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Title: **Federal Shariat Court's Judgment on Ribā-Free Economy of Pakistan: Challenges in Implementation and the Way Forward**

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Federal *Shariat* Court's Judgment on *Ribā*-Free Economy of Pakistan: Challenges in Implementation and the Way Forward

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Abstract

This paper explores the challenges in implementing the Federal *Shariat* Court (FSC) judgment on the *Ribā*-free economy of Pakistan. This study employs the Qualitative Content Analysis (QCA) method to analyze the data gathered through semi-structured interviews with various stakeholders, including *Shariah* scholars, Islamic economics and finance researchers, Islamic bankers, and central bankers. The findings suggest that the conversion of the existing large public sector debt (higher than the current GDP of Pakistan) to *Shariah*-compliant modes of financing is the most significant challenge ahead of Pakistan's government. The next potential challenge to the government is what it would do in case international donors (IMF, World Bank, Paris Club) do not lend money through Islamic modes of financing. Moreover, monetary policy management by the State Bank of Pakistan (SBP) in the Islamic banking system also remains a challenge. All these challenges can be addressed if the Pakistani government issues *Sukūk* instead of issuing T-Bills more frequently and in large quantums. Additionally, the government can get funding through the capital market. An alternative strategy might be to issue project-linked, equity *Sukūk* that generate new assets, rather than using existing assets to issue *Sukūk*. The findings may help the Government of Pakistan in the smooth transition of its current economy to a *Ribā*-free economy. Once Pakistan's economy is completely Islamized, then other *Muslim* countries may follow Pakistan in transitioning their economies as well. To the best of the authors' knowledge, this study is the first of its kind, which has identified the main challenges that may arise in implementing the FSC judgment. Moreover, few suggestions have been made to address such challenges.

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Keywords**:** Islamic banking, Islamic modes of financing, Islamic money and capital markets, monetary policy management, public sector debt, *Ribā*-free economy, *Sukūk*

Introduction

Even though Islamic banking is considered as the most prominent implementation of Islamic economics in modern times (Kuran, 2004), its idea predates the 20th century (Islahi, 2015). The origin of Islamic banking can be traced back to the early Islamic history and the nature of lending, borrowing, and financing of commercial activities in that period. Since the pre-Islamic age, the city of Makkah where Islam was revealed to Prophet Muhammad (SAW) has been an international commercial center (Watt, 1953). The Makkans may have established a global trade empire (Crone, 1987). They were primarily involved in trading and required financing for their commercial needs. Those with extra cash may have lent money to entrepreneurs and split the profits. Before prophethood, Prophet Muhammad (SAW) was actively engaged in trade and frequently traveled and traded with the financial capital of Khadijah (RA), who provided him with financing on a *Mudārabah* basis (Islahi, 2018). It should be noted that there were other forms of funding available for businesses in the early days of Islam besides *Mudārabah*, such as *Murābahah*, *Mushārakah*, *Salam*, and others (Saeed & Mulhim, 2016).

Sayyid Umar Qadiri, a religious and mystical figure from Hyderabad Deccan, formed an interest-free lending cooperative society in 1891. Its name was Muaiyidul-Ikhwan Society [1] (Hameedullah, 1948) and it remained operative until the middle of the 20th century (Islahi, 2018). In the Arab world, however, Ahmad al-Najjar founded the first Islamic bank in Egypt in 1963 under the name Mit Ghamr Saving House. The bank was named after the village of Mit Ghamr, where it was situated. It mainly served the rural population. It functioned on a profit and loss sharing (PLS) basis. Although it was a successful endeavor, it was ultimately liquidated in 1967 because of political motives (Kahf, 2004). Tabung Haji, the Malaysian-based venture in Islamic banking and finance, was established in 1963 to enable Muslims to make interest-free deposits and investments to meet their expenses associated with the Hajj pilgrimage to Makkah.

[1] Society for helping brothers.

Additionally, Tabung Haji assisted those traveling to Makkah for the pilgrimage (Laldin, 2008).

According to Al-Tamimi and Al-Amiri (2003), the first modern Islamic bank established in the private sector was Dubai Islamic Bank, established in 1975. The Islamic Development Bank (IDB), founded in 1975 to serve as an international financial institution, marked a crucial turning point in the history of Islamic banking. Afterwards, other Islamic banks, particularly in the Gulf region, began to operate, such as Kuwait Finance House (1977) and Bahrain Islamic Bank (1979). In the 1980s, following the announcements of Islamizing their economies by Pakistan, Sudan, and Iran, Islamic banking began to flourish globally (Islahi, 2018).

Pakistan was the first country to take practical steps toward materializing the idea of a *Ribā*-free economy (Mehmood, 2002; Mansoori & Ayub, 2022). On July 5, 1977, General Zia-ul-Haq seized control in Pakistan following political unrest. He initiated a thorough scheme to Islamize Pakistani society in the areas of politics, legislation, economics, and education. With the stated intention of converting Pakistan's economy into an Islamic economic system, ordinances and laws on *Zakat* (poor-due), *Ushr* (Islamic land tax), eliminating *Ribā* (interest), PLS scheme, *Mudārabah* (partnership), and twelve other modes of Islamic financing were promulgated (Haque & Gardezi, 1991). After extensive research and planning by the government-appointed Council of Islamic Ideology (CII), the gradual process of implementing Islamic banking in Pakistan started in February 1979 (Khan & Mirakhor, 1990). In one of its reports, CII proposed that from July 1, 1985, all domestic financial transactions conducted by banks and non-banking financial institutions be executed on an interest-free basis (Council of Islamic Ideology [CII], 1980).

The State Bank of Pakistan (SBP) introduced non-interest banking (NIB) in Pakistan, which was later declared unIslamic by the Federal *Shariat* Court (FSC) due to its non-*Shariah*-compliant nature on November 14, 1991. FSC found that NIB was primarily based on *Bay al-Īnah* (buy-back sale) and the sale/purchase of debts and receivables. The court ordered that the entire system needed to be Islamized in letter and spirit by the end of June 1992 (Mansoori & Ayub, 2022). The government and some conventional banks petitioned against the FSC judgment in the *Shariat* Appellate Bench (SAB) of the Supreme Court of Pakistan (SCP). After detailed hearings, SAB dismissed the appeal on December 23, 1999 and declared that the *Ribā* (interest) laws cease effect on June 30, 2001. Initially, the government was granted a one-year extension in implementing the judgment. Later on, the government filed a review petition in SAB, which was earlier allegedly reconstituted. The SAB ordered the FSC in June 2002 to rehear the *Ribā* case (Ghafoor, 2022).

The case remained pending in FSC for almost two decades until April 28, 2022, when it was decided that different types of interests on loans and debts all come under the definition of the Quranic term *Ribā*. FSC ruled that the government must replace the laws that were deemed unlawful because of the involvement of *Ribā* with the necessary legislative revisions by December 31, 2022. Moreover, it is required by the FSC to eliminate interest gradually until the end of 2027 (Mansoori & Ayub, 2022). Miftah Ismail, ex-minister of finance of the current administration, responded to the ruling by praising it in a tweet (Ismail, 2022). On June 25, 2022, SBP and some commercial banks filed an appeal before SAB against the FSC judgment on *Ribā*, requesting clarification on several issues and challenges related to the judgment's timely implementation (Ghafoor, 2022). It is pertinent to note that the government has now withdrawn its appeal, although other petitioners have not yet withdrawn their appeals made before SAB.

Shariah scholars who reviewed the FSC judgment have indicated some discrepancies, such as neglecting the deferred exchange of two currencies of different countries, which might open the door to currency futures contracts and currency *Salam*. The Islamic *Fiqh* Academy, Jeddah and the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), Bahrain categorically forbid both. *Shariah* scholars have additionally emphasized that the judgment did not resolve issues concerning inflation and indexation of loans and also did not discuss non-banking financial transactions (Mansoori & Ayub, 2022).

The primary aim of this research is to investigate the challenges the Government of Pakistan would encounter in implementing the FSC's judgment. It also aims to give recommendations to make the economy *Ribā*-free. In addition to the main aims, the research has the following four sub-objectives:

a) To investigate the issues and challenges confronting Pakistan's economy,

b) To explore how effectively these issues can be resolved in a *Ribā*-free economy,

c) To inquire into the possibility of expanding the *Ribā*-free economy into a globalized world economy, and

d) To propose practical steps, policy recommendations, and effective strategies for implementing the FSC's judgment in letter and spirit.

The rest of the paper is organized as follows. Section 2 reviews the available literature, Section 3 discusses the methodology, Section 4 makes a qualitative content analysis of the data and discusses the findings, and finally, Section 5 concludes the paper.

Literature Review

Issues and Challenges for Pakistan's Economy

Pakistan has been among the few developing nations that experienced average growth of more than 5% over the four decades ending in 1988-1989. Thus, by the end of the 1980s, the number of people living in poverty in Pakistan decreased from 40% to 18% (Husain, 2004). However, the country is currently experiencing one of the worst economic crisis in its history as a consequence of a balance-of-payments crisis, which compelled Islamabad to turn to multilateral lenders and so-called "friendly" countries, such as China, Saudi Arabia, the United Arab Emirates, and Qatar for dollars to avoid defaulting. Currently, Pakistan is struggling with a substantial current account deficit, the world's fastest-rising inflation rate, and a weakening currency as its foreign exchange reserves drop to under $8 billion, which is approximately 1.5 months' worth of imports ("Structural Problems", 2022). The newspaper went on to explain that although friendly nations have pledged to invest in the country's economy; still, this would not help dealing with either the structural issues it is currently experiencing or its ongoing failure to make enough money through exports to pay its import bills. It concluded that even though borrowing money might provide Pakistan with short-term relief, the nation must still deal with system-wide structural issues affecting its economy by boosting domestic production and exports, enticing FDI to reduce the debt burden, resolving balance-of-payment challenges, and setting the economy on a sustainable, accelerated growth rate. It is generally accepted that Pakistan's political elites are the country's main problem. Sadly, they do not have an excellent track record of implementing long-term economic and political reforms. If the past administration's economic experimentation showed anything, it is that quick fixes are of no use. To free the economy from the low-growth trap it is currently caught in, tough decisions must be made ("Economic Challenges", 2022).

Azam and Shafique (2017) discussed that Pakistan's economy is based primarily on agriculture. Nonetheless, the agricultural sector faces multiple challenges that harm the country's economy, including water shortage, poor management, and natural disasters. Their research indicated that Pakistan's economic growth fluctuates and is expected to slow down due to agricultural problems. In addition, these instabilities also slow down the total factor of production. In a recent report titled "Asian Development Review," the Asian Development Bank (ADB) claimed that the country's recent inability to produce enough wheat to meet local demand from a rapidly growing population has led to price increases, while the import of wheat puts pressure on the nation's foreign exchange reserves (Amin, 2022a). Furthermore, the World Bank's most recent report on food security indicates that Pakistan's recent flooding has worsened the country's already severe food insecurity (Amin, 2022b). Hence, rising food insecurity is another issue facing its economy.

Another issue in Pakistan is human development. The country is now ranked 161 out of 189 countries in terms of the Human Development Index (HDI). The nation's HDI ranking is the lowest among South Asian nations, even below Bangladesh and Nepal, and falls into the least developed nations category. What explains Pakistan's poor HDI score? HDI has three equal components, namely per capita income, health, and education. Life expectancy and the adult population's average years spent in school serve as health and education indicators. According to the latest UNDP figures, the country has a per capita income of $4,624, a life expectancy of 66.1 years, and an average of 4.5 years of adult schooling. It is highly concerning that Pakistan's perceptions, including those of foreign investors, may be negatively impacted by a poor HDI ranking (Pasha, 2022).

Pakistan's economy is also challenged by youth unemployment. According to the most recent Labor Force Survey (LFS) 2018-2019, the country's unemployment rate is 6.9%. Although these statistics may not seem very high, there is plenty to discuss behind the numbers. According to LFS, unemployment is the highest among people aged 15-29, indicating a shortage of entry-level jobs and the difficulties in obtaining them.

Furthermore, 78.5% of the unemployed are literate and 21.5% have had no formal education. This ratio shows that educated youth are more likely to have trouble finding employment (Nizamani, 2021). The authore went on to say that there are other methods for the government to assist young people besides providing them with non-functional posts in the civil service, such as skill mapping and counseling, the same as in Denmark. When Danes lose their jobs, they find new ones more quickly than everyone else. Danes receive 80% of their prior salaries six months after losing their jobs. Theoretically, high welfare states should lead to inefficient labor markets, which is not the case for Denmark. Pakistan is capable of doing the same. Since 64% of the nation's population is under 30 according to the 2017 census, while 29% of the population falls between the ages of 15 and 29, policymakers must create ideal conditions for the youth to compete in the future job market (Akhtar & Zia, 2022). The authors further maintained that Pakistan has a skills-technology gap, which may be filled in any of the two following ways: (i) by improving education to keep up with the needs of new technologies or (ii) by redirecting innovation to keep up with the skills of the present and future labor force.

Power shortages of differing extents regularly occur in various parts of Pakistan because of the country's inability to meet the power demand. Geographically, Pakistan is fortunate to have river flows that are helpful to the generation of electricity. The government has tried to expedite hydropower development through several policy initiatives but these efforts have failed. This is despite hydropower's enormous potential and inherent qualities which may help to promote the nation's energy security and flexibility in system operation. The nation's sustainable development is in danger due to the lack of power (Bhutto et al., 2012). Furthermore, its economy is negatively impacted by electricity load shedding, especially in the export sector, which depends on an uninterrupted electricity supply to keep machines working and deliver export orders on time ("SAI Calls", 2022).

The substantial risk of money laundering and terror financing gravely threatens the nation's socioeconomic well-being. Even though Pakistan complies with 38 out of 40 technical recommendations, Kiani (2022) reported that the Asia-Pacific Group on Money Laundering gave Pakistan a "low" effectiveness rating for 10 out of 11 international goals related to combating money laundering and terror financing. According to Zia et al.

(2021), the situation necessitates reforming unsatisfactory regulations and ineffective coordination, adopting new counter-strategies and technological advancements, and adequately training law enforcement personnel.

The massive and steadily rising debt, which is in no way sustainable, is the main challenge the country's economy is currently confronting. By the end of June 2021, Pakistan's overall debt and liabilities were Rs 47.8 trillion (100.3% of GDP) (Ghafoor, 2022). The SBP Amendment Act 2021 presents the administration with yet another challenge. The harshest amendment is found in Section 9 subsection C, which reads as follows: "The Bank shall not extend any direct credits to or guarantee any obligations of the government or any government-owned entity or any other public entity." The day-to-day affairs of the government have become too challenging due to this amendment (Aazim, 2022). The banks profit at the expense of the general public when SBP lends to banks that lend to the government during a market liquidity crisis. In order to pay off the enormously large debt, the public is also compelled to pay the cost of debt at ever-higher tax rates. The SBP Amendment Act 2021 emphasizes that price stability is the SBP's main objective, even though no specific inflation target has been established for it that may relieve the central bank of its duty to ensure economic growth. Furthermore, the central bank's secondary objective is to maintain financial stability, while its tertiary duties include to support development policies and optimal resource usage. The central bank is completely free to choose and implement monetary and exchange rate policies due to the revisions to the law, which abolish the finance ministry's engagement in those decisions ("State Bank's Role", 2022).

Islamization of Pakistan's Economy

Asad (2014) claimed that the Government of Pakistan (GOP) ordered him to establish and direct a Department of Islamic Reconstruction (DIR) when Pakistan was created in 1947. The aim was to build the conceptual Islamic foundations of statehood and community that the new political system might benefit from. He spent almost two years working there. The fact that DIR was established at the outset of the country's existence shows that the government was aware of its responsibility to establish a socioeconomic order in line with Islamic teachings. The Objectives Resolution, which also reveals the government's consciousness in this regard, is a declaration of intent on which the future constitution was to be founded. It was presented to the constituent assembly on March 7, 1949.

According to the Objectives Resolution, Allah (SWT) holds sovereignty over the entire universe and Pakistan's citizens, as a sacred trust, exercise their authority only within the boundaries established by Him. The resolution states that Muslims should be free to live their lives in accordance with the teachings and precepts of Islam as revealed in the Holy Quran and Sunnah. The Objectives Resolution is incorporated in the Preamble of Pakistan's three constitutions (1956, 1962, and 1973), making it a significant document in the country's constitutional history. However, in 1985, it was made a substantive portion of the constitution (Mehmood, 2002).

Muhammad Ali Jinnah, the founder of Pakistan, expressed the same viewpoint. In his remarks at the SBP's inaugural ceremony on July 1, 1948, he emphasized the need for the SBP to promote banking practices compatible with the Islamic conceptions of socioeconomic life. He further explained that Adopting western economic theory and practice will not help us achieve our goal of creating a happy and contended people. We must work our destiny in our way and present to the world an economic system based on the true Islamic concept of equality of manhood and social justice (State Bank of Pakistan [SBP], 1948). In his speech at the First All Pakistan Economic Conference in Lahore on April 28, 1949, Mr. Zahid Hussain, the first governor of SBP, reaffirmed that Islam is against the interest, all forms of speculation and all concentrations of wealth and power, all of which are basic features of present-day social and economic order (Janjua, 2003).

Several articles in the 1973 constitution directly drive the Islamization of Pakistan's economy. According to Article 2, "Islam shall be the State religion of Pakistan." While, Article 38 states,

> The State shall--(a) secure the well-being of the people, […], by raising their standard of living, by preventing the concentration of wealth and means of production and distribution in the hands of a few […] and by ensuring equitable adjustment of rights between employers and employees, and landlords and tenants; […] (e) reduce disparity in the income and earnings of individuals, […]; (f) eliminate Ribā as early as possible.

Similarly, Article 227, section (1) states, "All existing laws shall be brought in conformity with the Injunctions of Islam as laid down in the Holy

Quran and Sunnah, […], and no law shall be enacted which is repugnant to such Injunctions".

In its report on the elimination of *Ribā*, the Council of Islamic Ideology (CII) observed that during Pakistan's first thirty years of existence, the issue of eliminating *Ribā* from the economy could not receive the attention it deserved, with the exception of the constitution's inclusion of certain important Islamic provisions (CII, 1980). Eventually, in response to a political crisis in Pakistan in 1977, General Zia-ul-Haq seized power. He attempted to Islamize the banking system in order to restructure Pakistan's economic system. He advocated the elimination of *Ribā*, mandated the collection of *Zakat* from Sunni Muslims against their bank accounts, developed a profit-loss sharing (PLS) system in banks, imposed *Ushr*, and founded several institutions to study Islamic economics (Kennedy, 1990).

The following two precepts of Islamic economics serve as the foundation for the Islamization of the economy. Firstly, Islam offers an economic system in addition to being a religion. Secondly, Islamic economics is distinct from the contemporary secular science of economics since it is founded on Islamic religious principles, values, and traditions (Ahmad, 1981). In February 1979, Pakistan's economy started becoming Islamic, gradually. The House Building Finance Corporation Ordinance 1979 laid out the guidelines for changing the corporation's activities to *Shariah*-compliant ones. By this ordinance, rent-sharing-based housing finance was to be made available and the customer was to pay the corporation's estimated rents for a maximum of 15 years. The National Investment Trust stopped investing in securities with fixed rates of return in July 1979. Previously, it had combined bond and stock portfolios. In October 1980, the Investment Corporation of Pakistan, which aims to increase the private sector's equity base and promotes the growth of capital markets, changed its assets and liabilities into PLS-based modes. Importantly, all of the main specialized credit institutions in Pakistan switched to PLS-based financing by 1981 (Khan & Mirakhor, 1990).

However, getting rid of *Ribā* from commercial banks has proved to be challenging and complicated. On June 20, 1984, the SBP ordered the commercial banks to gradually convert their whole banking system to Islamic financing modes over the course of the following fiscal year. Additionally, effective from July 1, 1985, the SBP instructed all banks to stop taking interest-bearing deposits. According to the SBP's circular, Islamic modes of financing are the following: (i) interest-free loans, however, banks may take service charges; (ii) *Qard-e-Hasanah* loans, free of interest and service charges; (iii) purchase of goods by banks and their sale to clients with a mark-up in price on a deferred payment basis (*Murābahah* financing); (iv) purchase of trade bills; (v) purchase of property by the bank from clients with a buy-back agreement; (vi) leasing (*Ijārah* financing); (vii) hire-purchase; (viii) financing for the development of property based on a development charge; (ix) *Mushārakah* or profit-loss sharing; (x) equity participation and purchase of shares; (xi) purchase of *Mudārabah* based certificates, and (xii) rent-sharing (State Bank of Pakistan [SBP], 1984).

Nonetheless, SBP issued 23 circulars between June 1984 and July 1985 to eliminate interest from the economy. Discrepancies still existed though, and the government could not make any significant changes in the actual practice. On June 15, 1988, General Muhammad Zia-ul-Haq, President of Pakistan, made another step toward Islamization by promulgating the *Shariat* Ordinance, 1988. By the requirements of this ordinance, the President established a "Permanent Commission for the Islamization of Economy." Despite the commission's nearly eight-month labor and some of its accomplished work, its interim report is nowhere to be seen (Mehmood, 2002).

A law known as "the Enforcement of *Shariah* Act, 1991" was enacted while upholding the conceptual commitment to the Islamization process. According to this law, the state must ensure that Pakistan's economic system is founded upon Islamic economic objectives, fundamentals, and aspirations. The Commission for the Islamization of the Economy (CIE) was established in compliance with this law. One of the functions of the Commission was to "oversee the process of elimination of *Ribā* from every sphere of economic activity in the shortest possible time and also recommend such measures to the government as would ensure the total elimination of *Ribā* from the economy." The FSC now gained the opportunity to review the fiscal laws because of this law. It received several *Shariat* petitions questioning various fiscal laws involving interest-related clauses. Beginning on December 11, 1990, the hearings of these petitions continued as scheduled until October 24, 1991. The FSC ruled on November 14, 1991 following the hearing and ruled that the twenty-three financial laws under question were un-Islamic.

Furthermore, the FSC declared that the Non-Interest Based Banking (NIB) system did not adhere to the *Shariah*. FSC determined that NIB was primarily based on Bay al-Inah (buy-back sales) and the sale/purchase of debt and receivables and ordered that the entire system be Islamized in the truest sense by the end of June 1992 (Faisal v. Govt. of Pakistan, 1992). Numerous appeals were filed with the SAB of the Supreme Court against the FSC's ruling. The Court did not hear these appeals until 1999 for various reasons. The SAB endorsed the FSC's ruling in a revolutionary verdict on December 23, 1999 and ordered that the regulations governing interest would no longer be in effect on June 30, 2001.

It is important to note that the Supreme Court presented a thorough plan to change the banking and financial system into one that complies with the *Shariah*. The government requested a legal, financial, and economic framework that would serve as the foundation for removing interest from the banking and financial systems. The court addressed the following four aspects of the economy: the banking and financial sector, the stock market, the debt/bond market, and government borrowing and lending, in addition to ordering the removal of interest from different legislations. The court may have anticipated how its decision would affect the entire economy and intended to lay out the fundamental principles that the government should adhere to as it works towards completely transforming the economy (Mehmood, 2002).

The Government of Pakistan undertook numerous executive measures while implementing the court's ruling. It constituted an empowered the Commission for the Transformation of Financial System (CTFS) on January 23, 2000 in the SBP headed by Mr. I. A. Hanfi. In October 2000, CTFS delivered its First Interim Report to the government, outlining a number of steps necessary to provide the foundation for reforming the financial sector. The primary *Shariah*-compliant financing modes, the *Shariah* standards for each mode, the specimen agreements for different financing modes, and guidelines for converting the banks' and financial institutions' products and services were all listed in the Second Interim Report submitted in May 2001. The commission's final recommendations on all issues were formed by combining the two interim reports (Mehmood, 2002).

On January 22, 2000, a second task force headed by Dr. Mahmood Ahmad Ghazi was established. The following draft laws were put forward by the task force to CTFS on March 3, 2000: (i) A draft ordinance to repeal the Interest Act of 1839; (ii) A draft ordinance to further amend the Banking Companies Ordinance of 1962; (iii) and Five draft ordinances to bring the laws governing money lenders into compliance with Islamic tenets. On May 27, 2000, several revisions to the House Building Finance Corporation Act 1952 were put forth in response to the corporation's needs after it had also been reviewed. The task force also considered changes to other laws, although the "Prohibition of *Ribā* Ordinance" remained its main concern. Together with CTFS, this proposed law was discussed. On May 23, 2001, the final draft of the "Prohibition of *Ribā* Ordinance" was delivered to the ministers of both law and finance (Mehmood, 2002).

Another task force was formed in the Ministry of Financeto transform domestic borrowings into project-related financing and to create a mutual fund that would financially assist the government while complying with the *Shariah*. The task force finished the report in about two years and submitted it on June 3, 2002. The task was divided into two segments: (i) dealing with the current domestic debt burden and repaying responsibilities in light of the transition to Islamic financing and (ii) exploring workable *Shariah*-compliant financing modes for future borrowing by the government. The task force concluded its report with the following words:

> The Task Force, after carefully considering a series of financial data of the Government, the available assets, and their remunerative capacity, has concluded that the outstanding government debt cannot be securitized against the pool of the existing assets and a mutual fund based thereon. The Privatization program, one of the possible ways of reducing the debt burden, is another complication in the process. It further complicates the possibility of converting GOP borrowing into Islamic modes of financing. ...It is emphasized that none of the possible modes of financing under Shariah covers the emergencies of the kind faced by the Government presently where it may have perforce to meet a shortfall in revenues through [the] conventional system of borrowings. ...Regarding inter-government borrowing, the Federal Government cannot afford to convert them into interest-free loans and shift the burden of debt servicing onto its strained resources. Finally, the Task Force believes that if the Government could balance its privatization program to retain a minority share in the profitable or potentially

> profitable PSEs, an Islamic Instrument (I-Bill) could be developed to provide an avenue for the Islamic Bank to invest in Government securities/T-Bills, etc. (Mehmood, 2002, p. 695)

Meanwhile, in December 2001, an extensive set of criteria for establishing Islamic commercial banks in the private sector was set forth. Meezan Bank started its business as a full-fledged Islamic Bank on March 20, 2002. Conventional banks were also allowed to set up Islamic banking subsidiaries. A new Islamic Banking Division was established in the Banking Policy Department of the SBP to regulate and promote Islamic banking. However, in 2000, United Bank Limited (UBL) filed a review petition in the Supreme Court against the *Ribā* Judgment. It contended that the judgment in its present form could not be enforced and that the court went beyond its jurisdiction in the ruling. The petition was submitted along with an application for an interim injunction. The applicant asked the court to (a) halt the execution of the judgment, (b) extend the deadline until at least December 31, 2002, and (c) retain the status quo about the operation of all procedural and operative laws and permit all of the aforementioned laws to remain in effect. On June 14, 2001, the court decided the application and extended the deadline to June 30, 2002. The government was asked to act promptly to implement the ruling. On June 24, 2002, the court decided on the UBL review petition. The court accomplished two things with this decision, that is, it revoked its prior *Ribā* judgment, and it returned the cases to FSC for further consideration.

Almost twenty years passed while the matter remained pending before FSC. Then, it was decided by FSC on April 28, 2022 that all interests on loans and debts (whether for business, production-related, or personal purposes) are included in the definition of *Ribā*. FSC ordered that the interest be removed from the economy by the end of 2027 and that the government make the appropriate legislative revisions by December 31, 2022 to replace the legislation declared null and unconstitutional owing to the involvement of *Ribā* (Mansoori & Ayub, 2022).

Research Methodology

The current study is exploratory and uses a qualitative research methodology to explore the challenges in implementing the FSC judgment on the *Ribā*-free economy of Pakistan. It is based on interpreting qualitative data mainly gathered through 12 semi-structured interviews. Moreover, multiple data sources were used to establish triangulation, as suggested by Yin (2003). This type of data analysis converges data from several sources rather than treating it separately, such as semi-structured interviews, court decisions, and related literature. It has been stated that "this convergence adds strength to the findings as the various strands of data are braided together to promote a greater understanding of the case" (Baxter & Jack, 2008, p. 554).

Data and Sample

As the primary source of evidence, data from semi-structured interviews was used. A total of 12 semi-structured interviews were conducted with different stakeholders including *Shariah* scholars, Islamic bankers, regulators, and Islamic economics and finance researchers. The snowball sampling method was used to find the potential participants. Moreover, the number of interviews was determined through the saturation principle following Brown (2008) and Nouman et al. (2022). Different members of the same stakeholder group were interviewed. This is because the differences in context increase the validity of findings by generating a repeated chain of evidence in various circumstances (Yin, 2003). Court judgments and related literature were considered as sources of evidence for triangulation.

Data Analysis

Qualitative Content Analysis (QCA) was employed to analyze the collected data. QCA is used to systematically describe the meaning of qualitative data (Schreier, 2012). It is "a research method for subjective interpretation of the content of text data through the systematic classification process of coding and identifying themes or patterns" (Hsieh & Shannon, 2005). This method divides the discussion material into several groups with related meanings and inferences are validated by following the systematic coding method. Consequently, it helps to interpret the qualitative data scientifically (Moretti et al., 2011).

There are two approaches to QCA. One is the inductive approach and the other is the deductive approach (Mayring, 2000). This classification is based on research objectives (Elo & Kyngas, 2008) and the nature of the problem (Moretti et al., 2011). Importantly, the aforementioned two approaches are different from each other mainly in the way different categories are derived from the data (Kohlbacher, 2006). Using the inductive approach, researchers can derive coding categories from the data they gather (Mayring, 2000). This approach is the most effective when there is a lack of theory or literature (Hsieh & Shannon, 2005). Researchers get fresh ideas by actively engaging with the data, rather than relying solely on predetermined categories (Kondracki et al., 2002). Mayring (2000) called this approach "inductive category development", while Hsieh and Shannon (2005) termed it as "conventional content analysis". On the other hand, when using the deductive approach, QCA follows a more structured process (Hickey & Kipping, 1996). Importantly, the deductive approach derives its codes from pre-existing theories, frameworks, or literature (Kondracki et al., 2002; Potter & Levine-Donnerstein, 1999). It aims to strengthen or validate an existing theory or theoretical framework (Hsieh & Shannon, 2005). This method was referred to as directed content analysis by Hsieh and Shannon (2005) and as deductive category development by Mayring (2000). The current study employed the inductive approach with the aim of identifying and exploring the challenges to the implementation of the FSC judgment through focal questions.

Analysis and Findings

Major Issues and Challenges for Pakistan's Economy

Pakistan is a developing country with a mixed economy based on agriculture, manufacturing, and services. Data analysis indicates that its economy is currently facing several complex and interrelated challenges. These include

> Current account and fiscal deficits are two major problems. First, puts pressure on the exchange rate and brings import-led inflation. While the second stifles the Government's spending on development. Besides that, other challenges include high population growth, weak governance, low tax base and collection, deindustrialization, political instability, weak federation, high school dropout rate, and low skills and productivity in workers.
>
> *Participant 2, Islamic Economics and Finance Researcher*

According to another participant,

> One of the major issues facing the Pakistani economy is the lack of consistency in policies, discouraging FDI and hindering economic growth. Another issue is an undocumented economy, which results

> in lost tax revenue and reduced government oversight, leading to a weaker economy overall. Finally, an import and consumption-oriented economy poses challenges for Pakistan.
>
> *Participant 4, Shariah Scholar*

Further, a participant pointed out the following major economic issues and challenges, *Participant 8, Islamic Banker*, "Low GDP growth, inflation, unfavorable balance of payment, high debt to GDP Ratio, unemployment, low exports, high energy prices, and importantly, no policy and timeline for import substitution industries at the local level."

One participant thoroughly discussed the issues and challenges facing the economy,

> The topmost issue is the need for more planning to develop major sectors such as agriculture and export-oriented industry. Additionally, there needs to be more attention paid to preparing skilled labor, which can hinder the development of a strong and competitive workforce. Finally, there needs to be proper education planning for our population to be better educated. These issues require careful planning and effective policy measures to address them sustainably.
>
> *Participant 12, Central Banker*

As the findings suggest, the two critical challenges for the country's economy are the current account and fiscal deficits. The current account deficit can be reduced by promoting export-oriented industries, especially high-tech industries. In this way, the country can raise its foreign exchange reserves needed to repay its enormous foreign debt. However, fiscal deficit can be reduced only by broadening the tax base, formalizing the economy, improving the tax collection mechanisms, and downsizing the government.

Effective Resolution of Issues and Challenges in a Ribā-Free Economy

Until now, several efforts, both at institutional and individual level, have been made in Pakistan to eliminate *Ribā* from its economy. In this regard, the efforts of the legislative assemblies, judiciary (particularly the Federal *Shariat* Court and *Shariat* Appellate Bench of Supreme Court), Council of Islamic Ideology, and the State Bank of Pakistan are worth mentioning (Rehman & Shahzad, 2020).

In this regard a participatnt, *Participant 1, Islamic Economics and Finance Researcher,* stated that:"Only a *Ribā*-free economy cannot resolve economic problems, but we need a complete Islamic economic and social system to resolve such problems. *Ribā*-free institutions can only save people from getting involved in Harām transactions."

Similarly, another participant thoroughly discussed the matter as follows,

> Financial inclusion in Pakistan is low. The savings ratio is one of the lowest. The investment-to-GDP ratio is also one of the lowest. People do not bank partly because of religious reasons. It keeps our savings ratio low. Many businesses do not scale their setup through leverage to avoid interest. Islamic banking has the potential to raise all three ratios by offering a Shari'ah-compliant solution. External sector finance is not that problematic. Pakistan has issued *Sukūk*. Global DFIs urging fiscal responsibility can find a better mechanism to ensure that financing is linked with real sector assets/projects in Islamic finance structures and cannot automatically multiply. More financial inclusion on deposit and financing side will help document economy and greater tax mobilization.
>
> *Participant 2, Islamic Economics and Finance Researcher*

One participant stated,

> At this point, it is tough to say about the role of the *Ribā*-free economy in resolution of these issues. However, without *Ribā*, there will be transactions in real terms, not just in monetary terms. It will help the economy to grow in real terms.
>
> *Participant 7, Islamic Banker*

A central banker argued,

> At the macro level, instead of taking interest-based loans, equity-based structures can be used for raising money from abroad or locally for the genuine needs of the economy. In addition, the *Ribā*-free system will only permit raising money for genuine needs, which should be backed by assets; it would reduce the appetite of governments to take unnecessary debt.
>
> *Participant 10, Central Banker*

Expansion of the Ribā-Free Economy into the Globalized World Economy

Islamic economics and finance researchers argue that Islamic modes of financing are gaining acceptance among non-Muslims and international institutions. These modes of finance, which are based on the principles of risk-sharing and the prohibition of *Ribā* (interest), offer an alternative to conventional finance and effectively promote financial inclusion and economic development. The growing acceptance of Islamic finance is a positive development (Ayub, 2007), giving individuals and businesses more choices and flexibility in managing their financial affairs.

According to one participant, *Participant 3, Islamic Economics and Finance Researcher,* there are many challenges in expanding the *Ribā*-free economy into the globalized world economy. He argued,"The main challenge is the acceptability of Islamic financing modes. Lenders are not willing to take risks. Even in so-called partnership contracts in Islamic finance, financiers today always require various guarantees."

Similarly, another participant, *Participant 11, Central Banker,* strongly argued against such an expansion of the *Ribā*-free economy into the globalized world economy,"There is little possibility because every banking system originates from its economic system. Since we have not implemented the Islamic economic system, how can we convince the world, which is following capitalism?"

Although another participant, a *Shariah* scholar by profession, remaiend quite optimistic about such an expansion. He said,

> Such an expansion is possible because there is a negative interest rate in Japan, a developed country in the non-Muslim world. Other non-Muslim countries, such as the UK, have started Islamic banking. In the USA, an organization called La-*Ribā* provides Islamic banking services. Australia recently allowed Islamic banking. Therefore, there is a possibility of a *Ribā*-free economy globally.
>
> *Participant 5, Shariah Scholar*

One participant, a central banker by profession, added to these arguments in the following words,

> Central banks/financial services authorities of several non-Muslim countries such as the U.K., Hong Kong, Singapore, Luxembourg, Germany, Thailand – to name a few- have taken an interest in Islamic banking and finance, and most have licensed Islamic banks and other financial institutions, or raised money through *Sukūk*. Therefore, its expansion to other markets will not be a huge challenge. However, what I see as a bigger challenge is that out of 58 or so OIC countries, Islamic finance (more importantly, Islamic banking and Takāful) is only active in the top 15 countries. If other 40 or so OIC countries become more active in this sector, the outreach of Islamic finance at the global level would have been quite different.
>
> *Participant 10, Central Banker*

Challenges in Implementation of FSC's Judgment

A significant move towards the Islamization of the economy was made in 1980s, which resulted in a system based on *Bai al-Īnah* and the sale and purchase of debt instruments. However, FSC declared this system un-Islamic. Since 2002, the government has adopted a dual system of conventional and Islamic banking, with Islamic banking experiencing growth in deposits, assets, financing, and profitability (Mehmood, 2002; Mansoori & Ayub, 2022).

Nonetheless, FSC rendered a ruling on April 28, 2022 stating that all forms of interest on debts and loans are included in the definition of *Ribā*. The court instructed the government to replace the invalid legislation (because of its being in favour of *Ribā*) with the required legislative revisions by December 31, 2022 and to remove interest from the economy by the end of 2027 (Mansoori & Ayub, 2022).

The participants were asked about the challenges faced by the Government of Pakistan in implementing the said judgment. One participant replied,

> Challenges are lack of political will; larger conventional banks favoring status quo; perception that Islamic modes of financing are less flexible and controllable if the Government wants deficit financing continuously; fear that Islamic banks have low liquidity; negative perception about Islamic Banking; higher spread in Islamic banking which leads to the impression that IB is costly. In addition,

> the Government fears that external sector borrowing would not be possible on Islamic modes of financing.
>
> *Participant 2, Islamic Economics and Finance Researcher*

Another participant, *Participant 5,* a *Shariah* scholar, pointed out another major challenge, "Pakistani economy depends on IMF. So globally, there are greater challenges in implementing a *Ribā*-free economy."

An Islamic banker also pointed out the same challenge elaborately in the following words,

> To the extent of *Ribā*-free banking within Pakistan, I do not see any bigger issue and challenge, but for a country like Pakistan which is highly dependent on interest–based loans, the dream of a *Ribā*-free economy seems to be a difficult task until we eliminate our budget deficit, increase exports and generate a favorable balance of trade.
>
> *Participant 8, Islamic Banker*

A central banker when asked about the challenges said,

> Lack of understanding of true concept and consequences of Ribā and lack of commitment with Islamic values. Commitments with international institutions like the IMF are the major hurdle. Our political, banking leadership and elite class is "ignorant" concerning religion, Shariah, and Islamic values.
>
> *Participant 12, Central Banker*

Borrowing through Islamic Modes of Financing from IMF, World Bank, and Paris Club

The participants were asked what the government would do if international donors (IMF, World Bank, Paris Club) wouldn't lend money through Islamic modes of financing. *Participant 1, Islamic Economics and Finance Researcher* responded, "In the first place, excessive borrowing is the main problem for Pakistan's economy. There must be some checks on borrowing. IMF, WB, and other institutions are well aware of Islamic finance and have indicated their willingness to use Islamic modes."

Another participant pointed out,

> Going to these lenders is not a choice; governments approach them in times of need. If policies are stable and the economy is working

> properly, there would remain no need to seek such loans. If there is a need, instead of borrowing, we can enter into partnership agreements like CPEC, etc.
>
> *Participant 4, Shariah Scholar*

An Islamic banker *Participant 8* advised the Muslim world to curtail their expenses. He said, "In the modern world, the borrower cannot dictate his terms. The Muslim world should curtail their expenses and find solutions to their problems by establishing more institutions like the Islamic Development Bank."On the other hand, a central banker considered the Pakistani government and senior beaurocrates as the main hurdle in obtaining finance through Islamic modes from multilateral instititutions. He said,

> In my interactions with the senior officials of multilateral institutions including IMF, World Bank, and Asian Development Bank, I was informed that it is actually the Pakistani Government and senior beaurocrates dealing with multilateral who are not interested in obtaining finance through *Shariah*-compliant mechanisms. Therefore, if Pakistan insists on these and other multilateral institutions providing funding on Islamic modes, they will probably agree. However, it will be challenging for Paris Club like commercial entities to offer *Shariah*-compliant funding. To address this issue, several strategies can be adopted. For example, going to the capital market, issuing *Sukūk*, and reducing expenditures. Similarly, a more practical way could be to issue project-linked, equity *Sukūk*, which generates new assets (instead of using existing assets to issue *Sukūk*).
>
> *Participant 10, Central Banker*

Issuance of Sukūk to Convert Existing Interest-based Public Debt into Shariah-compliant Public Debt

The participants were asked about the country's total public debt, which is greater than its GDP. They were asked if the issuance of *Sukūk* of the required quantum practically possible? One participant replied, *Participant 3, Islamic Economics and Finance Researcher,* "There are legal impediments in this regard, in addition to a lack of saleable assets and the inability of the government to adequately fulfill *Shariah* requirements regarding a valid sale."

Another participant, *Participant 5,* a *Shariah* scholar, opposed the issuance of *Sukūk* to foreign investors. He said, "I am not in favor of issuing *Sukūk* to foreign investors due to mismanagement and bribery environment in Pakistan because we can lose our national assets in case of default."

An Islamic banker, *Participant 8,*however, was not sure whether the government has assets in such a quantum to back *Sukūk* issuance. He argued, "Not possible as the government does not have assets of such huge amounts to offer as asset-backed/based securities against the *Ijārah Sukūk,* except roads, motorways, airports, and some buildings."

While, a central banker favored the idea of issuing *Sukūk* to raise funds from the public. He said,

> It is an excellent proposal. We need to use *Sukūk* to raise funds from the public under various schemes. For better results, we need to restructure drastically the existing avenues of investment where the general public parks their money like stock market, real estate, and banks. Moreover, this borrowing will not add to inflation like borrowing from the banking system. For this, we must create an atmosphere where people resort to Islamic *Sukūk* in a big way.
>
> *Participant 11, Central Banker*

Current Dual Banking System in Pakistan

The participants were asked whether the dual banking system, in which Islamic banks coexist and compete with conventional interest-based banks, diminishes the demand for a *Ribā*-free economy in Pakistan? One participant responded,

> It may have worked both ways. Some people may refer to the healthy growth of Islamic banking as demanding a greater push for it. In contrast, other people who may have found no practical difference between the two systems might think differently.
>
> *Participant 3, Islamic Economics and Finance Researcher*

An Islamic banker deliberated on the issue as follows,

> In Pakistan, the customers have both the options available. The faith-based customer has already shifted to Islamic banking. However, still, we cannot say that demand for Islamic banking has diminished as it is linked with the awareness programs and inclusion

> of new banking customers in the system. However, most existing and prospective customers are concerned with their needs irrespective of the type of banking they are practicing. They are more concerned with the rates of financing, profit rates, easy access, and service quality instead of shariah compliance of the banking.
>
> *Participant 8, Islamic Banker*

Another participant, a central banker, responded,

> Probably yes. Especially when people have realized after first-hand experience that dealing with Islamic banks is not significantly distinguishable from dealing with conventional banks in terms of upholding ethical principles and the high cost they have to pay for acquiring Islamic banking products.
>
> *Participant 10, Central Banker*

Another central banker suggested that if Islamic banks are different then they are required to perform better and show better results than the conventional interest-based banks. He said,

> If Islamic banks are different, working to eliminate youth unemployment through *Mudarbah*, financing SMEs and Microfinance under *Salam*. Then, they could bring better results even under dual banking. Islamic banks are not bound to compete with conventional banks; they are supposed to show better results.
>
> *Participant 11, Central Banker*

SBP's Mechanisms for Converting the Interest-based Banking System to Islamic Banking System

The participants were asked whether SBP has infrastructural mechanisms to convert the entire interest-based banking system to Islamic banking system. If not, how such an issue can be resolved? One participant replied,

> Faisal Bank has converted all its branches into Islamic branches. It can be done by other conventional banks, too. SBP has to provide proper supervision and regulatory framework. It is pertinent to note that SBP may face difficulties applying monetary policy.
>
> *Participant 1, Islamic Economics and Finance Researcher*

Another participant, *Participant 3, Islamic Economics and Finance Researcher* responded, "SBP has invested in capacity building in the past few years, but more concerted efforts are needed." An Islamic banker, *Participant 8,*suggested,"There should be a separate financial sector regulatory authority apart from the SBP."A central banker, *Participant 11,*said that there are no mechanisms currently available with SBP in case the entire banking system is converted to the Islamic banking system. He said,"SBP has no mechanism strong enough for this conversion. We should first have an Islamic profile of the institution of central banking. For example, finding an alternate profit-based benchmark instead of current central bank interest-based policy."

Monetary Policy Management in the Islamic Banking System

The participants were asked how the monetary policy would be managed in the Islamic banking system? *Participant 1, Islamic Economics and Finance Researcher* replied,"Almost all monetary policy instruments are interest-based, and alternate Islamic instruments are not defined yet. However, the Government can announce the desirable rate of profit for different products of Islamic banks for different sectors of the economy."

A *Shariah* scholar *Participant 4,* argued that the government is required to develop monetary policy management instruments. He further suggested, "*Shariah*-compliant monetary instruments may be developed. Most likely, the government, instead of issuing T-Bills, should issue *Sukūk* in large quantum that are helpful in managing the liquidity by Islamic banks."

An Islamic banker *Participant 7,* argued, "SBP is currently implementing the monetary policy through Islamic banks. However, when the overall banking system is converted to an Islamic one, there will certainly be other solutions." Similarly, a central banker gave an important suggestion in this regard,

> This is the most important area of work. Taking monetary policy as "regulation of cost and volume of money," we must have an alternate mechanism for determining the cost of money under profit of real sector and not under KIBOR or SBP discount rate.
>
> *Participant 11, Central Banker*

Practical Steps and Major Policy and Regulatory Strategies to Implement the Judgment

The participants suggested different practical steps, policies, and regulatory strategies to implement the judgment in letter and spirit in order to establish an equitable economic system. Some of them are as follows:

> We should start what we can do now. There is a long way to go. Special teams must be constituted to give their recommendations on each aspect. First, we need to know where we stand today to chalk our way to the destination.
>
> *Participant 4, Shariah Scholar*

> Eliminating *Ribā* economy wise is the key challenge. Once *Ribā* is eliminated, most of the unbanked population will deposit their savings in banks, increasing productivity, employment opportunities, etc. Due to interest, most Pakistanis do not deposit their savings in banks; consequently, most of our wealth is idle.
>
> *Participant 5, Shariah Scholar*

> Government, SBP, and SECP should announce their full commitment to establish an equitable economic system. However, the financial system cannot be Islamized in isolation until the fiscal and taxation systems are reformed accordingly. The country has to focus on economic independence by increasing exports. Until then, it has to learn to live in its means so that more debt is not taken, as high debt servicing reduces the room for any meaningful fiscal policy reform.
>
> *Participant 10, Central Banker*

Participant 11, Central Banker stated that "It is the mainstream question. The answer to this question is the implementation of the Islamic Economic System, which I call Madinah Economics."

Conclusion

The findings suggest that the government has a long way to go in implementing the FSC judgment on *Ribā*-free economy in Pakistan. There are significant challenges to confront and enormous hurdles to overcome.

Further, the findings suggest that the conversion of the existing large public sector debt (higher than the current GDP of Pakistan) to *Shariah*-compliant modes of financing is the most significant challenge ahead of the country's government. In this regard, FSC directed the government to convert the existing public debt by issuing *Sukūk* of different categories. It was concluded that the issuance of *Sukūk* in such a large quantum is practically impossible. However, some structures, such as *Murābahah Sukūk*, can help to mitigate such massive debt (though their *Shariah* permissibility and tradibility remain challenging).

FSC directed the government to adopt Islamic modes of financing, while borrowing either from domestic or foreign sources. The next challenge is what the government would do in case international donors (IMF, World Bank, Paris Club) do not lend money through Islamic modes of financing. Although the World Bank, and other multilateral institutions are well aware of Islamic finance and are willing to use Islamic modes of financing. However, it would be challenging for the Paris Club and other commercial entities to offer *Shariah*-compliant funding. To address this issue, the government can get funding through the capital market, issuing *Sukūk* and reducing expenditures. An alternative strategy might be to issue project-linked, equity *Sukūk* that generate new assets rather than using existing assets to issue *Sukūk*.

The findings further suggest another challenge, that is, monetary policy management by SBP in the Islamic banking system. The issue can be resolved by considering monetary policy as a "regulation of cost and volume of money." There should be an alternate mechanism to determine the cost of money under the profit made by the real sector and not under KIBOR or the SBP discount rate. There is also a lack of *Shariah*-compliant monetary policy instruments. To tackle this issue, the government is required to issue *Sukūk* in large quantum instead of T-Bills.

Conflict of Interest

The authors of the manuscript have no financial or non-financial conflict of interest in the subject matter or materials discussed in this manuscript.

Data Availability Statement

The data associated with this study will be provided by the corresponding author upon request.

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