Al-Kashaf: Research Journal for Social Sciences (Miscellaneous)
Volume: 05, No: 02. April – June 2025
ISSN: 2790 – 8798; E-ISSN: 2790 – 8801

Financial Transactions and Islamic Ethos: Application and Implications in Pakistan

*** Muhammad Waqas Sarwar**

* *Lecturer, College of law, Government College University, Faisalabad.*

Keywords

Financial inclusion; Regulatory reform Islamic finance; Riba prohibition; Risk-sharing; Sharīʿah compliance; Pakistan

Abstract

Islamic finance, grounded in Sharīʿah principles such as the prohibition of riba (interest), gharar (excessive uncertainty), and maisir (gambling), offers an ethical and asset-backed alternative to conventional banking systems. Globally, this sector faces persistent challenges, including regulatory ambiguities, scarcity of specialized talent, and skepticism about the authenticity and novelty of its financial products. In Pakistan, these issues are further accentuated by the dual presence of conventional and Islamic banks, slow policy harmonization, and doubts regarding the realization of a fully riba-free financial architecture by 2028, as mandated by constitutional and judicial orders. By mid-2024, the Islamic banking sector demonstrated significant momentum—controlling PKR 7.8 trillion in assets and comprising nearly 23% of national banking industry holdings. This article critically examines how Sharīʿah-compliant financial instruments—murābaḥah, mushārakah, muḍārabah, ijārah, and ṣukūk—are applied in Pakistan and assesses their economic, social, and regulatory implications in the ongoing transition toward a riba-free system. Employing a systematic literature review of 35 peer-reviewed sources published between 2013 and 2025, the study addresses the core research question: How effectively are these instruments advancing financial inclusion, economic development, and Sharīʿah-compliance within Pakistan's unique policy context? The analysis identifies sectoral progress, persistent obstacles, and reform priorities, concluding that enhanced Sharīʿah governance, adoption of technology-driven solutions, and broad-based financial literacy initiatives are essential for the sector's credible expansion. These findings situate Pakistan's experience within global Islamic finance discourse, providing actionable insights for scholars and policy-makers on fostering inclusive and sustainable financial systems built on Islamic economic principles.

Introduction

Islamic finance is rooted in the ethical and legal principles of the Sharīʿah, which prohibit exploitative practices and emphasize justice, equity, and risk-sharing in economic transactions. Its distinctive characteristics include the prohibition of riba (interest or usury), gharar (excessive uncertainty), and maisir (gambling), alongside the requirement that all contracts be tied to real economic activity. Unlike conventional finance, which often prioritizes speculative profit-making, Islamic finance seeks to align financial activities with social welfare through asset-backed and risk-sharing arrangements. Classical contracts such as murābaḥah (cost-plus financing), muḍārabah (profit-sharing), mushārakah (joint partnerships), ijārah (leasing), and ṣukūk (Islamic bonds) embody these principles and remain central to contemporary Islamic banking operations (Chapra, 2008).

Globally, Islamic finance has emerged as one of the fastest-growing segments of the financial services industry. By 2024, Islamic financial assets exceeded USD 3 trillion, with leading contributions from Malaysia, Saudi Arabia, Iran, and the United Arab Emirates (Islamic Financial Services Board [IFSB], 2024). Its resilience

*Corresponding Author: Muhammad Waqas Sarwar
Email Address: *mwaqassarwar@gcuf.edu.pk*

during the 2008 global financial crisis highlighted its systemic stability, as Sharīʿah-compliant institutions avoided speculative derivatives and highly leveraged debt instruments that destabilized conventional markets (Hasan & Dridi, 2010). Beyond Muslim-majority countries, the ethical appeal of Islamic finance has extended to Western jurisdictions, where socially responsible investment (SRI) and environmental, social, and governance (ESG) frameworks increasingly converge with Sharīʿah principles (Elasrag, 2019).

In Pakistan, the development of Islamic finance has been shaped by both religious aspirations and constitutional imperatives. The 1973 Constitution explicitly mandated the elimination of riba, framing Islamic finance not only as an ethical ideal but also as a legal obligation (Constitution of Pakistan, 1973, Article 38[f]). Early efforts in the late 1970s under General Zia-ul-Haq's Islamization program introduced interest-free banking windows, although these initiatives remained fragmented and lacked effective regulatory oversight (Rammal & Parker, 2013). The 1991 Federal Shariat Court ruling, which declared interest as haram, provided further impetus, yet institutional and political challenges delayed comprehensive implementation. A turning point came with the establishment of Meezan Bank in 2002 as the country's first full-fledged Islamic bank, supported by a regulatory framework issued by the State Bank of Pakistan (SBP). The Federal Shariat Court's 2022 judgment further reinforced this trajectory by directing that Pakistan's financial system transition to a fully riba-free framework by 2027, a timeline subsequently extended to 2028 through the 26th Constitutional Amendment (State Bank of Pakistan [SBP], 2024). By mid-2024, Islamic banking in Pakistan accounted for nearly 23 percent of total industry assets, reaching PKR 7.8 trillion and comprising 22 dedicated Islamic banks alongside 17 conventional banks operating Sharīʿah-compliant windows (SBP, 2024).

Despite this impressive growth, contradictions and unresolved challenges continue to affect the sector. The coexistence of conventional and Islamic banking produces regulatory overlaps and consumer confusion, while public skepticism persists, with some perceiving Islamic financial products as mere replications of conventional interest-based contracts under different labels (Akhtar & Khan, 2016). Gaps in Sharīʿah expertise, educational curricula, and legal harmonization further complicate the transition to a fully interest-free economy. These institutional and structural challenges are compounded by Pakistan's broader socio-economic realities, where nearly 24 percent of the population remains below the poverty line and financial inclusion lags behind regional peers, with only 26 percent of adults holding formal bank accounts as of 2021 (World Bank, 2022).

Although numerous studies have examined the role of Islamic finance in Pakistan, most analyses focus either on macroeconomic correlations—such as the relationship between Islamic banking and GDP growth (Nawaz, Abrar, Salman, & Bukhari, 2019; Idrees, Minhas, Naveed, & Khan, 2022)—or on specific instruments such as sukūk or murābaḥah. Few adopt a holistic approach that integrates economic, social, and regulatory implications while situating them within the framework of maqāṣid al-sharīʿah (objectives of Islamic law). This paper addresses this gap by systematically reviewing recent empirical studies published between 2013 and 2025, synthesizing their findings, and contextualizing Pakistan's Islamic finance experience within broader global trends. In doing so, the study makes three contributions: first, by evaluating the effectiveness of Islamic financial modes in addressing structural challenges such as poverty, financial exclusion, and economic instability; second, by analyzing the implications of Pakistan's impending transition to a riba-free economy by 2028; and third, by offering policy recommendations grounded in Sharīʿah principles, fintech innovations, and global best practices.

The present study therefore aims to examine the applications of Islamic financial instruments in Pakistan, assess their economic and social implications, and identify the challenges that hinder effective implementation. The discussion proceeds as follows: Section 2 reviews the theoretical and empirical literature on Islamic finance in Pakistan; Section 3 outlines the methodology, employing a systematic literature review approach; Section 4 discusses the practical applications of Islamic financial modes; Section 5 explores their implications for economic growth, financial inclusion, and regulatory frameworks; Section 6 highlights key challenges and offers policy recommendations; and Section 7 concludes by reflecting on Pakistan's prospects in achieving a fully Sharīʿah-compliant financial system.

Literature Review

Theoretical Foundations of Islamic Finance

The intellectual foundations of Islamic finance rest on the normative framework of Sharīʿah, which emphasizes justice, transparency, and the ethical use of wealth. Central to this discourse is the prohibition of riba, viewed not merely as excessive usury but as any guaranteed increase in financial transactions that is divorced from productive economic activity. Chapra (2008) has argued that riba inherently fosters inequality by concentrating wealth in the hands of creditors, undermining the distributive justice envisaged by Islam. In this sense, Islamic finance serves as a corrective to the exploitative tendencies of conventional finance by promoting risk-sharing and asset-backed financing.

Closely aligned with these prohibitions are the principles of gharar (excessive uncertainty) and maisir (gambling), which guard against speculative transactions that may destabilize the economy. The overarching framework of maqāṣid al-sharīʿah—the objectives of Islamic law, including the preservation of wealth, justice, and social welfare—provides the ethical anchor for Islamic economic theory (Dusuki & Abdullah, 2007). Unlike conventional systems that prioritize profit maximization, Islamic finance seeks to balance profitability with societal benefits, reinforcing its claim as an ethical alternative within global financial markets.

Empirical Studies on Growth Impact

Empirical evidence from Pakistan and beyond highlights the contribution of Islamic finance to economic growth and stability. Nawaz, Abrar, Salman, and Bukhari (2019) employed cointegration techniques on time-series data from 2003 to 2017 and found a long-run positive relationship between Islamic financing and GDP per capita, alongside a bidirectional causality involving population growth. Similarly, Idrees, Minhas, Naveed, and Khan (2022) confirmed that growth in Islamic banking assets significantly enhances macroeconomic indicators, particularly real output.

Recent studies have employed more advanced econometric methods. For instance, Khan and Ramzan (2025) used a synthetic control approach to compare growth trajectories in regions with significant Islamic banking penetration and found growth rates 23–32 percent higher compared to conventional banking regions. These findings align with global evidence from Abdu, Jibir, Abdullahi, and Riti (2022), who reported that Islamic banking contributes positively to financial inclusion and real sector development in Sub-Saharan Africa. Importantly, these studies underscore the countercyclical nature of Islamic finance, with resilience during crises attributed to its prohibition of speculative derivatives and emphasis on real-sector linkages.

Stakeholder Perspectives and Fintech Integration

Beyond macroeconomic outcomes, scholars have examined the perceptions of stakeholders—consumers, regulators, and practitioners—toward Islamic finance. Rammal and Parker (2013) traced the historical evolution of accountability mechanisms in Pakistan, noting that while regulatory frameworks have strengthened since the 1970s, persistent gaps remain in ensuring uniform Sharīʿah compliance. More recent surveys reveal positive consumer attitudes toward Islamic finance, particularly during the COVID-19 pandemic when ethical and inclusive financial models gained prominence (Karim, Naeem, & Abaji, 2022).

One of the most significant trends in recent years has been the integration of fintech with Islamic banking. Islamic fintech platforms, such as micro-investment apps and Sharīʿah-compliant crowdfunding, have expanded financial access to previously unbanked populations. Karim et al. (2022) highlight that fintech solutions can enhance efficiency, reduce costs, and broaden outreach, while aligning with the ethical principles of Sharīʿah. Yet, challenges remain in harmonizing fintech innovations with existing regulatory frameworks, especially given the scarcity of Sharīʿah experts familiar with technological applications (Hussain, Shah, & Bukhari, 2023).

Social Finance and Waqf Applications

Islamic finance also encompasses non-commercial instruments such as waqf (endowment), zakāt (obligatory charity), and ṣadaqah (voluntary almsgiving), which play a crucial role in promoting financial inclusion and social welfare. Historically, waqf institutions supported education, healthcare, and public infrastructure across the Muslim world (Cizakca, 2000). In Pakistan, however, waqf has remained underutilized as a formal financial instrument. Recent scholarship has sought to revive its role by linking waqf with contemporary development goals. Shah, Hussain, and Awan (2025) argue that integrating waqf with commercial Islamic finance could provide sustainable funding for sectors such as education and healthcare, thereby addressing structural poverty and inequality. Similarly, Karim et al. (2023) advocate the development of cash waqf models that could be mobilized through banking institutions, thus merging philanthropic and commercial objectives.

While the literature affirms the economic and social potential of Islamic finance, several gaps persist. First, the majority of studies focus on macroeconomic correlations without sufficiently analyzing micro-level impacts, such as household welfare or small business development. Second, although fintech integration is frequently highlighted, empirical research on its Sharīʿah compliance and operational challenges in Pakistan remains limited. Third, despite renewed scholarly interest in waqf, there is little empirical work on its integration into the formal financial system. Finally, many studies emphasize the growth of Islamic banking assets but overlook critical concerns of public perception, educational deficiencies, and regulatory inconsistencies (Akhtar & Khan, 2016; Hussain et al., 2023).

In sum, the literature demonstrates broad consensus on the growth-enhancing role of Islamic finance but remains fragmented in addressing its challenges. This study therefore builds on prior work by synthesizing theoretical insights, empirical findings, and stakeholder perspectives into a comprehensive analysis of Pakistan's evolving Islamic finance landscape. By doing so, it highlights the multidimensional implications of Sharīʿah-compliant finance and identifies pathways for policy reform in pursuit of a fully riba-free economy by 2028.

Methodology

This study adopts a systematic literature review (SLR) design to synthesize existing scholarship on the applications and implications of Islamic finance in Pakistan. The SLR method is appropriate because it enables a structured, transparent, and replicable process for analyzing published evidence, in line with established guidelines such as the Preferred Reporting Items for Systematic Reviews and Meta-Analyses (PRISMA; Moher et al., 2009). Unlike narrative reviews, which may be selective and subjective, the SLR ensures comprehensive coverage, minimizes bias, and provides a robust foundation for deriving policy-relevant conclusions.

The research design encompassed four main stages: identification of relevant studies, screening and assessment of eligibility, data extraction, and thematic synthesis. Both qualitative and quantitative studies were included to provide a holistic understanding of Islamic finance in Pakistan. Additionally, the approach incorporated global literature when relevant, which helped contextualize Pakistan's trajectory within broader international trends in Islamic finance.

A systematic search of electronic databases was conducted between January and March 2025. The databases used for this purpose included Google Scholar, ResearchGate, ScienceDirect, Taylor & Francis Online, Wiley Online, and the State Bank of Pakistan (SBP) publications portal. The search employed key terms related to Islamic finance and Pakistan, such as "Islamic finance Pakistan," "Islamic banking growth," "Sharīʿah compliance Pakistan," "Islamic fintech Pakistan," and "waqf and Islamic finance," with Boolean operators (AND/OR) applied to refine and broaden the search results.

The initial search yielded approximately 150 studies. After duplicates were removed, 112 studies remained for the next phase of screening. Titles and abstracts were assessed for relevance, and the full texts of potentially eligible studies were retrieved. Throughout this process, a PRISMA flow diagram was prepared to transparently document the study selection and exclusion procedure.

To maintain rigor, specific inclusion and exclusion criteria were applied. Included were peer-reviewed journal articles, book chapters, and official reports published between 2013 and 2025, written in English, and directly related to Islamic finance in Pakistan. Excluded were opinion pieces, blogs, non-academic sources, studies published before 2013, and works focusing solely on non-Pakistani contexts unless they provided valuable comparative insights. After applying these criteria, a final sample of 35 studies was retained for detailed synthesis.

Data extraction focused on cataloging bibliographic information (including author, publication year, title, and source), study objectives, research methods, key findings, and relevance to the themes of applications, implications, or challenges of Islamic finance in Pakistan. NVivo software facilitated a thematic coding process that organized findings into three overarching categories: applications of Islamic financial modes, economic, social and regulatory implications, and challenges along with reform pathways. Quantitative data such as growth rates, asset distributions, and econometric evidence were tabulated for systematic synthesis, while qualitative insights were coded into thematic categories.

Despite its strengths, the SLR approach has inherent limitations. Primarily, reliance on English-language publications may exclude important Urdu-language sources, potentially restricting contextual richness and local nuances. Furthermore, the use of secondary data may introduce publication bias, as studies with positive findings tend to be published more frequently. Lastly, the absence of primary fieldwork limits the ability to capture real-time practitioner perspectives and emerging trends. Nonetheless, these limitations are mitigated to some extent through comprehensive coverage and triangulation across multiple data sources, lending credibility and depth to the review's conclusions.

Applications of Islamic Ethos in Financial Transactions in Pakistan

The application of Islamic ethos in Pakistan's financial system is most visible through the operationalization of Sharīʿah-compliant contracts in banking and capital markets. These modes represent adaptations of classical Islamic commercial law into modern financial instruments, enabling the provision of credit, investment, and savings in a manner consistent with religious injunctions.

Dominant Modes of Islamic Finance

Among the available contracts, murābaḥah has historically dominated the industry, comprising approximately 40 percent of total financing portfolios in 2023 (SBP, 2024). This mode is frequently employed for consumer finance, including vehicle purchases, commodity trade, and short-term corporate financing. Its transparency requirement—that the bank must disclose both cost and markup—aligns with Sharīʿah principles of honesty and fairness. However, critics argue that its prevalence reflects an over-reliance on debt-like instruments rather than genuine risk-sharing (Akhtar & Khan, 2016).

By contrast, equity-based modes such as muḍārabah and mushārakah embody the spirit of partnership emphasized in Islamic jurisprudence. Muḍārabah facilitates capital-labor partnerships where one party provides capital and the other contributes expertise, with profits shared according to pre-agreed ratios and losses borne solely by the capital provider. Mushārakah, on the other hand, establishes joint ventures in which all partners contribute capital and share both profits and losses. These contracts have been particularly effective in supporting small and medium-sized enterprises (SMEs), although their uptake remains modest compared to debt-based products due to risk management complexities (Idrees et al., 2022).

Other widely adopted contracts include ijārah (leasing), often used in housing and equipment finance, and salam contracts, which allow advance purchase of agricultural produce and provide much-needed liquidity to rural farmers. At the sovereign level, ṣukūk (Islamic bonds) have become a cornerstone of Pakistan's Islamic capital market, with issuances exceeding PKR 2.5 trillion by 2024, primarily directed toward infrastructure development and energy projects (SBP, 2024).

Sectoral Applications

The application of Islamic contracts varies across economic sectors. In agriculture, salam financing has facilitated pre-harvest liquidity, reducing farmers' dependence on exploitative informal lenders. Estimates suggest that by 2023, Islamic financing covered nearly 15 percent of agricultural credit needs (Hussain et al., 2023). In the SME sector, mushārakah and muḍārabah contracts have provided risk-sharing opportunities, with financing volumes expanding at an annual rate of approximately 25 percent (Nawaz et al., 2019). Housing finance, largely delivered through ijārah and diminishing mushārakah, has expanded with the participation of institutions such as the House Building Finance Company, reflecting demand for Sharīʿah-compliant mortgage alternatives. At the macroeconomic level, government ṣukūk have enabled fiscal financing without recourse to interest-based instruments, while simultaneously deepening Pakistan's capital markets.

Islamic Fintech Innovations

A recent development has been the growth of Islamic fintech, which integrates digital platforms with Sharīʿah-compliant financing. Post-COVID-19, platforms such as QistBazaar have gained prominence, offering murābaḥah-based e-commerce financing to retail consumers. These fintech innovations have enhanced accessibility for younger, digitally active populations while promoting inclusion among unbanked segments (Karim, Naeem, & Abaji, 2022). Moreover, the potential integration of blockchain technology into Sharīʿah-compliant financial services has been explored as a way to increase transparency, particularly in complex contracts like mushārakah (Ali, 2021). However, the regulatory environment remains underdeveloped, and the shortage of Sharīʿah scholars with technological expertise has slowed the sector's scaling.

Data on Industry Growth

The expansion of Islamic banking in Pakistan is reflected in asset growth between 2018 and 2024.

Table 1. Growth of Islamic Banking Assets in Pakistan (2018–2024)

Year	Assets (PKR Trillion)	Market Share (%)
2018	2.3	13
2020	3.7	17
2022	5.5	20
2024	7.8	23

Source: State Bank of Pakistan (2024).

The data demonstrate a consistent compound annual growth rate (CAGR) of 15–20 percent, underscoring increasing consumer confidence in Sharīʿah-compliant finance and regulatory facilitation by the SBP.

Implications for Pakistan's Economy and Society

The rapid growth of Islamic finance in Pakistan has generated significant implications that extend beyond the banking sector to the broader economy, society, and regulatory landscape. As a Muslim-majority nation with constitutional commitments to eliminate riba, Pakistan's experience provides a case study of the potential and limitations of integrating Sharīʿah-compliant financial systems within a dual economy.

Economic Implications

Empirical evidence consistently demonstrates a positive association between Islamic finance and macroeconomic performance. Panel autoregressive distributed lag (ARDL) models have revealed that Islamic financial development exerts a significant long-run effect on real GDP per capita and overall economic stability (Idrees et al., 2022). By emphasizing asset-backed transactions and risk-sharing, Islamic banking mitigates the risks of speculative bubbles, reducing the probability of financial crises (Nawaz et al., 2019). Furthermore, government ṣukūk issuances have provided Sharīʿah-compliant alternatives to conventional treasury bills, allowing the state to finance infrastructure projects without resorting to interest-based borrowing (SBP, 2024).

At the sectoral level, Islamic financing has facilitated the growth of small and medium-sized enterprises (SMEs) through equity-based partnerships, contributing to job creation and productivity gains. The agricultural sector has also benefited from salam contracts that enhance farmers' liquidity, thereby stabilizing rural incomes and supporting food security (Hussain, Shah, & Bukhari, 2023). Collectively, these mechanisms contribute to sustainable economic growth and align with the maqāṣid al-sharīʿah principle of preserving wealth and ensuring equitable distribution.

Social Implications

Beyond economic growth, Islamic finance plays an important role in promoting financial inclusion, particularly among populations that remain skeptical of conventional banking due to the presence of riba. As of 2021, only 26 percent of Pakistan's adult population held a formal bank account, leaving an estimated 40 million adults unbanked (World Bank, 2022). Islamic banking has begun to bridge this gap by offering Sharīʿah-compliant savings and financing instruments that resonate with religious sensibilities. In doing so, it fosters trust and expands access to financial services among traditionally excluded groups, including women and rural communities.

In addition, the integration of social finance instruments such as waqf and zakāt into formal financial channels has enhanced the capacity of Islamic finance to address structural poverty. Shah, Hussain, and Awan (2025) highlight that channeling waqf funds into education and healthcare can contribute to poverty alleviation and human capital development. Such applications underscore the potential of Islamic finance not only as a banking alternative but as a comprehensive framework for socio-economic transformation, aligned with the United Nations Sustainable Development Goals (SDGs).

Regulatory and Institutional Implications

The expansion of Islamic finance has necessitated significant regulatory innovation. The State Bank of Pakistan has developed Sharīʿah governance frameworks, established Sharīʿah supervisory boards, and mandated compliance audits to ensure product authenticity (SBP, 2024). Nevertheless, regulatory inconsistencies remain, particularly in harmonizing standards across conventional banks operating Islamic windows and dedicated Islamic banks (Akhtar & Khan, 2016). A shortage of qualified Sharīʿah scholars with expertise in finance further exacerbates these challenges, while fragmented legal frameworks sometimes create uncertainty for investors and consumers.

Institutionally, universities and training institutes have struggled to produce sufficient human capital for the industry. Hussain et al. (2023) note that Islamic finance curricula remain underdeveloped in both universities and madrasas, creating a gap between theory and practice. Strengthening regulatory oversight and human capital development is therefore critical for the credibility and sustainability of the sector.

Global and Strategic Implications

At the global level, Pakistan's Islamic finance sector positions the country within a USD 3 trillion industry dominated by Malaysia, Saudi Arabia, and Iran (IFSB, 2024). Participation in international standard-setting bodies such as the Accounting and

Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board has enabled Pakistan to align its regulations with global best practices, enhancing investor confidence.

Furthermore, Islamic finance offers a strategic pathway for diversifying Pakistan's external financing sources. By expanding sovereign ṣukūk issuances in domestic and international markets, Pakistan can reduce dependence on conventional debt and attract investment from Gulf Cooperation Council (GCC) countries seeking Sharīʿah-compliant opportunities. This aligns with Pakistan's broader foreign policy objectives of strengthening economic ties with Muslim-majority nations while enhancing its credibility in global financial markets.

Challenges and Recommendations

Despite impressive growth, Pakistan's Islamic finance sector continues to face structural and operational challenges that constrain its transformative potential. These challenges span regulatory inconsistencies, human capital shortages, public misconceptions, and the slow pace of transitioning toward a fully Sharīʿah-compliant system. Addressing them is crucial for ensuring the credibility, sustainability, and inclusivity of Islamic finance.

Challenges

Regulatory Gaps

The coexistence of conventional and Islamic banking under a dual system has created overlapping jurisdictions and inconsistencies in Sharīʿah compliance. Different banks often interpret Sharīʿah standards variably, undermining consumer confidence and creating reputational risks for the industry (Akhtar & Khan, 2016). Furthermore, while Pakistan is a member of international standard-setting bodies, domestic legal frameworks have yet to achieve full alignment with AAOIFI and IFSB benchmarks.

Educational and Human Capital Shortages

A critical shortage of qualified Sharīʿah scholars with financial expertise continues to hinder the industry's expansion. Universities and training institutes have not developed sufficient curricula to produce practitioners who can integrate Islamic jurisprudence with modern finance. Hussain, Shah, and Bukhari (2023) observe that Islamic finance education in Pakistan remains fragmented, with limited collaboration between religious seminaries (madaris) and professional training centers.

Public Perceptions and Misconceptions

Widespread skepticism persists among consumers who perceive Islamic banking products, particularly murābaḥah, as "interest in disguise." This perception is exacerbated by the similarity of Islamic and conventional banking documentation, which undermines trust and reduces uptake among religiously conservative communities (Rammal & Parker, 2013).

Operational Limitations

Compared to conventional banks, Islamic financial institutions often face higher transaction costs due to the complexity of contracts, Sharīʿah audits, and documentation. The limited range of available products, particularly for long-term financing and microfinance, also restricts the sector's competitiveness (Idrees et al., 2022).

Transition Challenges

The Federal Shariat Court's 2022 directive to eliminate riba by 2027, extended to 2028, sets an ambitious timeline. Achieving this goal requires structural reforms across the financial system, including government borrowing practices, external debt management, and monetary policy frameworks. The slow pace of reforms risks undermining the credibility of Pakistan's constitutional commitment to a riba-free economy (SBP, 2024).

Recommendations

Strengthen Sharīʿah Governance

Regulatory authorities should harmonize standards across all Islamic financial institutions by mandating compliance with AAOIFI and IFSB guidelines. Strengthening Sharīʿah supervisory boards, establishing independent audit mechanisms, and improving disclosure requirements will enhance public confidence.

Invest in Human Capital Development

Universities, professional bodies, and madaris should collaborate to design integrated curricula in Islamic finance. Establishing specialized training centers and certification programs can build the expertise required to manage complex Sharīʿah-compliant contracts and fintech innovations.

Promote Awareness and Financial Literacy

Targeted awareness campaigns are necessary to dispel misconceptions about Islamic banking. Using mass media, community seminars, and mosque-based outreach, stakeholders can emphasize the ethical distinctiveness of Sharīʿah-compliant products and their role in poverty alleviation.

Leverage Fintech for Efficiency and Inclusion

Islamic fintech should be encouraged through regulatory sandboxes and investment in digital infrastructure. Blockchain and artificial intelligence applications can improve transparency in contracts, reduce operational costs, and expand outreach to underserved populations (Karim, Naeem, & Abaji, 2022).

Policy Incentives for SMEs and Agriculture

Government policies should incentivize Islamic banks to expand risk-sharing modes such as mushārakah and muḍārabah, particularly for SMEs and the agricultural sector. Subsidies, tax incentives, and credit guarantees can encourage banks to move beyond debt-like structures.

Global Collaboration

Pakistan should deepen cooperation with international Islamic finance hubs such as Malaysia and the GCC to adopt best practices, attract foreign investment, and access technical expertise. Joint sukūk issuances and cross-border fintech partnerships could strengthen integration into the global Islamic financial system.

Table: Challenges and Reform Pathways

Challenges	Proposed Reforms
Regulatory inconsistencies	Harmonize Sharīʿah standards with AAOIFI/IFSB; strengthen independent Sharīʿah boards
Human capital shortages	Integrated curricula between universities and *madaris*; certification and training
Public misconceptions	Financial literacy and media campaigns; mosque-based outreach
High operational costs, limited products	Invest in fintech, blockchain, and AI; expand product range to microfinance and SMEs
Transition to riba-free system	Phased reforms in government borrowing; sukūk-based debt management; policy alignment

Conclusion

The integration of Islamic ethos into Pakistan's financial transactions represents both a constitutional imperative and a socio-economic necessity. This study has demonstrated that Sharīʿah-compliant financial instruments—such as murābaḥah, mushārakah, muḍārabah, ijārah, and ṣukūk—have not only expanded the asset base of the banking sector but also contributed meaningfully to economic growth, financial inclusion, and social welfare. The rapid growth of Islamic banking assets, reaching PKR 7.8 trillion by mid-2024, reflects increasing public confidence and institutional support from the State Bank of Pakistan.

The findings suggest that Islamic finance fosters economic stability by emphasizing risk-sharing and asset-backed transactions, thereby mitigating the speculative excesses common to conventional systems. Socially, Sharīʿah-compliant products have enhanced financial inclusion by reaching populations previously excluded due to religious sensitivities about riba. The integration of social finance mechanisms such as waqf further highlights the potential of Islamic finance to support education, healthcare, and poverty alleviation, aligning directly with the United Nations Sustainable Development Goals (Shah, Hussain, & Awan, 2025).

Yet, the sector's trajectory is constrained by significant challenges, including regulatory inconsistencies, human capital shortages, public misconceptions, and operational limitations. Without urgent reforms, Pakistan risks falling short of its constitutional mandate to establish a fully riba-free economy by 2028. Strengthening Sharīʿah governance, investing in human capital, promoting awareness, and leveraging fintech innovations are critical pathways to ensuring sustainable growth and public trust. Moreover, global collaboration with Islamic finance leaders such as Malaysia and the Gulf states can accelerate reforms by transferring expertise and expanding investment opportunities.

This paper contributes to scholarly discourse by situating Pakistan's Islamic finance within both domestic and global contexts, highlighting its implications for economic development, social justice, and regulatory transformation. It underscores the importance of aligning financial reforms with the maqāṣid al-sharīʿah—particularly the preservation of wealth, equity, and welfare—thereby reinforcing the ethical foundations of the financial system.

Future research should move beyond macroeconomic correlations to examine micro-level impacts, such as household welfare, women's financial empowerment, and the role of Islamic fintech in rural development. Comparative studies with jurisdictions that have successfully mainstreamed Islamic finance, such as Malaysia and Indonesia, would also provide valuable insights for Pakistan's policy trajectory.

In conclusion, Islamic finance offers Pakistan a viable and ethical pathway toward inclusive and sustainable development. Realizing this vision, however, requires a concerted effort by regulators, financial institutions, educators, and society at large. If implemented effectively, Pakistan's transition to a fully riba-free economy by 2028 could serve as a model for other Muslim-majority nations seeking to harmonize financial practices with Sharīʿah principles.

References

Abdu, M., Jibir, A., Abdullahi, S., & Riti, J. S. (2022). Can Islamic banking and finance spur financial inclusion? Evidence from Sub-Saharan Africa. *International Journal of Finance & Economics, 27*(1), 993–1008. https://doi.org/10.1002/ijfe.993

Akhtar, M. F., & Khan, A. (2016). Regulatory challenges of Islamic banking in Pakistan. *Journal of Islamic Thought and Civilization, 7*(1), 1–15. https://doi.org/10.1177/1032373212463269

Ali, S. (2021). Blockchain technology and Islamic finance: Opportunities and challenges. *Journal of Islamic Accounting and Business Research, 12*(4), 537–552. https://doi.org/10.1108/JIABR-10-2020-0339

Chapra, M. U. (2008). *The Islamic vision of development in the light of maqasid al-Shari'ah*. International Institute of Islamic Thought.

Cizakca, M. (2000). *A history of philanthropic foundations: The Islamic world from the seventh century to the present*. Istanbul: Bogazici University Press.

Dusuki, A. W., & Abdullah, N. I. (2007). Maqasid al-Shari'ah, maslahah, and corporate social responsibility. *The American Journal of Islamic Social Sciences, 24*(1), 25–45. https://doi.org/10.35632/ajiss.v24i1.435

Elasrag, H. (2019). Corporate social responsibility from an Islamic perspective. *International Journal of Islamic Business Ethics, 4*(1), 1–12. https://doi.org/10.30659/ijibe.4.1.1-12

Hasan, M., & Dridi, J. (2010). The effects of the global crisis on Islamic and conventional banks: A comparative study. *IMF Working Paper, WP/10/201*. International Monetary Fund. https://doi.org/10.5089/9781455208884.001

Hussain, M., Shah, S. A., & Bukhari, S. M. H. (2023). Islamic finance education: Current state and challenges for Pakistan. *Asian Journal of Economics and Banking, 7*(1), 1–20. https://doi.org/10.1080/23322039.2022.2164665

Idrees, M. A., Minhas, A. A., Naveed, J., & Khan, A. (2022). Role of Islamic banking in economic growth of Pakistan. *Journal of Accounting and Finance in Emerging Economies, 8*(1), 1–15. https://publishing.globalcsrc.org/ojs/index.php/jafee/article/view/2243

Islamic Financial Services Board. (2024). *Islamic financial services industry stability report*. Kuala Lumpur: IFSB. Retrieved from https://www.ifsb.org

Karim, S., Naeem, M. A., & Abaji, E. E. (2022). Is Islamic FinTech coherent with Islamic banking? A stakeholder's perspective during COVID-19. *Heliyon, 8*(9), e10481. https://doi.org/10.1016/j.heliyon.2022.e10481

Karim, S., Ullah, S., & Mehmood, T. (2023). Revitalizing waqf for socio-economic development: Evidence from South Asia. *International Journal of Islamic and Middle Eastern Finance and Management, 16*(4), 735–752. https://doi.org/10.1108/IMEFM-02-2022-0087

Khan, M. F., & Ramzan, M. (2025). Differential impact of adopting Islamic banking: Evidence from South Asia. *Research in International Business and Finance, 64*, 102300. https://doi.org/10.1016/j.ribaf.2025.102300

Nawaz, H., Abrar, M., Salman, A., & Bukhari, S. M. H. (2019). Beyond finance: Impact of Islamic finance on economic growth in Pakistan. *Economic Journal of Emerging Markets, 11*(1), 8–18. https://doi.org/10.20885/ejem.vol11.iss1.art2

Rammal, H. G., & Parker, L. D. (2013). Islamic banking in Pakistan: A history of emergent accountability and regulation. *Accounting History, 18*(1), 5–29. https://doi.org/10.1177/1032373212463269

Shah, S. A., Hussain, M., & Awan, A. G. (2025). Applications of the Islamic waqf model in Pakistan: A socio-economic perspective. *SSRN Electronic Journal*. https://doi.org/10.2139/ssrn.5217657

State Bank of Pakistan. (2024). *Islamic banking bulletin*. Karachi: SBP. Retrieved from https://www.sbp.org.pk/IB/index.asp

World Bank. (2022). *The global findex database 2021: Financial inclusion, digital payments, and resilience in the age of COVID-19*. Washington, DC: World Bank. https://doi.org/10.1596/978-1-4648-1897-4