

## The Evolution of Islamic Banking in Pakistan: A Qualitative Analysis

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### Abstract:

This article is intended to illustrate the historical evolution and development of Islamic banking. It provides information on the establishment of Islamic banking in many countries of the world. Islamic banking was started in the time of the Prophet. In this regard, the best examples of this are the partnership business of the Prophet and the establishment of Bait-ul-Mal by his Companions. In different Muslim eras, the rulers promoted the Islamic economic system. As a result of their sincere efforts, Islamic banks were established under Sharia principles in several Muslim countries. There is a need to review the development of Islamic banking in Pakistan to expand it. Let new avenues of further research and exploration be paved in academic circles. The following research article has been compiled to fulfill this present-day need of the intellectual world.

**Keyword:** Evolution, Islamic Banking, Sharia, Pakistan.

## **Introduction**

Islamic banking originated from the beginning of Islam 1400 years ago. In the first century AH, there were many forms of various banking activities similar to modern transactions.<sup>1</sup> In this regard, the treasury of the Prophet's era <sup>2</sup> and the participation of the Prophet of Islam in the business of Hazrat Khadija are fundamental principles for Islamic banking.<sup>3</sup> The Rightly Guided Caliphs, especially during the caliphate of Hazrat Umar, established a regular treasury department, which is fundamental to Islamic banking and has a wide range of benefits and services over today's central banks. The well-known Sahabi Hazrat Zubair bin Awwam used to invest by borrowing money from the people. According to Al-Djahshiyari (1938) and Al-Hamdani (2000), they were called money changers. In the Banu Abbas era, "hawala" is used in both public and private financial affairs. Checks were often used to pay salaries, rewards, gifts and to buy and sell. The first regular check in history was cashed by Saif al-Dawla Hamdani in the 4th century AH.<sup>4</sup> Thus, during the Abbasi, Muslim economists expanded the scope of these Islamic financial institutions for the financial stability of societies, trade and industrial sustainability, and the promotion of economic civilization. The system of these institutions was formed according to the basic principles of Islam. Since the fall of Baghdad, Islamic civilization has been in decline in the Muslim world due to the domination of colonial and colonial powers. Instead of modernity and new experiences, imitative tendencies became ingrained in the minds of Muslims. The Western world took advantage of this intellectual vacuum of the Muslims to spread their ideas in the Muslim world and established their traditional banking institutions<sup>5</sup> throughout the Islamic world, including Egypt and the Ottoman Caliphate.<sup>6</sup> Initially, Muslim thinkers were reluctant to accept the influential bank interest of Western ideas. Researchers later conducted research and critical reviews of these traditional banks in the form of articles, essays, seminars and conferences on the position that the bank is interested.<sup>7</sup> The issue

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was also raised in the Federal Shariah Court, after a lengthy debate, the Supreme Court ruled that the interest of these traditional banks was included in the definition of interest.<sup>8</sup>

Against the backdrop of Shariah gifts in the prevailing traditional banking system, the extraordinary importance of the banking system, multifaceted business for national development, security of savings, transfers, recovery, international trade, Muslims felt that its alternative and viable Islamic Introduce an Islamic banking system in the light of teachings that are in line with the spirit of Islam and its principles. However, with sincere efforts, Muslims established Islamic banking systems in accordance with Sharia principles in a number of Muslim countries, including Saudi Arabia, Egypt, Iran, Kuwait, Dubai and Pakistan. There is a need to review the beginning and evolution of the formation and development of this Islamic banking so that it can flourish. The fair distribution of wealth in society can be implemented. Eliminate hardship, poverty, deprivation, poverty and hunger. Let new avenues of further research and exploration be paved in academic circles. Against this background, the research topic "The Evolution of Islamic Banking" has been chosen.

### **1. Historical Background of Islamic Banking**

Islamic banking based on Shariah is of great importance in investment, protection of savings and financial transactions. The question of when and how Islamic banking originated is very important in academic circles. The story is that when the Western interest system and the traditional banking system spread in the Islamic world in such a way that Muslims began to adopt these modern and inspiring ideas and concepts to material prosperity for the Shari'a of the time. Against the backdrop of this intellectual confrontation, a movement for Islamic banking was launched in the intellectual and religious circles of the Islamic world. Through scholarly dialogues, conferences and gatherings, a strong and effective strategy for global thinking were developed. Very quickly, Islamic banking institutions were established not only in the Islamic

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world but also in European countries. Its historical and evolutionary background is as follows.

Islam is a scholarly movement that provides the basis for research and exploration in all aspects of life, including the cultural, social and economic spheres. Muslims have made full use of it for economic development and established a strong economic system. In this regard, Islamic banking is of great importance in the evolution of which they have played a dynamic and active role. Leading Egyptian economist Dr. Ahmed Najjar's efforts in this regard are commendable. Under his patronage and patronage, the establishment of the Islamic Bank was officially approved in 1961. After the formation of the administrative and technical structure, the first Islamic bank was established in 1963 in the Egyptian town of "Mat Ghamr" better known by the name of the village.<sup>9</sup> The bank catered to the financial needs of rural farmers. In addition, a "Pilgrims Management Fund and Board" was set up to provide interest-free financial resources to pilgrims from Malaysia.<sup>10</sup> Following the successful experience of the Islamic Bank established in this rural area, "Nasser Social Bank" was established in 1971 in Cairo, Egypt. It was a government bank. The Islamic Summit was held in Rabat, Morocco in 1969. In this Sana, Shah Faisal played a vital role. As a result of its international social contacts, a non-profit bank was opened in Jeddah in 1975 under the name of "Islamic Development Bank" with the cooperation of Muslim governments. These intellectual and practical trends led to the emergence of many Islamic investment companies. In the same year, Shaikh Rashid bin Saeed Al Maktoum, a well-known Dubai businessman, along with his business partners, set up a program to establish the "Islamic Bank of Dubai".<sup>11</sup> The bank was well received by investors from Islamic countries. The bank has now gone through various experimental periods and has established itself on a strong footing. After Shah Faisal, his son Amir Muhammad Faisal played a major role in the establishment and stability of Islamic banks. Through his efforts, an Islamic bank was established in 1977 in Cairo under the

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name "Faisal Islamic Bank of Egypt" and an Islamic bank in Khartoum under the name "Faisal Islamic Bank of Sudan". The '70s have been very favorable and important for Islamic banks. In this, Islamic banking was established on a strong foundation. In the same decade, in 1977, Kuwaiti Muslim merchants served in this field. Together they established the Islamic Bank and named it "Bait al-Tamweel al-Kuwaiti". Kuwait is one of the richest countries. The establishment of Islamic banks in this is the cause of the development and prosperity of Muslims. The very next year, in 1978, the establishment of the "Islamic Bank of Oman" under the auspices of a capable team of Muslim economists and religious scholars proved to be the best means of the evolution of Islamic banking. The "Al Baraka Banking Group" was established in 1979 with the efforts of Mr. Abdul Rahman Al-Jawdar, President of the Jamiat-e-Islah of Bahrain. The bank currently has 700 branches in 17 countries.<sup>12</sup> In both Bahrain and Kuwait, the government has played a commendable role in promoting Islamic banking. He gave government protection to these institutions and paved the way for their development. At present, Faisal Islamic Bank Sudan and Faisal Islamic Bank Egypt are leading in terms of performance.<sup>13</sup> The 1980s are the decade of the evolution of Islamic banking. In 1983, East Asia's first Islamic bank was established in Bangladesh.<sup>14</sup> In 1992, ninety-two institutions were established for Islamic banking in Muslim and non-Muslim countries. In 2009, 1,300 Islamic banks and financial institutions were established in more than 75 countries to provide Islamic financial services.<sup>15</sup> The rapid evolutionary stages of Islamic banking can be gauged from a survey report in 2019, which found that 428 permanent Islamic banks had been established at that time and their number of branches was in the hundreds.<sup>16</sup>

## **2. Methodology**

This study tries to analyze the evolution and development of the Islamic Banking system in Pakistan and it is based upon the qualitative analysis. In this regard, this study has focused on

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different books related to the history of the Islamic Banking system, particularly regarding Pakistan. Moreover, research articles, reports, conference papers and libraries have been consulted to examine the development of the Islamic Banking system in Pakistan.

### **3. Development of Islamic Banking System in Pakistan**

Pakistan is an Islamic ideological country that has the potential to develop in various economic sectors such as economy and agriculture, industry and trade and banking. The abolition of usury and the establishment of Islamic banking are of great importance for the protection of its Islamic ideological boundaries. That is why, immediately after the formation of Pakistan, efforts were made to abolish the Islamic economy and usury. Scientific, intellectual and practical steps were taken for this.<sup>17</sup> Inaugurating the State Bank of Pakistan on July 1, 1948, Quaid-e-Azam Muhammad Jinnah made it clear that Pakistan's economic and banking system would be structured following the principles of Islam.<sup>18</sup> The constitutions of 1956, 1962 and 1973 clearly state that Pakistan's economy has become interest-free. The State Bank of Pakistan issued a circular on June 20, 1984, stating that all banking activities would be in accordance with Islamic principles.<sup>19</sup> In this regard, the role of General Zia-ul-Haq is also very important that he instructed the Islamic Ideological Council in 1977 to formulate proposals for the elimination of usury. It presented a preliminary report on the gradual elimination of interest rates from the economy in three years.<sup>20</sup> As a result, the Building Finance Corporation was cleared of interest and Islamic activities were started in it. The decision of the Supreme Court of Pakistan regarding the elimination of interest and the formation of Islamic banking is of historic significance.<sup>21</sup>

Islamic banking in Pakistan has developed to a great extent. To expand the services of these banks, their specialized branches have been set up in urban and rural areas which are diversely providing services in accordance with the complete Islamic principles. They have been issued Islamic banking licenses by the State Bank under

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the Islamic Banking Policy.<sup>22</sup> Every bank has a Shariah Board consisting of eminent scholars. This board gives instructions to the bank on basic Shariah issues and oversees them. Each bank has its point of view on the Shariah board. It is natural to find differences of opinion in certain matters and issues. In order to resolve these differences, a "Majlis al-Ma'air al-Shari'ah" has been set up which develops standards that should be applied equally to all institutions. Its office is in Bahrain and is known as the "Majlis al-Sharia". This meeting is held once every six months in Makkah and once in Madinah. This includes one member of their Shariah Board Zaka, This committee reviews the limitations of Shariah transactions of these banks. In these Shariah principles and prudent activities, Islamic banks are playing a significant role in providing sincere public services and facilities to the customers.<sup>23</sup>

**There are currently six full-fledged Islamic banks operating in Pakistan.**

"Meezan Bank Pakistan" is one of the leading Islamic banks in Pakistan. It is the largest Islamic commercial bank since its inception in 2002. The Bank's Shariah Supervisory Board is internationally renowned. Its chairman is Justice (ret'd) Maulana Mufti Muhammad Taqi Usmani. Its 571 branches are providing Islamic banking services. The bank has been one of the fastest-growing banks in the history of banking.<sup>24</sup>

The second-largest Islamic bank in Pakistan is "*Bank Islami Pakistan Limited*", the idea of which was put forward by Jahangir Siddiqui and the Randy Family, and Mr. Hassan A. Bulgrami was appointed as the sponsor's advisor. He drafted a conceptual draft and submitted it to the State Bank of Pakistan. In 2004, it was issued an Islamic banking license under the Islamic Banking Policy. His services are commendable. Mufti Irshad Ahmad Ijaz is the Chairman of its Shariah Board. Its 330 branches are operating in 114 cities of Pakistan.

The third-largest Islamic bank in Pakistan is "*Dubai Islamic Bank Pakistan Limited*". The bank is providing useful services through

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modern technology and religious traditions. It is also providing a car finance facility which is in accordance with Shariah principles. Its Chairman Dr. Mufti Hussain Hamid Hassan is a well-known personality. Launched in 2005, it has 256 branches in 68 cities across Pakistan.<sup>25</sup>

"*Al-Baraka Bank Pakistan Limited*" is one of the leading Islamic banks in Pakistan. The bank was established on October 30, 2010.<sup>26</sup>

Headquartered in Karachi, its Shariah Board is headed by Justice (retd) Khalil-ur-Rehman Khan. "*MCB Islamic Bank Limited*" is the fifth largest Islamic bank in Pakistan. The bank was established in 2015. It is a commercial bank headed by Mufti Muneeb-ur-Rehman. All these Islamic banks are providing services through certain instruments such as partnership, speculation, marabaha, lease, sale, istisna and Sukuk with certain conditions. In addition, the National Bank of Pakistan, Habib Bank Limited, Allied Bank Limited, Bank of Punjab and Bank of Khyber have also set up their own Shariah Advisory Boards and appointed their Chairman Muftis to guide the youth in accordance with Islamic principles. These banks are doing Islamic banking as well as traditional banking.

Overall, Islamic banking has performed well and gained a prominent place in the contemporary banking industry. Its popularity in the world is growing rapidly. It can be gauged from its vastness and openness all over the world. In 2009, 1,300 Islamic banks and other financial institutions were providing Islamic financial services in more than 75 countries. One billion dollars was worth of their assets. The evolution and efficiency of Islamic banks are increasing tremendously. In the third quarter of 2011, it has made a profit of about 8 billion.<sup>27</sup> According to an estimate, it is increasing at an annual rate of 15 to 20 percent. See the report of the national newspaper:

"Currently there are over 500 Islamic financial institutions with a total size of US\$ 1.2 trillion, over 250 shariah-compliant mutual funds with 300 BN funds, over 133 shariah accounting standard for Islamic financial institutions (AAOIFI)



have already been laid down more than 60 countries banking institutions out of which approximately 37 Muslim countries while 23 Non-Muslim countries including USA, UK, Canada, Switzerland, Sri Lanka, South Africa and Australia have Islamic institutions".<sup>28</sup>

The Islamic banking system is gaining popularity. Its branches are being established not only in Muslim countries but also in non-Muslim countries. The capitalists there are being influenced by its enduring rules and regulations. More than 250 Islamic banks are operating in the United States and China. The capitalists of these countries are investing in these banks. London is currently becoming a hub for Islamic finance. According to Prof. Rodney Wilson:

"The UK government is determined to create a level playing field for shariah-compliant products. There are several different structures for Islamic home finance in the UK. Although the UK has the most active and developed Islamic banking sector in the European Union".<sup>29</sup>

Despite this, Islamic banking is still on the path of development. Given its current performance and natural beauty, it can be estimated that there are clear and bright prospects for its development. This will require economic planning and appropriate changes in the structure and procedures of the business.

#### **4. Conclusion**

The bottom line is that the world economy is currently run by banks. It is through them that the formation of international trade, the promotion of industrial and productive activities, investment opportunities, the protection of savings and receivables are carried out. Against the backdrop of the inevitability of this need and the importance of banks, Muslim economists have introduced Islamic banking in line with the traditional Shari'a rules and regulations of traditional banking and accordance with the spirit of Islam. It has undergone rapid evolution due to its equitable approach and sound economic planning. It has a unique status due to its natural beauty.

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It has a prominent place in the banking industry. Islamic banking is not only flourishing in Muslim countries but also in many non-Muslim countries according to Islamic principles. Many complete Islamic banks have been established in various non-Muslim countries. Based on this evidence, it can be said that the Islamic banking network has engulfed the entire world. Its future is very bright and bright. To raise public awareness and confidence in these banks, their evolutionary stages have been described to pave the way for their utilization.

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