

Chapter VII

CONCLUSIONS

The purpose of our study was basically two-fold. Firstly, to evaluate if the process of Islamization of Banking in Pakistan, i.e. elimination of *riba* was initiated with proper planning and secondly, to assess implications of prohibiting interest from the economy.

The basic moral principles and normative values of Islam are contained in the Holy Quran and the teaching of Prophet Muhammad (PBUH). It is therefore essential for a true Muslim to believe fully in the principles and values of the Holy Quran. The criterion, therefore, by which an economic system claiming to be Islamic can be measured is the extent to which Islamic principles are followed by that society.

The basic economic guiding principle of Islam is based on the axiom of *Al-Adl* and hence any economic activity which may digress from the principle of justice would not qualify to be consistent with Islamic values.

In the Quran, '*riba*' has been prohibited. Although there is still some

controversy about the definition of '*riba*' nevertheless there is complete unanimity amongst Muslim scholars that interest in all forms and types is '*riba*' and as such prohibited as falling in purview of '*riba-al-Nasi'ah*'. The concept of *Riba al-fadl* is equally pertinent in the issue as it encompasses the concept of 'just exchange'.

The broad condemnation of *riba* in the Quran basically stems from exploitative and unjust characteristic of *riba*. It can clearly be inferred that *riba* takes place in transaction/dealings, wherever a person or a group of people take undue advantage/benefit from other person/group of people due to latter's inferior economic or social status, thereby giving rise to injustice and exploitation which is in itself inconsistent with the Divine Law of Adl. This broad and pertinent definition of *riba* is very essential to comprehend in its true spirit in order to evolve an economic system which is free from injustice and exploitation and is based on the guidelines given by the Quran and the Sunnah.

After the decline of the Islamic state, the decadence of moral values and spread of Western influence in the period of Colonial domination of Muslim countries by Western powers, the practice of Islam became a private and personal affair. However, due to the resurgence throughout the Muslim world, serious attention was given to the social, political and

economic dimensions of the Islamic system and consequently specialised works started to appear in the fourth decade of this century.

The process of Islamization of the financial system in Pakistan was initiated in 1979. Chapter III of this thesis extensively deals with the admissible (Islamic) modes of financing in Pakistan. It has been evidenced that since the introduction of Non-interest Banking system in Pakistan there has hardly been any progress in the sphere of Islamization of banking. Almost entire commercial banking operations are conducted on the basis of mark-up which is not only objected to by *Shariah*, the Federal Shariat Court has also declared the markup system in vogue as un-Islamic in its judgement on interest (*Riba*).

It is a matter of interest to note that the policy makers did not fully envisage the complexities of the matter. Revolutionary changes require extraordinary efforts and measure at all levels and a complete support from all. Appropriate and just expenditure policies, effective and efficient judicial system are some of the prerequisites for the implementation of Islamic banking.

The model, however, presented in the study under the Keynesian framework, by substituting the fixed interest rate by variable rate of return

proves under certain conditions that the variable return system which is in principle consistent with *Shariah* is not only feasible but also stable. There is a direct link between the capital/money market with real sector, and as such the remuneration to capital would be related to the productivity of its use in the real sector which essentially negates the exploitative character of lending. The model also suggests that the system is more sustainable to economic shocks and market failures.

These results verify our hypothesis that the process of Islamization of Banking in Pakistan was not initiated with any proper planning, even though Islamic banking system devoid of interest (fixed and pre-determined rate of return) may well be operational and yielding.

Although concerns have been expressed that the adoption of an Islamic banking system may lead to a reduction of saving and restrained financial intermediation, it is, however, basically an empirical question, and no conclusive judgement on theoretical consideration can be given. Problem of risk aversion is bound to come up, but essentially diversification of lending portfolio would not only impede fluctuations in the rate of return but would also increase investments. It is asserted that once the system is fully operational with pre-requisites as discussed above, the resultant institutional changes based on equity participation

would have desirable and just economic consequences.

The faith of Muslims on the fact that all that is in the earth and Heavens belongs to Allah, the concept of risk aversion is thus somewhat negated. Risk is to be taken to earn a yield in a calculated manner, i.e. "no risk" on one hand and excessive risk on the other are the boundaries between which calculated risk is to be assumed. No risk in form of fixed interest and uncalculated, excessive risk falling under the domain of speculation is not allowed in Islam.

Assuming the fact that the Islamic Banking system is operative and feasible, it then becomes a policy matter envisaging total reformation of the prevailing system in terms of *Shariah*. The main aspects to look into would be institutional changes governing the legal framework, training of banking staff, appropriate expenditure policies, tax rationalisation and large fiscal deficits.

Although it is not the subject matter of this study to elaborate upon all the unresolved issues regarding equity based financial system, however, an overview, subject to further research and evaluation is attempted here. In fact the uncertainty surrounding the real yield on investment would be dependent not only on productivity of the real sector but also

inflation rate. If the productivity of the real sector is high as compared to inflation rate the savers would be rewarded in real sense. Since the banks operating upon equity financing basis will diversify their lending portfolios and direct their resources to more productive and profitable investment opportunities in order to ensure higher average rate of return, in all probability the savers would be rewarded in real sense.

Lending on equity based principle would not only require constant vigilance by the banks but also professional staff which would imply higher administrative costs. However, effective and efficient judicial system, honesty and a general high degree of morality, which serve as some of the determining prerequisites of the Islamic system would definitely increase the yield of real sector and consequently the rate of return.

Another very pertinent issue¹¹ relates to short term funding and placements with the banks. The remuneration to savers, and calculation and computation of profit and loss in cases of short term financing needs to be looked into with greater understanding to evolve a system which is consistent to *Shariah*. One answer would be to use accurate and sophisticated accounting system based up on quarterly/half yearly basis.

In order to ensure that transaction between Islamic countries and non-Islamic countries are in conformity with Islamic principles, Interest earnings are to be dealt through special accounts, different from bank's general account.

What is basically required is a total commitment to the cause which is in complete consistency with the Divine Law. It is the faith of a Muslim that what ever is ordained by Allah is for the betterment of mankind and hence there is no room for any reservations to the fact that economic system devoid of interest is not feasible and yielding, if it is implemented with complete honesty and dedication.

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