

# Islamic Banking, Its Growth and Challenges in an Islamic Society



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The Iranian government's declaration that they do not recognize any superpower other than Allah has reignited the memory of early Muslims during the days of the Prophet and after, when they demolished both the Persian and Roman empires. Success or defeat in war is Allah's prerogative as ordained in the Quran. Belief in and establishment of Islamic values and submission to Allah's will is the essence of an Islamic society and country.

After the Ottomans sided with Germany in the First World War, the Ottoman Empire was dismembered into small vassal states subservient to western nations, and now to the US. Even Pakistan appears to be dependent on the IMF for financial support. If China were to source just 15% of its total agricultural imports of USD 204 billion (2025) from Pakistan, the country would have no current account deficit.

Pakistan during the last fifty years has grown its wealth substantially. Even the beggars in Karachi seem to be healthy and properly clad. Saylani food services for the poor are also commendable. But banking in Pakistan has followed the conventional western model and missing the very ethics and values of an Islamic society.

Banking is a tool for managing wealth in a country. The concept of wealth itself, accumulated over centuries of human life, is Allah's gift to an individual, community or a society which passes on from one generation to another. It is not only wealth, but power and fame too, that are Allah's gifts that need to be used to serve the people. The wealth of the Roman empire was passed on to the European countries and increased manifold after the Industrial revolution. The concept of stock exchange has facilitated ownership transfer. In Ayat-ul-Kursi, Allah states that He has knowledge of the present and future and bestows on mankind new knowledge as needed in each new era. The Malthusian theory of population that human population will exceed the resources of the earth has proven false. New knowledge about crops, poultry meat and other food sources has always kept pace with the growing human population which is nearing 8 billion.

**Table 1: HBL 2024 Balance Sheet & Returns Analysis**

| Item | Rs Billion / % | Computation |
|---|---|---|
| **Deposits** | 4,370 | — |
| **Capital** | 409 | — |
| **Capital (Adjusted ×2)** | 814 | 409 × 2 |
| Total (Deposits + Adjusted Capital) | **5,184** | 4,370 + 814 |
| **Profit Before Tax (PBT)** | 120 | — |
| **Interest Expense** | 567 | — |
| Total (PBT + Interest Expense) | **687** | 120 + 567 |
| **Return to Depositors** | 13.2% | 687 ÷ 5,184 |
| **Return to Shareholders (Pre-Tax)** | 26.5% | — |
| **Return to Shareholders (Post-Tax)** | 18.55% | After 30% tax |

The Islamic concept is that the banking sector as a whole should serve as a Modaraba that collects money from where it is in excess, for safety and return and lends to industry, agriculture and trade for investment purposes. The returns on investment are passed on to the depositors after retaining some for bank shareholders.

Rs 2,528 billion out of total Rs 5,743 billion, representing 44% of liquid assets, have been invested in Treasury Bonds. The

SME sector and agriculture sector has been left to private financiers. This practice is against the basic Islamic tenets. Where the Quran permits mortgage of assets against loans it also advises lenders to be lenient in hard economic times and instead of foreclosure, give time for recovery.

The settlement of financial disputes and banking loans too are out of line with Islamic tenets. Instead of banking courts, SBP should have a dispute resolution department that decides matters within two to three sittings between the banks and the borrower. At most, retired judges of High Courts may be deputed for dispute resolution.

On the investment side, how a bank should share profit with a borrower is a complex question. However, simulation modelling for industry and trade averages can be drawn as a benchmark for bank and borrower profit sharing.

Inflation normally results from cost push factors, such as devaluation or supply disruption. Controlling inflation through monetary policies of SBP is an inappropriate tool according to Islamic tenets.

Where the Quran explicitly forbids interest, Pakistan, instead of depending on its own strength, resources and blessings of Allah, has adopted the western model of managing its finances. In the fifties, Pakistan gave a loan to Germany to help its development program, today Pakistan's debt trap is as follows: Domestic Debt Rs 54.5 trillion (2025) plus Rs 1.15 trillion in Treasury bills held by banks. Pakistan's annual budget is Rs 17.57 trillion (2025) with a resource deficit of Rs 6.3 trillion, meaning Pakistan is short of this amount in annual tax collection.

An ideal situation would be that government saving schemes be abolished. There should be no Treasury bills issued by SBP and all this money be deposited with regular commercial banks where depositors would receive 13% (as illustrated above with HBL) or more on their deposits. These deposits should be utilized for economic growth rather than funding government expenditure.

Pakistan's tax to GDP ratio in 2024 was 10.3% against that of Turkey at 23.5% in 2023. Innovative methods need to be designed to follow Turkey's example in addressing the deficit of Rs 6.3 trillion. The four sectors defined are agriculture (25%), industry (25%) and services (50%) of GDP. Though industry is largely covered, the other two sectors, agriculture and services, need to be seriously reviewed for taxation. Transport is largely ignored, but it does use diesel, which can be considered a means of taxation for this sector.

External public debt stands at around USD 92 billion, representing about 70% of total public debt to GDP in 2026. The current account in Pakistan averaged USD -783.73 million from 1976 until 2025. The situation due to the recent Iran Gulf war has changed which may result in lower labour remittances.

This development also needs to be accommodated in Pakistan's policy actions. If China were to source just 15% of its total agricultural imports of USD 204 billion (2025) from Pakistan, the country would have no current account deficit. A related problem is that yield per hectare in Pakistan is among the lowest in the region. Chinese contribution could improve productivity and bring greater wealth to farmers.

Moreover, significant oil and gas discoveries during 2025–2026, following a three-year survey conducted with a foreign partner, have confirmed substantial reserves in Pakistan's territorial waters, often described as a potentially fourth-largest global find. These new finds of gas, oil, copper and gold (Reko Diq) would be extremely helpful in enabling Pakistan to stand on its own feet.

Though Pakistan was thriving in the 1950s as an Asian tiger, it has been left far behind in economic growth by Germany, Japan, South Korea and even India. What is Pakistan's real problem of governance? Consider that the USA with a population of 330 million has 50 states whereas Pakistan with 250 million people has only 4 provinces. The US has on average 6.6 million people per state. By this scale, Pakistan should have 37 provinces. If not 37, at least 20 provinces would be needed for better governance. The political landscape is significantly influenced by established power structures within both provincial and national assemblies, which may limit the inclusion of emerging urban perspectives. At the same time, different regions such as Balochistan and Khyber Pakhtunkhwa continue to express concerns and demand greater representation and development within the existing system. Unless governance and institutional reforms evolve in a more inclusive direction, these disparities may continue to create political and administrative challenges with broader national implications.

Unless the above-mentioned challenges are addressed, the effective adoption of an Islamic banking system and broader

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