Chapter 4
Islamic Banking in Pakistan: Emergence, Growth, and Prospects

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ABSTRACT

Since 1960, after a trial of almost 40 years, the reformation of economy of Pakistan from conventional to Islamic could not be achieved. Since 2000, the government changed the strategy to gradually Islamize the economy and adopted a dual system. In this ambit, the State Bank of Pakistan deliberately announced the vision to make the Islamic banking as first choice for users of banking in Pakistan. This chapter bring insights on the background, current state, issues, challenges, and avenues of future policy regarding Islamic banking of Pakistan. The empirical data about Islamic Banking has been collected from the State Bank of Pakistan for the period 2003-2018. This is to evaluate the current state in terms of market performance, modes of Islamic financing, and financing portfolios of Islamic banking. The findings of this chapter show there is a substantial lack of interest by the government to develop the Islamic banking, and Islamic banking is also deviating from its social and ethical proclaims.

1. INTRODUCTION

Islamic banking is considered as a new wave of corporations, whose social goals are as much important as making profits (Haniffa & Hudaib, 2007; Zafar & Sulaiman, 2019). The word Islamic fore mentioned, reflects the real economic activity, social and economic development (Platonova, 2013) and it is an institution having ideology of social welfare and well-being in build (Cebeci, 2012). The social preference and responsibility are regarded as the utmost objective of Islamic banking, regardless of financial consequences, positive or negative (Dusuki, 2008; Dusuki & Abdullah, 2007). This is a real model of
banking in modern economy for developing, poor and deprived countries. Pakistan has also a developing economy, having issues of governance, poverty, social and economic developments (Husain, 2018; Zaidi, 2005).

Besides the social and economic significance of Islamic economics, finance and banking for an emerging and developing economy, Pakistan is a country whose constitution also insists on the Islamic social and economic structure (Islamic Research Institute, 2009). Therefore, the government of Pakistan since its foundation, continuously tried to bring the reformations in the economic system, so to make it Shari‘ah compliant under the state theory. Initially, the government started to bring reformations as a whole, and also declined to be part of dual economy or banking in early 1970’s of Islamic banking evolution in the world (Iqbal & Molyneux, 2005, p. 64). But since 1960, after a trial of almost forty-years, the government has badly failed in its strategy (Khan & Bhatti, 2008).

Since year 2000, the government adopted the different strategy, that to bring reformations in the economic system of Pakistan gradually, while explicitly allowing the conventional sector to work along (Saba, 2017). In year 2002, the State Bank of Pakistan issued the first Islamic banking license to the Meezan Bank and captioned the vision, to make the Islamic banking as the first choice for users in Pakistan (State Bank of Pakistan, 2007b). After completion of one-and-a-half decade by Islamic banking in Pakistan, it has overall 13.5% share in banking sector in terms of assets and 15.5% in terms of deposits, with 2851 branches in all around the country (State Bank of Pakistan, 2018a). In addition, State Bank of Pakistan envisioned to increase the share of Islamic banking up to 20% by 2020 (State Bank of Pakistan, 2014b). The rate of growth of Islamic banking is very slow in contrast of vision to transform the economy. In the light of current progress of the Islamic banking and strategic envisioning of government of Pakistan, it will require an entire century to completely transform the economic system. There is a need to study the background and current-state of Islamic banking, point out the issues and challenges, and suggest the avenues of future policy for prompt growth. This chapter therefore intends to do so.

2. BACKGROUND OF ISLAMIC BANKING IN PAKISTAN

The background of Islamic banking in Pakistan has three main phases (Table 1), first, the political motives behind the foundation of Pakistan, secondly, the role of government in transformation of economic structure into Islamic during year 1960 to 2000, and third phase involves, the government strategy after year 2000, that to move both sectors parallel, conventional and Islamic.

The history of development of Islamic economic structure in Pakistan can be traced in the political movement behind foundation of Pakistan, which carried the ideology of a state where the Muslims can enjoy their lives under the Islamic principles. In 1948, Muhammad Ali Jinnah, the founder and Governor General of Pakistan inaugurated the State Bank of Pakistan and said:

_I shall watch with keenness the work of your research organization in evolving banking practices compatible with Islamic idea of social and economic life._

Moreover, the Objective Resolution which is considered as backbone of the constitution of Pakistan was passed on March 12, 1949 by the National Assembly of Pakistan, also elicited the political motive of the country as:
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