputes. Salam contracts can be made concerning 'Dhawatul-Amthal,' which refers to goods whose units are homogeneous in nature and can be traded through counting, weighing, or measuring, as indicated by the usage and customs of trade. Therefore, certain items such as precious stones and livestock cannot be subject to Salam contracts because each stone or individual animal may vary from others. It is essential that the raw material, which is the subject of the Salam agreement, is primarily intended to be available at the time of delivery.

Salam contracts cannot be executed for transactions involving variables that must be exchanged on the spot. For instance, transactions like the exchange of gold for silver or wheat for barley require simultaneous delivery of each item, which is essential according to Sharia. Additionally, Salam contracts cannot be tied to the development of a specific farm, field, or tree. In a Salam transaction, the buyer cannot legally obligate the seller to repurchase the commodity for resale to another party. However, after the delivery has been made, the buyer and the seller can enter into a separate sales transaction independently, exercising their full discretion and freedom.

8.8. ISTISNA

Istisna is a unique method of sale, at an agreed-upon price, whereby the buyer places an order to make, assemble, or manufacture a product to be delivered at a future date. The product must be sufficiently defined to eliminate any ambiguity regarding its specifications, including type, kind, quality, and quantity. The cost of the items to be manufactured must be determined in clear and unambiguous terms. The agreed-upon price may be paid in a single sum or in installments as mutually agreed upon by the parties. The provision of materials required for the manufacturing of the product is not the responsibility of the buyer. However, unless otherwise agreed, either party may cancel the contract, especially if the supplier has not incurred any direct or indirect expenses in relation to it. Once the items are manufactured in accordance with the agreed specifications, the buyer cannot refuse to accept them unless there is a significant defect in the product.

However, the contract can stipulate that if the delivery is not made within the agreed time frame, then the buyer has the right to refuse acceptance of the goods. The bank (buyer in Istisna) can enter into an Equal Istisna contract with no condition or linkage to the original Istisna contract. In one of them, the bank can be the buyer, and in the second, the service provider. Each of the two arrangements can be independent of the other. They cannot be interlinked in such a way that the rights and obligations of one agreement are contingent upon the rights and obligations of the other. Furthermore, Equal Istisna is permitted only with a third party. In Istisna transactions, the buyer may not, prior to the receipt (actual or constructive) of the goods, sell or transfer ownership of the product to another person.

8.9. ISLAMIC EXPORT REFINANCE

In the Islamic export refinance scheme, the interest rate is subject to variation from month to month, determined by the bank's head office in accordance with its fixed assets and approved by SBP BSC Refinance Scheme unit. Different Islamic banks may also offer varying interest rates. This scheme was developed by the SBP to cater to the needs of exporters seeking financing under Sharia-compliant modes. Exporters can benefit from this scheme through Islamic banks if they meet the criteria outlined in the Musharika scheme. The company must be classified as a blue-chip company according to the Musharika scheme. To apply for Islamic refinance, the exporter must meet one of the following criteria: (1) Have a good record on the stock exchange, (2) Have a credit rating of B+, or (3) Have an average return on equity (ROE) higher than the rates on EFS. The bank typically charges around 8.40% on the financed amount. If the profit from exports exceeds this 8.4%, the surplus is transferred to the takaful fund. Conversely, if the profit is less than expected in any financial year, the bank takes its share of profit from the takaful fund.

8.10. PAKISTAN AS A GLOBAL LEADER IN ISLAMIC BANKING

In recent years, Islamic banking (IB) and finance in Pakistan have witnessed remarkable growth. Currently, Islamic deposits held by dedicated Islamic banks (IBs) and Islamic windows of traditional banks constitute approximately 9.7% of the total bank deposits in the country. This indicates that approximately every tenth rupee is now being deposited in an Islamic account. Moreover, in 2013, London-based Edbiz Consulting published a ranking of the top 10 countries in Islamic banking and finance on its Islamic Finance Country Index (IFCI).

8.11. SBP CONTRIBUTION IN PROMOTING ISLAMIC BANKING

In recent years, Islamic finance has experienced remarkable growth globally, with double-digit expansion observed in the industry. The estimated size of the Islamic finance industry stands at around Rs. 837 billion. In Pakistan, the asset base of Islamic banking institutions (IBIs) has shown significant growth, averaging around 60% per annum since 2005. This growth has led to a steady increase in the

market share of IBs, reaching approximately 9.7% in deposits and 8.6% in assets by 2013. Presently, there are six full-fledged Islamic banks and thirteen conventional banks offering Islamic banking services, collectively operating through a network of over 550 branches.
Islamic banking institutions (IBIs) have historically relied on the Karachi Inter Bank Offered Rate (KIBOR) as a benchmark for pricing their financial products. However, KIBOR is based on interest rates and is primarily used by conventional banks, leading to concerns among Islamic scholars and Shariah advisors about its compatibility with Shariah principles. To address this issue, efforts have been made to establish an Islamic equivalent of KIBOR known as the Islamic Inter Bank Offered Rate (IIBOR). IIBOR is designed to reflect the principles of Shariah and provide a more appropriate benchmark for Islamic financial transactions, ensuring that IBIs operate in accordance with Islamic law. By using IIBOR, Islamic banks can align their operations more closely with Shariah principles and offer products that are in line with the ethical and religious considerations of their customers.
Indeed, Pakistan's progress in Islamic finance is commendable and reflects its commitment to developing a robust Islamic financial system. Despite starting later than some other countries, Pakistan has achieved significant milestones and demonstrated impressive growth in its Islamic banking and finance sector. This success is a testament to the dedication of policymakers, regulators, financial institutions, and Shariah scholars in promoting Islamic finance and ensuring its adherence to Shariah principles. By surpassing some leading countries in Islamic finance, Pakistan has established itself as a key player in the global Islamic finance industry and continues to contribute to its growth and development.
Up to this point, the efforts directed towards the advancement of Islamic banking have primarily focused on establishing the necessary financial infrastructure, including legal, regulatory, and administrative frameworks. These efforts have been successful in positioning Islamic finance as a viable alternative mode of finance, appealing to faith-sensitive customers. Through these initiatives, Islamic banking has gained recognition not only as a Shariah-compliant financial system but also as a means to foster financial inclusion and cater to the diverse needs of the population.

9. ACHIEVEMENTS OF SBP

The proactive role played by the State Bank of Pakistan (SBP) in promoting Islamic banking has resulted in significant achievements and recognition both domestically and internationally. A robust three-tiered Sharia compliance mechanism has been established, drawing from global experiences, and has been functioning effectively in ensuring adherence to Sharia principles within Islamic banking institutions (IBIs). This mechanism includes Sharia boards, Sharia advisors in all banks offering Islamic finance, and Sharia audits to ensure compliance.
Additionally, SBP has endorsed fundamentals and model agreements for Islamic modes of financing, providing clarity and standardization in Islamic finance transactions. The Fit and Proper Criteria for Shariah Advisors of IBIs have been approved to ensure objectivity in the selection process and mitigate potential conflicts of interest.
SBP has also played a pivotal role in advocating for legislative changes to support Islamic finance, such as amendments to the Sales Tax Act for Murabaha financing arrangements. Furthermore, tax reforms in the Finance Bill 2007 ensured that taxation from Sharia-compliant Islamic banking would be treated on par with traditional banking.
To enhance standardization and consistency, SBP has issued risk management guidelines for IBIs, along with instructions and guidelines for Sharia compliance. Essentials for diminishing Musharaka, as well as guidelines for Islamic microfinance businesses and Islamic agricultural finance, have also been provided.

10. ISSUANCE OF “FIT & PROPER CRITERIA” FOR SHARIAH ADVISOR

In furtherance of the efforts to ensure the integrity and compliance of Islamic banking institutions (IBIs) with Sharia principles, the State Bank of Pakistan (SBP) issued a revised 'Fit and Proper

Criteria for Shariah Advisors of IBIs' through IBD Circular No. 02 dated March 20, 2007. This circular supersedes the previous guidelines outlined in IBD Circular No. 3 dated October 26, 2004. The revised criteria provide detailed qualifications and experience requirements for individuals to be appointed as Shariah advisors by IBIs. These criteria are designed to ensure that Shariah advisors possess the necessary expertise and knowledge to effectively guide IBIs in adhering to Sharia principles. By setting out clear qualification and experience standards, the circular aims to enhance the credibility and effectiveness of Shariah governance within IBIs. This initiative reflects SBP's commitment to promoting transparency, professionalism, and compliance in the Islamic banking sector, ultimately contributing to the development and growth of Islamic finance in Pakistan.

11. SHARIAH AUDIT AND CAPACITY BUILDING

To strengthen Shariah compliance in Islamic banking institutions (IBIs), the State Bank of Pakistan (SBP) is actively engaged in capacity building initiatives. In collaboration with external consultants, SBP has developed a comprehensive manual for conducting Shariah Compliance Inspections of IBIs. This manual provides detailed guidelines and procedures to ensure thorough and effective inspections, helping to identify and address any non-compliance issues. Additionally, SBP has drafted Directions and Rules for Shariah Compliance in IBIs, aimed at further enhancing the Shariah compliance framework within the Islamic banking industry. These directions and rules outline specific requirements and standards that IBIs must adhere to in order to ensure proper Shariah compliance in their operations and practices. By implementing these measures, SBP aims to strengthen the Shariah governance framework in IBIs and promote a culture of compliance with Shariah principles. These efforts are crucial for maintaining the integrity and credibility of Islamic banking institutions and fostering trust among stakeholders in the Islamic finance sector.

12. CONCLUSION

The successful launch and progress of the Islamic Banking Project (IBP) by the State Bank of Pakistan (SBP) is a testament to careful planning and hard work. The results indicate that the implementation of the IBP has been effective, and the growth has exceeded expectations. Achieving a market share of 9.7% within approximately eight years in a rapidly evolving banking industry is a remarkable accomplishment, especially when compared to leading countries in the field of Islamic finance. This achievement underscores the significant strides made by Islamic banking in Pakistan and demonstrates its growing importance in the financial sector. SBP is committed to taking its efforts to the next level by expanding its outreach and enhancing its services. This will involve further developing the banking community within the modern banking landscape and expanding into larger segments such as microfinance, agriculture finance, and small and medium enterprises finance. SBP will also strengthen the Shariah compliance mechanism by increasing the membership of the SBP Shariah Board and supporting it with a larger body of recognized Shariah experts. Additionally, SBP will bolster the regulatory framework by providing guidelines for the new sectors the industry will venture into. At the same time, SBP will continue to improve upon the existing regulatory system by providing support and guidance. The Joint Forum of SBP and SECP will address cross-sectoral administrative perspectives, ensuring a coordinated approach to regulation. SBP will continue to support the industry in resolving taxation and liquidity management issues, recognizing that these measures will not only spur the growth of Islamic banking but also provide it with the robust regulatory framework it needs to become a sustainable industry leader. This approach will position us as pioneers in Islamic banking globally and will also help attract confidence-sensitive foreign investment. Indeed, the clear communication indicates that Islamic banking is growing at a faster rate than the traditional banking system in Pakistan, and according to SBP, Islamic banking will continue to expand in the future. Absolutely, following the high growth rate experienced by Islamic banking institutions (IBIs), there should be special emphasis on ensuring that a well-trained human resource is employed by these institutions. Banks are encouraged to provide appropriate training to their staff on how to operate more effectively. The distribution network should also be expanded. While Islamic banks have shown significant growth in branches, they still lag behind conventional banks in terms of branch network size. One primary reason for this difference is that conventional banks have been established longer than Islamic banks. However, Islamic banks need to continue investing more to meet the growing market demand.

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