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Reforming Money And Banking

How a Full-Reserve, Interest-Free System can Eliminate Govt Debt, Deficits, and Inflation

DEPT OF LLB SHARIAH AND LAW

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ
مِنَ الْمَسِّ ذَٰلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ
الرِّبَا فَمَن جَاءَهُ مَوْعِظَةٌ مِّن رَّبِّهِ فَانتَهَىٰ فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ
وَمَنْ عَادَ فَأُولَٰئِكَ أَصْحَابُ النَّارِ هُمْ فِيهَا خَالِدُونَ

The standing of those who eat Riba is like standing of the one who is confounded by Devil's stroke – that's because they say trade is just like Riba, whereas Allah has permitted trade and forbidden Riba. Hence those who have received the admonition from their Lord and desist, may keep their previous gains, their case being entrusted to Allah; but those who revert shall be the inhabitants of the fire and abide therein forever.

How can we stop Riba from destroying our society as it is prohibited in Islam and as our country is ISLAMIC Republic of Pakistan? Well that is exactly what we will figure out in this article.

1.GENERAL ASPECTS OF AN ISLAMIC INTEREST-FREE FINANCIAL SYSTEM.

The goal of Islamic banking is to maintain its products and services according to the principles of shariah. It is important to begin examining the Islamic banking system by first defining some basic terminology.

1.Riba or Interest also known as interest and usury means the predetermined return on use of money. It means increase or addition. Any excess compensation without due consideration. The most comprehensive meaning can be derived from the Hadith of Prophet Muhammad (peace be upon him) saying:

"Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, like for like, equal for equal, and hand-to-hand. If the commodities differ, then you (may) sell as you wish provided that (the exchange) is hand-to-hand"

This teaches us two main things;

(1) Deferment in time; Riba is created when there is delay in exchange.
(2) Excessiveness; exchanging unequal quantities of similar things creates riba.

The Negative Impacts of Riba on Society and the Economy

2.Types of Riba

There are two main types of Riba;

(1) Riba an Nasiyah
(2) Riba al Fadl

Riba an Nasiyah is the deferment in the time of exchange. It includes interest based lending of money, It relates to loan transactions. The Prophet (SAW) said: (Every loan that derives a benefit to the lender is Riba). For example if A lends 200 rupees from B by saying that A shall return 250 rupees after a week. Here the extra 50 rupees is Riba.

Riba al Fadl is excess in quantity of the counter value. For example giving more wheat or gold than the other person.

"O those who believe do not eat up riba doubled and redoubled." [Surah Al-e-Imran 3- 130]

2. HISTORICAL BACKGROUND OF ISLAMIC BANKING

The thought of ethical and risk-sharing trade can be traced back to Mecca before Islam. During the mid-5th century, a lot of small merchants were facing difficulty in finance, often leading to bankruptcy and sometimes starvation of their families. **Hashim, who was the leader of a Meccan clan,** introduced the concept of mudaraba, a type of partnership in which one side provided money or capital and the other managed the business. They used to share the profits according to the pre-agreed ratio, while losses were endured by the provider of capital unless caused by negligence. This revolution allowed small merchants to participate in trade without falling back to interest-based loans.

Following the advent of Islam, the postulates of **riba prohibition, fair trade, and ethical investment** were structured in the Quran and Sunnah.

In Pakistan, the interest-free banking movement began soon after independence in 1947. **Zahid Hussain**,The first governor of the State Bank of Pakistan, explained in 1948 the need to orient banking operations in the light of Islamic principles. In 1952, within the State Banks Research Department, an Islamic Economic Section was established to study interest free financial systems. Scholars like **M.N. Siddiqi and Muhammad Uzair** proposed marshal banking on the basis of **mudaraba** in the 1950s, though serious implementation was still delayed. The issue gained more importance under the 1973 Constitution, which led the State to eliminate riba at the rathe. In 1979, the President mortgaged to terminate interest within three years, assigning the Council of Islamic Ideology the task for preparing a framework, which were followed by further Islamization actions in the banking sector during Zia-ul-Haq's era.

3. CURRENT BANKING SYSTEM: CONVENTIONAL MODEL AND ITS IMPLICATIONS

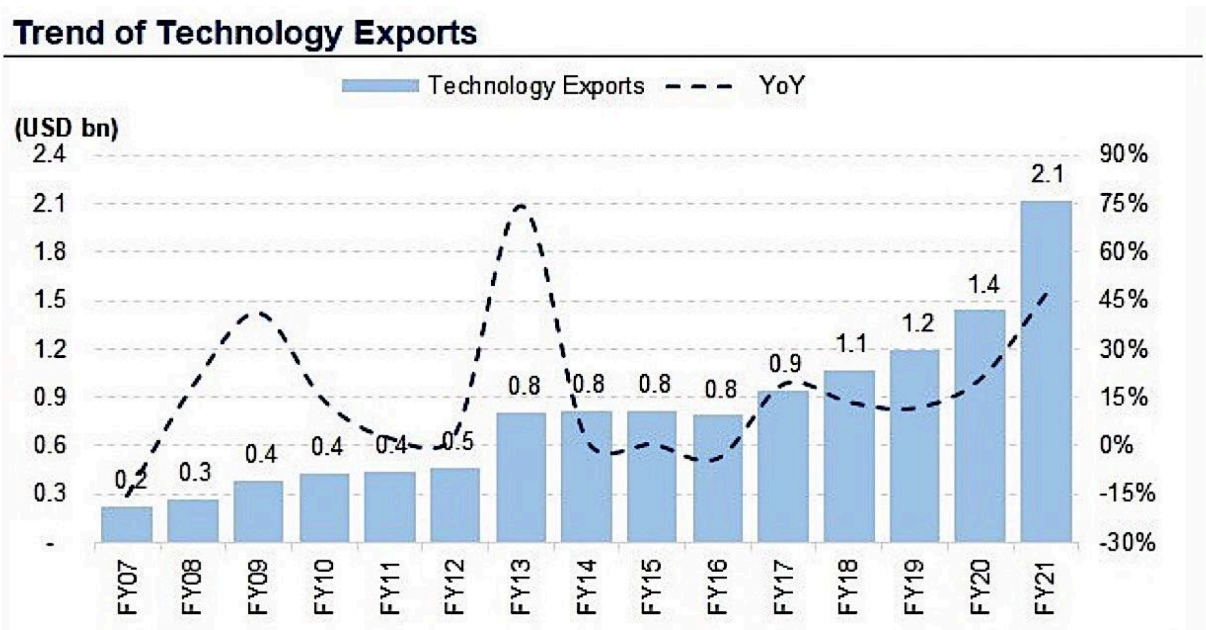
1. The nature of Deposit Accounts

- **Current Accounts:** No specific intrinsic approach is used; banks can use these funds for investment or other purposes nonetheless Shariah prohibitions. The services that are offered to customers are Free-of-cost effectively acting as interest.
- **Savings Accounts:** Similarly, savings accounts have no intrinsic Shariah compliant mode. Funds are used for profit generating techniques, establishing a debtor-creditor relationship between the bank and the customer.
- Both accounts display depositors risk free returns for the bank while ignoring the ethical or risk sharing principles decreed by Islam.

2. Financing Procedure and Loan-Based System

- Conventional banks count almost entirely on **loans** as the intrinsic mode of financing. Products such as credit cards, running finance, car and house financing, long term corporate loans, and "leasing" arrays are all radically debt instruments with interest or mark-up.
- Money is treated as a commodity; lending is done for interest without relating returns to asset performance or business aftermath.

3. Risk and Liability

- Risk is almost entirely shifted to the **customer**, while the bank enjoys guaranteed returns.
- In asset financing, if the customer destroys or damages the asset, he remains liable to pay installments until or unless there is settlement or insurance otherwise is reported as a defaulter in e-CIB, harming credit history.
- The system does not differentiate between inescapable losses and negligence, putting the customer at a structural disadvantage.
- 

Graph; fully reserved banking vs fractional reserved banking

4. Systemic and Structural Issues

- Conventional banks are driven on a **fractional reserve basis**, creating money "from nothing" and amplifying credit without full backing. This leads to inflation as money supply increases without corresponding real economic growth.
- Debt-determined lending fuels **government deficits**: the state borrows to finance expenses, increasing public debt, while interest payments become a solid financial load.

- Inflation acts as a **hidden tax**, eroding savings and purchasing capacity, disproportionately affecting lower-income populations. Exploitative taxation through interest-based lending louden economic inequality.

5. Impact on Pakistan

- Despite diversification and competition, conventional banking's interest and loan dependent structure worsen **debt accumulation, fiscal deficits, and inflationary pressures**,which threaten economic stability.
- Pakistan has six Islamic banks and thirteen conventional banks offering Shariah feedback desk, but conventional methods still dominate, with credit extension primarily driving growth.
- Customer perception indicates higher satisfaction with Islamic banks due to ethical, risk-sharing practices, and avoidance of interest-based exploitation.

Key differences between Islamic and conventional banking

This slide covers the details related to comparing the Islamic and conventional banking systems. It includes distinguishing between the two based on their scope, objectives, and operations.

Parameters	Islamic Banking	Conventional Banking
Nature of Business	Based on Shariah principles	Based on interest-based system
Source of Funds	Deposits from customers and shareholders	Deposits from customers and other financial institutions
Objective	Promote socio-economic development and social justice	Maximize profit for shareholders
Financing Methods	Profit and loss sharing, lease financing, mudarabah, musharakah, and wakalah	Interest-based loans, overdrafts, and credit cards
Risk Sharing	Banks share profits and losses with customers	Customers bear all risks and banks receive fixed interest
Collateral	Collateral-free loans are allowed in some cases	Collateral is required for loans
Investment in Speculative Activities	Prohibited	Allowed
Transactions	Transactions must be transparent, fair, and ethical	Transactions must comply with regulatory requirements
Penalties	Non-compliance with Shariah principles results in penalties	Non-compliance with regulatory requirements results in penalties

This slide is 100% editable. Adapt it to your needs and capture your audience's attention.

4. Failure of the Conventional Banking System

The conventional banking system is constructively flawed due to its dependence on interest based lending and fractional reserve banking. By treating money as a commodity and without full asset backing, creating credit encourages excessive debt, transpose all risk to borrowers, and guarantees returns to banks disregarding real economic outcomes. This debt driven framework escalates government borrowing, widens monetary deficits, and fuels inflation, which set off as an undeclared tax on the public. These fragility become evident during financial stress, when banks lack ample reserves to respect depositors’ claims, which leads to liquidity catastrophe and institutional failures, as observed in Pakistan’s banking history.

1.Case Study: KASB Bank Limited (2014)

In 2014, KASB Bank faced a catastrophe because despite having very low capital and it lent out most of its depositors' money.When people began withdrawing their deposits (a bank run), the bank was not able to pay everyone because of the lack of liquid money..The State Bank of Pakistan imposed a six-month suspension, limited withdrawals to Rs 300,000, and eventually sold the bank to BankIslami for Rs 1,000. This happened because:

- the bank was driven under fractional-reserve banking,
- loans went off,
- and deposits were not fully reinforced or backed up by real reserves and the deposits .

It proves that the current system permits banks to lend out deposits and become unable to return money during stress. A full-reserve, Islamic, asset-based system would prevent this because deposits would always remain 100% backed and safe.

2. Case Study: Indus Bank Limited (2000)

The bank had lent out a huge chunk of depositors money, its assets had become fragile due to poor loans, and it no longer had ample liquidity to cross withdrawal demands which is a classic outcome of fractional-reserve banking.

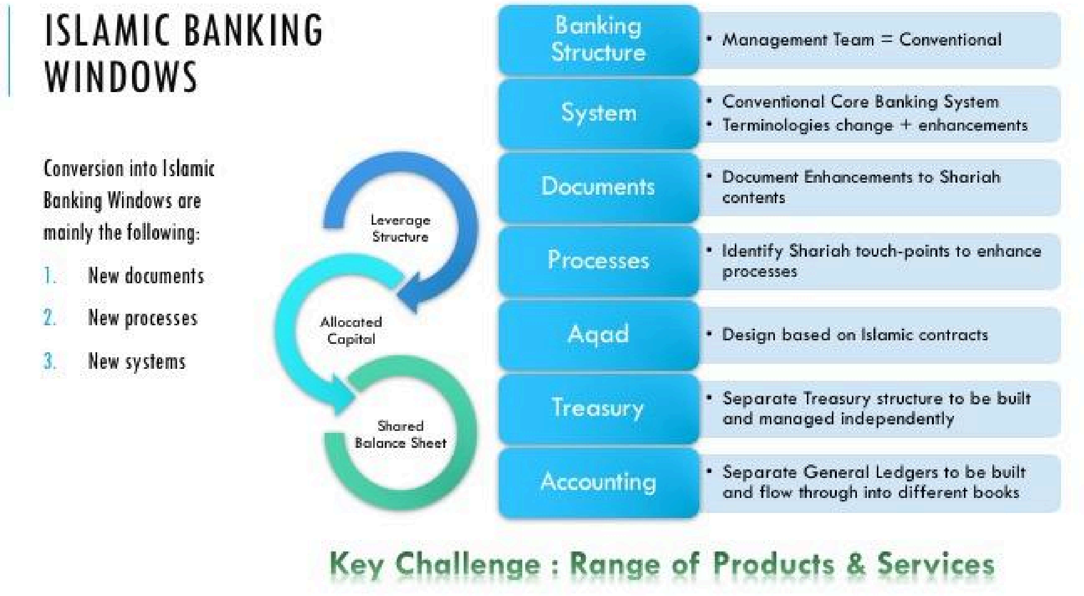
The collapse of Indus Bank Limited shows that Pakistan's present banking formation allows banks to become liquidated when loans go fragile or reserves run low. When that happens, depositors suffer because their money was never fully backed.

3. Lessons Learned from Banking Failures

Banking collapse shows that interest based and fractional reserve systems encourage excessive debt, liquidity scarcity, and financial instability. Risk is unjustly transposed to borrowers while banks obtain guaranteed returns. Credit creation generates inflation, acting as an invisible tax and aggravating government debt and fiscal deficits. These collapses highlight the need for an asset backed, interest-free, and full reserve system.

5. Islamic Alternatives to Riba

Islamic finance provides moral, risk-sharing and ethical alternatives to riba (interest), which is prohibited as it centralises wealth, fuels exploitation, and leads to economic mismatch like government debt cycle and inflation. According to the Hadith of the Prophet (SAW): **"Gold for gold, silver for silver, like for like, equal for equal, and hand-to-hand,"** riba arises from delay or excess in exchanges, making asset-backed exchange crucial.



These alternatives line up with full reserve banking by guaranteeing 100% reserves on deposits, handling money as a middle point of exchange rather than a goods, and consolidating creation under state authority connected to real growth. This challenges and curbs money supply expansion without yielding assets, lowering inflation as a hidden tax and government dependence on interest-based acquiring (e.g, Pakistan's external debt rising from $10 billion in 1980 to $42 billion in 1998, with 60% of outlays on servicing). Means are classified by risk: full (profit-loss sharing like Mudarabah/Musharakah) and small (trade-based like Murabaha/Salam), advocating justice ('adl) and generosity or charity (ihsan).

1.Qard-e-Hasaneh (Benevolent Loans)

Qard-e-Hasaneh entails interest free loans where only the principal is reimbursed, with optional assistance charges for operational cost. As a supportive means, it extracts from the Quranic highlights on charity and justice (e.g. Surah Al-Baqarah 2:280-281)

(وَإِن كَانَ ذُو عُسْرَةٍ فَنَظِرَةٌ إِلَىٰ مَيْسَرَةٍ ۚ وَأَن تَصَدَّقُوا خَيْرٌ لَّكُمْ ۖ إِن كُنتُمْ تَعْلَمُونَ) ٢٨٠

In practice, it facilitates needy individuals, students, or segments like agriculture, secured from bank profits or savings.In a full reserve system, Qard-e-Hasaneh helps governments tackle deficits without riba, backing welfare via Zakat or grants or donations rather than debt. This lessens public debt burdens, as seen in Pakistan's historical drive for riba abolition under the 1973 Constitution, hindering debased money printing for non productive consumption.

2.Mudarabah (Profit-Sharing Partnership)

Mudarabah is an agency collaboration where the Rabbul Mal (capital provider e.g., bank) invests funds, and the Mudarib (agent/supervisor) provides labor/work. All the Profits are divided as per pre-agreed fractions, while the losses are endured by the capital supplier until or unless due to negligence. Following the Hanafi scholars like Imam Muhammad, it allows flexibility(limited or unlimited mandates), allowing activities like purchasing or vending, lending transactions, and travel.

The main types of mudarabah include confined (Muqayyadah, limited scope) and unconstrained (Mutlaqah, full prudence). credits are treated as Mudarabah, where the depositors are Rabbul-Mal and banks are Mudarib, both sharing profits without control rights for depositors.

This type of mode encourages full reserves by routing the investments into real assets (e.g., agriculture or commerce), and prohibiting fractional money creation. It eliminates government debt by transferring the public funding to PLS models, where the state projects generate shared profits instead of the stable interest, curbing deficits and inflation from the unrestricted borrowing.

3.Musharakah/Shirkah (Joint Partnership)

Musharakah, which is originated from Shirkah (sharing), is a joint partnership where the partners donate or supply capital, effort, or expertise, and share profits according to a mutual contract and losses are shared in proportion to their investment. According to Syedna Ali (RA):

"Loss is shared according to investment, while the profit is according to the agreement."
The main types of Musharakah are Shirkat-ul-Milk (joint ownership) and Shirkat-ul-Aqd (contractual).

The Partners have their rights to trade, acquire goods, recruit workers, deposit assets, and utilise funds in Mudarabah. Termination occurs upon the goal completion, willing notice, the death of a partner , or legal incapacity. In such cases, the distribution of assets is preferred over dissolution or monetary settlement.

Diminishing Musharakah allows gradual buyout, ideal for financing (e.g., housing), combining sub-contracts for partnership, lease, and sale.

In full reserve banking, Musharakah ensures reserves are backed by shared-risk investments, reducing government shortfall by funding infrastructure via equity (no riba payments). This addresses rise in prices by limiting money to income generating activities , as in Pakistan's 1980 Modaraba Ordinance promoting fair partnerships over debt.

4.Murabaha and Bai-Muajjal (Cost-Plus and Deferred Sales)

Murabaha is a sale with profit added where the bank buys goods and sells them at cost plus revealed profit, ensuring control and risk transfer. Relationships evolve: principal-agent, promisor-promisee, buyer-seller, then creditor-debtor if delayed. Profit is accepted only when due, recorded as income not yet received otherwise.

Bai-Muajjal allows deferred payment (lump sum/scheduled payments) at a final price, higher for credit without calling it interest. Conditions: fixed price at contract, full possession to buyer, no changes post-sale, guarantee allowed.

Uses include raw materials, equipment, imports/exports, consumer goods, houses, vehicles, and packages (education/medical/tours). In full reserves, these modes back dealings with real assets, preventing price rising money creation. For governments, they replace debt bonds with trade-based funding, reducing deficits from interest burdens (e.g., Pakistan's 600% debt-to-revenue ratio).

5.Musawamah (Bargaining Sale)

Musawamah is a simple sale in which the buyer and the seller bargain and agree on a price. In this type of sale, the seller does not tell the buyer the original cost of the goods. This method is useful in markets where prices keep changing.All the rules of Murabaha apply to Musawamah, except one rule: there is no need to disclose the cost price.

Musawamah supports a full-reserve banking system because it is based on real buying and selling, not on lending money. This helps control inflation, as money is linked to real goods and assets.Governments can also use Musawamah to purchase goods and services without dealing in riba (interest). In this way, governments can avoid taking interest-based loans to cover budget deficits.

6.Bay Salam (Advance Payment Sale)

Bay Salam involves full advance payment for future delivery of specified commodities, allowed as an exception for requirement (e.g., farmers/traders). Conditions for bay salam are upfront payment, exact specs (quality/quantity), fixed date, no sale before possession, parallel contracts independent.

Uses: Agriculture, industrial production, exports, handicrafts. Price can be lower than spot; security/penalty for delay allowed.

In full reserves, Salam ties money to goods, preventing unbacked expansion and inflation. For governments, it funds projects without debt, reducing deficits by advance asset sales instead of interest loans.

7.Istisna’a (Manufacturing Contract)

Istisna’a is for producing non-existent items at fixed price/specs, with deferred/scheduled payments. Differences from Salam are that there is no advance payment required, and is for manufactured goods only. The contract may be cancelled before manufacturing begins. Parallel or third-party contracts are allowed, provided they are separate and independent. A penalty for delay in delivery may also be imposed.

Istisna is commonly used for Houses, factories, bridges, BOT(build-operate-transfer) projects such as highways where toll-collection rights are used as payment.

This mode aligns with full reserves by backing finance with constructed assets . It helps eliminate government debt through partnership based arrangements (no riba). It reduces inflation by linking money to useful production, as per OIC Fiqh Academy rulings.

8.Istijrar (Repeated Purchases)

Istijrar ia a sale arrangement that allows repeated purchases under a master agreement, with price decided after (or in advance). Conditions for Istijrar are known/stable market prices,and also no confusion. There are two main types:

1. The price is decided after all purchases are made.
2. The price is fixed at the beginning of the agreement.

With Murabaha: Bank must take control. Istijrar is commonly used for ongoing supplies for businesses such as raw materials and inventory.

In full reserves, it ensures asset-based repetition, reducing inflationary risks from debt. Governments can use it for ongoing purchasing , avoiding deficit borrowing.

9.Ijarah (Leasing)

Ijarah is a contract in which the right to use (usufruct) of an asset is transferred to the lessee, while ownership/risk stays with the lessor. It can only be applied to non-consumables assests.Rent fixed at contract, variable by phases (linked to inflation/taxes); starts after delivery/usable condition.

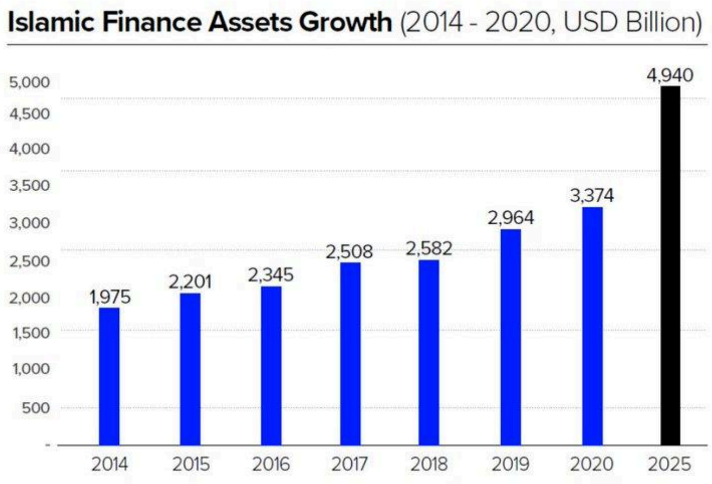
Lessor bears maintenance/insurance while the lessee is liable for negligence. Penalty for late rent to charity, not taken as income. Termination if unusable; no automatic ownership—separate promise allowed per OIC.

Commonly used for Equipment, vehicles, houses. In full reserves, Ijarah backs reserves with leased assets, helping governments fund infrastructure without riba debt, reducing deficits and inflation from loans without real output.

10.Ijarah wa Iqtina (Hire-Purchase)

This mode combines lease(Ijarah) with the eventual ownership transfer through a separate sale/promise, not automatic. Payments made by the customer includes both capital and rent and the ownership shifts gradually.

It supports full reserves by asset transfer without interest, aiding government projects (e.g., public equipment) to eliminate loan obligations and borrowing that increases price.



Source: Islamic Finance Development Report 2021

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6. Islamic Banking and Full Reserve Systems in Muslim Countries: Focus on Sudan and Malaysia.

Islamic banking operates on Shariah principles, prohibiting riba (interest) and emphasizing risk-sharing, asset-backing, and fair financial practices. A full reserve system in this context requires banks to hold 100% reserves on demand deposits, preventing money creation through lending more than deposits ,which is often seen as incompatible with Shariah due to its link to riba and unbacked expansion. True Islamic banking advocates full reserves to treat money as a medium of exchange rather than things used only to earn money , aligning with Quranic calls for just measures (**Surah Al-Mutaffifin 83:1-3**: "Woe to those who give less [than due]"). Full-reserve banking in Islamic finance helps:

- Reduce inflation caused by excess money supply.
- Lower government debt from interest obligations.
- Avoid fiscal deficits by promoting productive investments.

While no country has fully implemented "full reserve" banking in the strict Western sense (e.g., Chicago Plan), several Muslim nations have adopted fully Islamic systems that approximate it by eliminating interest and focusing on real assets. Below, we explore Sudan and Malaysia, with brief notes on others.

1.Sudan: A Pioneer in Fully Islamic Banking

Since 1983, the banking system is purely Islamic, where all banks conduct business without the element of interest (Riba). The Banking of Sudan Act, along with fatwas, contributed to eliminating riba within three years. Not a single loan remains in the classical form, but all have been shifted to the following Islamic practices:Mudaraba (profit-sharing),Musharaka (joint enterprise),Murabaha (cost-plus sale),Istisna’a.

The loans increased considerably between 1989-1991 (from 4,941 million to 14,027 million Sudanese Pounds). The deposits by 1996 were 559,107 million, while advances were 339,483 million, with remarkable growth without interest.

Sudanese banks are nearly operating at full reserves because they don’t offer interest-based lending. They have to maintain reserves and prioritize entrepreneurial activities rather than generating finances through borrowing. This practice is helpful because it control Inflation by Linking Money to Asset Value.

With 28 banks (10 foreign banks, 18 local banks) under observation from religious boards, the Sudanese model maintains Shariah compatibility, in line with the first ever Islamic bank, Faisal Islamic Bank of Sudan (1977). The issue of rural areas needs to be addressed, but this example illustrates how full Islamic banking secures stability without the instability caused by riba.

2.Malaysia: Dual System with Growing Islamic Banking

Malaysia has a dual banking structure where both conventional and Islamic banks operate alongside each other. They are supervised by the Bank Negara Malaysia (BNM) and the Ministry of Finance. Although the history of the introduction of the Islamic banking started in 1963 through the "Muslim Pilgrim Savings Corporation" (later changed in 1969 to "Tabung HAJ" in 1969 for savings of the Haj journey and 'Sahar Investment' in accordance with the Syariah). In the 1980s, another institution emerged named the 'Bank Islam Malaysia Berhad (BIMB)'. As of December 2019, the funds of the Islamic banking stood at USD 254 billion

There is no strict full reserve in Malaysia; rather, it is based on the minimal savings that a bank is expected to keep (Statutory Reserve Requirement) in conventional banking. However, for Islamic banking, they use arrangements in which they safeguard funds (Wadiah – safeguarding funds), profit sharing (Mudarabah), Musharakah (profits and losses equally), Murahaba (buy-back), Bai’ Bithaman Ajil (payment later), and Ijarah wa Iqtina (lease to own) are used. It is monitored by the United Shariah Board although not based on the reserve system but gets closer to the concept by discouraging riba.

This offsets public debt by directing money into responsible investments, manages deficits by undertaking risk-sharing schemes, and helps reduce inflation in relation to performance. The presence of a third-largest Islamic finance market in Malaysia has a degree of mixed success in the realm of hybrids but a call for complete reserves to remove all fractional parts.

3.Other Muslim Countries: Comparative Insights

Iran has had a complete shariah-complaint system since the 1980s, with modes like Qard-e-Hasaneh(interest free loan)and Mudarabah, approximating full reserves by banning interest and requiring money linked to real goods, which has controlled debt and inflation.

Pakistan's ongoing Islamization (1979-1985 phases, 1999 Supreme Court rulings) promotes PLS to phase out riba, reducing deficits through shariah approved options. Broader Muslim countries face the "Islamic banking paradox": true Shariah compliance requires full reserves to avoid riba-linked fractional systems. Proposals advocate 100% reserves for demand deposits, using PLS for investments, to eliminate unfair money/wealth distribution like debt concentration(too much borrowing by few people).

7. Principle Features of the Islamic Financial System

The Islamic financial system is grounded in islamic laws, emphasizing moral behaviour, fairness in society,and risk-sharing while prohibiting interest (riba), speculation (gambling), and uncertainty (gharaar). It seeks to promote economic well-being while avoiding moral or social harm, treating wealth as a trust from God and ensuring fair distribution. Below, I outline the key features based on standard Islamic economic principles, drawing from core sources like the Quran, Hadith, and agreements among islamic scholars(e.g., Council of Islamic Ideology frameworks). These align with the provided points and are substantiated by contemporary analyses, such as those from the International Monetary Fund and Bank of England, which highlight Islamic finance's focus on deals tied with real goods and fair investment.

For clarity, I've structured the features in a table, enumerating them with explanations, examples, and references where relevant.

Feature	Description	Key Rationale and Examples
1. Halal and Haram in Economic Activity	Islam permits pursuit of economic well-being but prohibits activities that are morally or socially harmful, ensuring all business remains ethically and socially responsible.	It is based on the Quranic principle of halal earning. For instance, Surah Al-Baqarah 2:168 says, "Eat of what is lawful and good on the earth." Examples of haram activities or businesses are those dealing with gambling, alcohol, or pork. It promotes ethical responsibility, as seen in Islamic banks avoiding investments in prohibited sectors, fostering social harmony and reducing exploitation.
2. Individual Ownership and Responsible Spending	Individuals have the right to own wealth legitimately earned but are obliged to spend wisely, avoid hoarding, and not squander wealth.	Hadith: "The son of Adam has no right to hoard wealth except for what he eats, wears, or gives in charity" (Sahih Muslim): Ownership is a divine trust-trust given to man-a promise that encourages moderation and wards off incidents leading to economic disorder such as inflation occasioned by wasteful spending.

3. Social Welfare and Wealth Distribution	Islam encourages reducing excess wealth margins to support the poor and deprived, with inheritance laws preventing excessive concentration of wealth in few hands.	The distribution of wealth is returned through Zakat, a 2.5 percent annual wealth tax and Sadaqah, as mentioned in Surah At-Tawbah 9:60. Moreover, inheritance laws like fixed shares for heirs ensure wide circulation and prevent monopolies, which are equitably provided to check against unduly high and variable rates of inflation that place an uneven burden on the earnings of the poor.
4. Balance of Social Justice and Individual Enterprise	The economic system aims for social justice without unnecessarily restricting individual enterprise; individual business activity is allowed unless harmful to self or society.	This balances personal freedom with collective good, prohibiting riba, thereby allowing entrepreneurship to continue but regulating hurtful practices like speculation in support of sustainable growth without debt-fueled deficits. Eiman: it is permitted by Allah as trade, while forbidding riba.
5.Profit-and-Loss Participation	Investments in Islamic financial institutions are based on profit-and-loss sharing, encouraging responsible investment and prudent risk management through policies like diversification.	ROOTED IN MUDARABAH AND MUSHARAKAH MODES: The sharing of profit is in accordance with the agreement while losses are borne in proportion to the capital. As the Hadith says, "Profit is according to agreement, loss according to capital" - Ali ibn Abi Talib. This minimizes speculative risks, for banks assess the performance for funding approval and thus avoid creating inflationary bubbles through unsupported lending.
6.Performance-Based Resource Allocation	Profit-and-loss sharing ensures better resource management; banks evaluate operational results before extending financial support.	This encourages efficiency, whereby financing links to actual results rather than straight interest. It follows the avoidance of gharaar, which helps in stabilizing economies through the allocation of funds to viable projects, hence controlling government deficits on poor investments.
7. Separation of Shareholders' Capital and Client Deposits	Islamic banks maintain a clear distinction between their capital and client funds, ensuring Sharia-compliant profit sharing.	Deposits are recognized as either trusts, Wadiah, or as investments, Mudarabah, but not as loans. This avoids riba. Such a separation ensures ethical conformance and minimizes systemic risk factors that create inflation in conventional systems..

8. Promotion and Support of Islamic Banking	The International Association of Islamic Banks (IAIB) plays a key role in cooperation and growth; membership has grown to over 100 institutions across 75+ countries (updated from original 28, as per recent data). Support from public and private sectors is essential for full development.	The coordination of Shariah compliance and research is carried out by the IAIB, founded in 1977. Public-private partnership drivers in many countries, such as Malaysia and Sudan, actually enhance financial inclusion and stability without riba-induced debt crises.

8. Promotion and Support of Islamic Banking

The promotion and support of Islamic banking are essential for changing from riba-based systems to fair, asset-backed finance, which aligns with full reserve banking by emphasizing profit and loss sharing and real economic activity. This reduces government dependence on interest loans, mitigating loan obligations (e.g., Pakistan's 60% expenditure on servicing), budget shortfall from unproductive borrowing, and inflation through stable, Shariah-compliant money supply. As the Quran urges in Surah Al-Ma'idah 5:2: "Cooperate in fair and moral behaviour, but do not cooperate in sin and aggression," international and national efforts foster cooperation to build strong and stable systems.

1. International Cooperation and Resolutions

Since 1978, the Islamic Conferences of Foreign Ministers have urged the members "to support the Islamic banking system". The goal of this declaration is the economic development based on shariah laws.The goal is to encourage sharia-compliant banking, which will not be dependent on conventional debt, hence the impact of the conventional debt for the rise of prices and the deficit.

International Association of Islamic Banks (IAIB), formed in 1977, oversees Shariah compliance as well as encourages cooperation among member Islamic banks. Membership among the involved initial 28 countries of Asia, the Arab states, and Africa remains extensive; currently, more than 100 institutions spread across 75+ countries, all to support and develop research and connectivity for enhancement. In turn, this global platform assists Muslim nations to move away from the riba system of debt, thereby reducing the pressure of inflation triggered by the unbacked monetary system.

2. Seminar Objectives and Institutional Development

Seminars tend to review Islamic banking, assess growth, and evaluate management systems in order to enhance equitable banking. Institutions such as Dar Al-Maal Al-Islami have initiated global halal services, supporting asset-backed models that minimize scarcity within government funds by stimulating productive investments rather than borrowing on interest.

Such development supports full reserves through the provision of structures for risk-sharing in order to tackle inflation as an unnoticed burden on the poor, based on systems tied to real assets that are stable.

3. Government Support

The establishment of Islamic banks requires governmental aid with respect to regulations and guidance, as practised in Pakistan and Sudan. The governments are encouraged to fulfill the Islamic requirements by encouraging the comprehensive Islamic economic system with an exemption until the enactment of the law.

This is imperative in ensuring the elimination of riba-based debt (such as found in Pakistan's constitution), deficit reduction through PLS financing, as well as inflation management by keeping finances within moral bounds.

4. Role of Central Banks

Central banks need to facilitate and oversee Islamic banks, especially in their initial development stages, by providing interest-free tools for cash availability and investments. They might encounter some issues if they cannot access money markets and need similar refinancing as other conventional banks. Amongst recommendations for Africa and Asia, such as adoption by Sudan and Malaysia governments, are operational facilitations such as specific approval. This is crucial for lessening public debt by moving to shariah-compliant financing as opposed to riba systems, thus lowering inflation.

9. Challenges and Needs for Islamic Banking

There are distinct challenges for Islamic banking because of its strict adherence to Islamic values, especially on the prohibition against riba. This affects Islamic banking's ability to apply conventional techniques for liquidity management. These issues are intensified with the shift to a full reserve banking system where banks are required to keep 100% reserves on deposits to not create any money from fractions but from assets through the asset-backed finance approach.

It is vital to address these to eliminate government debts (as in reforms from interest bonds to PLS), deficits (funded in an ethical and responsible manner), and inflation (managed by being linked to real assets). As of 2025, emphasis in international surveys focuses on continued concerns for standardization and human resource shortages. For countries specifically—Sudan's political instabilities heighten liquidity shortages, while the Malaysian dual banking system has made significant advances in meeting its regulatory demands. We will enumerate vital needs and concerns in the next discussion through historical development attempts (as in the case of Pakistan's development between 1979 to 1985 phases) and available data.

10.Prohibition of Interest-Based Transactions

The Islamic bank cannot involve itself in any form of Riba. This creates difficulties in its liquidity management and operations compared to conventional banks. This is because Islam focuses on real assets instead of debt money, as indicated in the Quran (Surah Al-Baqarah 2:275), "Allah has permitted trade and forbidden Riba."

By ensuring full reserves, this makes fractional lending impossible, thereby suppressing inflationary increases in money, though other mechanisms must follow. The 1983 full transformation in Sudan initially experienced liquidity problems during the transition period, while Malaysia's Shari'a-based component, with 38% market shares in 2019, with expected high single-digit growth in 2025-2026, faces fewer halal instruments under AI disruptions. The demand fuels public debt reduction through PLS to suppress deficits from non-productive borrowing.

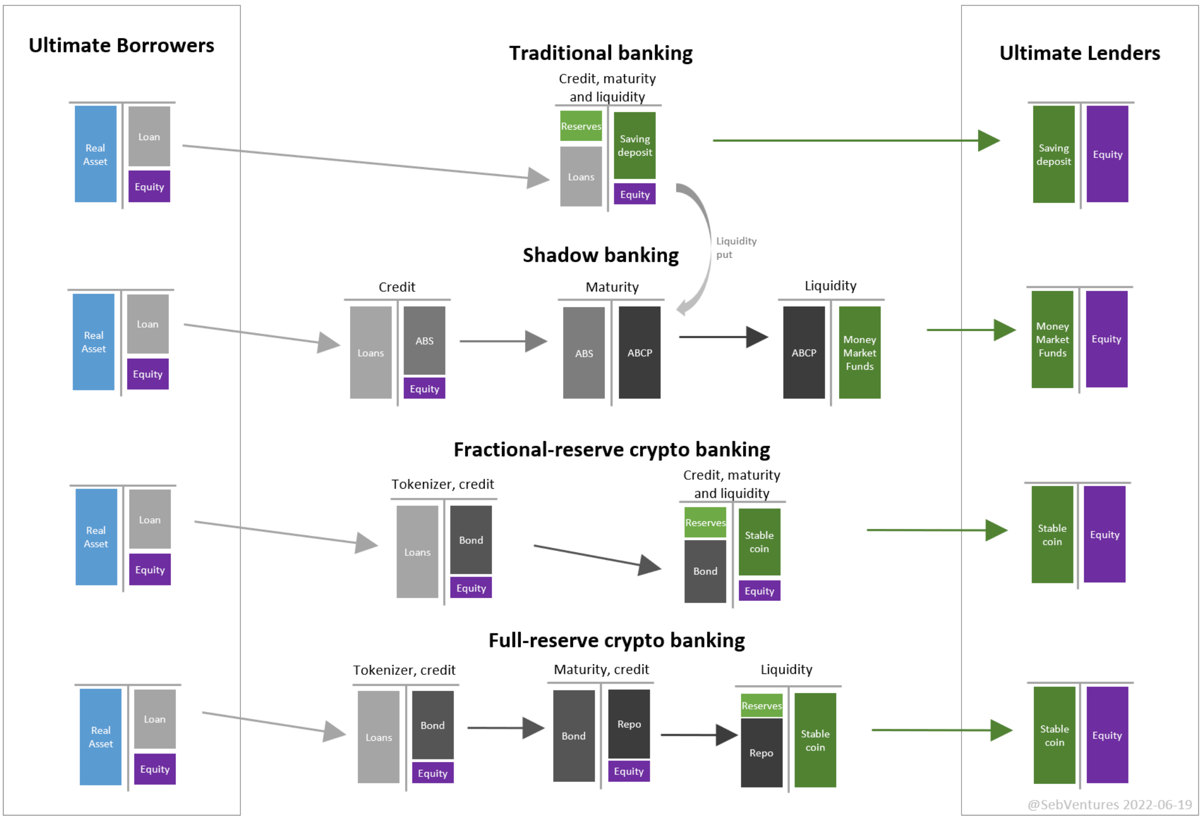
11. Need for Central Bank Support

The central bank needs to issue interest-free instruments to fulfill its statutory liquidity requirements and to invest surplus amounts into short-term yielding channels. Having an effective market for this is vital for achieving Islamic finance goals.

This is crucial for overcoming full reserves because, this way, Islamic reserves are ensured, and inflation caused by unbacked money is eliminated. The Bank of Sudan Act in Sudan aided this through fatwas to ensure loans increase (from 960 million Sudanese Pounds to 14,027 million Sudanese Pounds within 1983 to 1991, respectively), excluding riba. Bank Negara Malaysia aids through guiding documents, but there are demands, according to 2025 news, to focus on sustained finance to reduce inequalities compared to conventional Banks.

12. Inadequacy of Present Banking Laws

The laws in most Islamic nations do not regulate Islamic transactions, thus a review is necessary for the application of conventional laws or a separate body of laws for Shariah-compliant banks. In full reserves, revamped laws guarantee asset backing, fighting inflation. Sudan's 1983 reform blending



shariat into its laws remains contested due to conflict-related demands for implementation. Malaysian laws in Islamic banking offer guidelines under its dual system; however, surveys in 2025 show an urgent need for unified laws regarding HR issues and standardization. Debt is refixed by making PLS legal for public money, thus keeping public drains on finances subordinated. #### Formation des Départements Spécialisés "Each central bank.should have some departments related to guiding and supervising Islamic banks, particularly dealing with special services like Profit & Loss Sharing, Shariah Instruments, etc." It helps to increase full reserves by specializing in ethical supervision, thus lowering risks associated with inflation. The Sudanese Supreme Religious Board oversees all 28 banks for compliance. In Malaysia, the Unified Shariah Board and BWM sections manage the same. However, in 2025, challenges in AI incorporation and foreign funds participation will arise. Expert servicing helps in debt relief using effective and interest-free funds.

13. Building a Relationship between Islamic Banking and Monetary Authorities

Engage in Non-Interest financing/refinancing activities, Support short-term investment of PLS for excess funds, and Provide Tax exemptions/tax incentives to Islamic depositors just like conventional Banks.

In full reserves, favorable relationships offset disadvantage effects, ensuring stable monetary supply regardless of inflation. The Sudanese model involves authorities collaborating with religious boards on this. Malaysia, with excellent 2025 growth, requires more appropriate modalities in foreign investments, as reported in relation to uniform regulations. This makes debt-free public financing possible through halal financing mechanisms.

14. Operational Recommendations for Islamic Banks

The operational recommendations for an Islamic bank would be based on modernizing, integrating welfare, internationalization, and collective cooperation to promote and improve Shariah-compliant finance practices and models. These recommendations are not only based on implementing full reserve banking but through this process could also help to promote asset-backed investments and risk-sharing models and reduce or prevent overdependence on Riba-driven liquidity that is increasing government debt, as observed in Pakistan, where 60% of their expenses are used to repay their Riba-driven liquidity for government debt. The growth of Islamic finance, according to 2025 data from the Islamic Financial Services Board (IFSB), is at 14.9% year-over-year, and there is focus on AI and sustainability. The London Stock Exchange Group and the Islamic Corporation for the Development of the Private Sector estimate that global Islamic finance assets would be at $9.7 trillion by 2029 through innovative digitization.

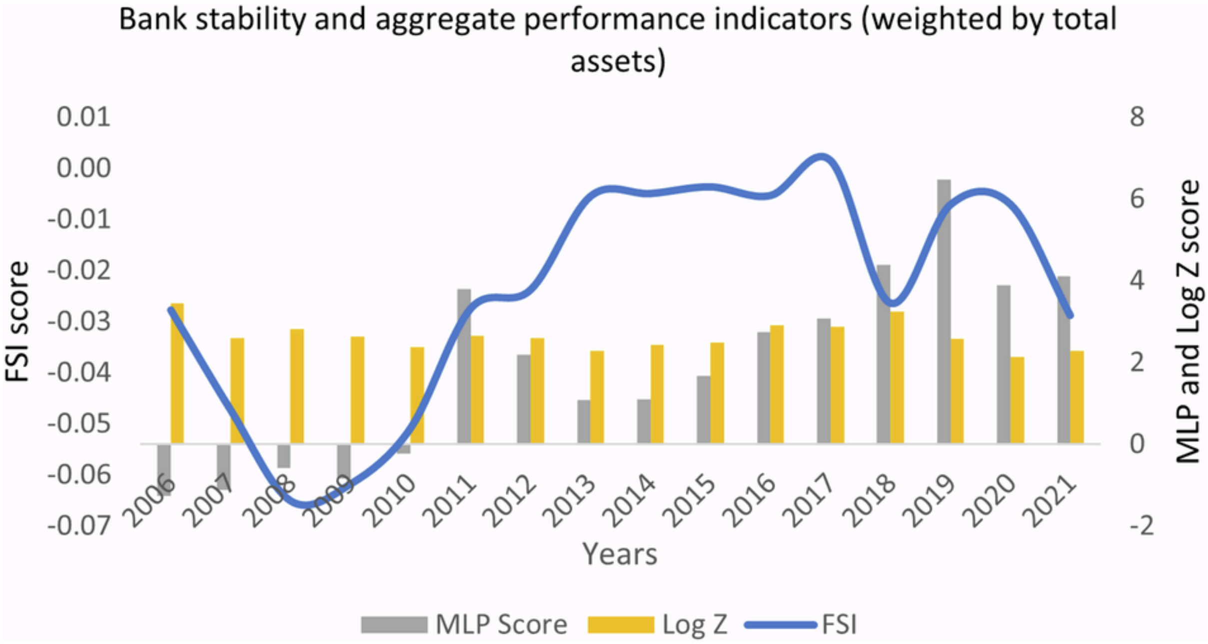
15. Implementation Recommendations

In some African and Asian countries, central bank recommendations have been followed with calls from some for others to exempt Islamic operations until legislation is in full bloom. This is a good way of allowing growth of Islamic banking and helping to sort out many issues faced by Shariah-compliant banks, including foreign investments and shareholder restrictions.

By facilitating these, Islamic banking minimizes dependence on riba debt to create fiscal balance and stable prices.

15. Remaining Challenges

Islamic banks require modalities for foreign investments and currency assets. There is also a need to repeal the restrictions on shareholder nationality in some jurisdictions. They need



similar facilities provided to riba-based banks so that they can play fairly.

Overcoming these ensures that promotion counters debt/inflation and advances the causes of full reserve through ethical global finance## Reforming Money and Banking: How to Get from Here to a Full Reserve System Through an Islamic Lens to Eliminate Government Debt, Deficits, and Inflation

16. Modernisation of Operations

Islamic banks should expand services to meet modern business requirements, improving methods for attracting funds and channeling them into halal investments. This includes adopting digital platforms, AI for data analytics, and sustainable finance tools, as highlighted in the Global Islamic Bankers' Survey 2025 by the General Council for Islamic Banks and Financial Institutions (CIBAFI). In Malaysia, two Islamic digital banks have been licensed and are now operational, enhancing accessibility and efficiency.

Modernization supports full reserves by digitizing asset-backed transactions, reducing inflationary risks from fractional lending. It helps governments shift from riba debt to halal funding, curbing deficits amid 2025's resilient growth projections (high single-digit in Malaysia).

17. Provision of Funds for Welfare Sectors

Allocate financing for social and welfare initiatives, such as Zakat and Waqf, to promote community development. This aligns with Islamic principles of social justice, extending to climate and sustainable agendas, where Islamic finance assets reached nearly $4 trillion in 2025.

In full reserves, welfare funding via Qard-e-Hasaneh or Waqf reduces government deficits by shifting social spending to ethical sources, mitigating inflation's impact on the poor and supporting debt-free public initiatives.

18. International Role and Collaboration

Islamic banks should operate nationally and internationally, as exemplified by Dar Al-Maal Al-Islami (DMI) and subsidiaries. Promote consortium approaches like joint ventures and syndicated financing, with examples including DMI, Faisal Islamic Bank (FIB) in Egypt, and Sudan's collaborative models. In 2025, the International Finance Corporation (IFC) announced its first Islamic financing in sub-Saharan Africa ($40 million to Banqui Islamic Society), boosting MSME loans. Sub-Saharan Africa now has 104 Islamic banks/windows across 28 countries.

Encourage coordination over rivalry, as in the IsDB Group's 2025 Annual Meetings for cross-border collaboration. This international role aids full reserves by fostering global halal liquidity, reducing government debt through syndicated PLS projects and curbing

deficits/inflation from isolated riba systems.

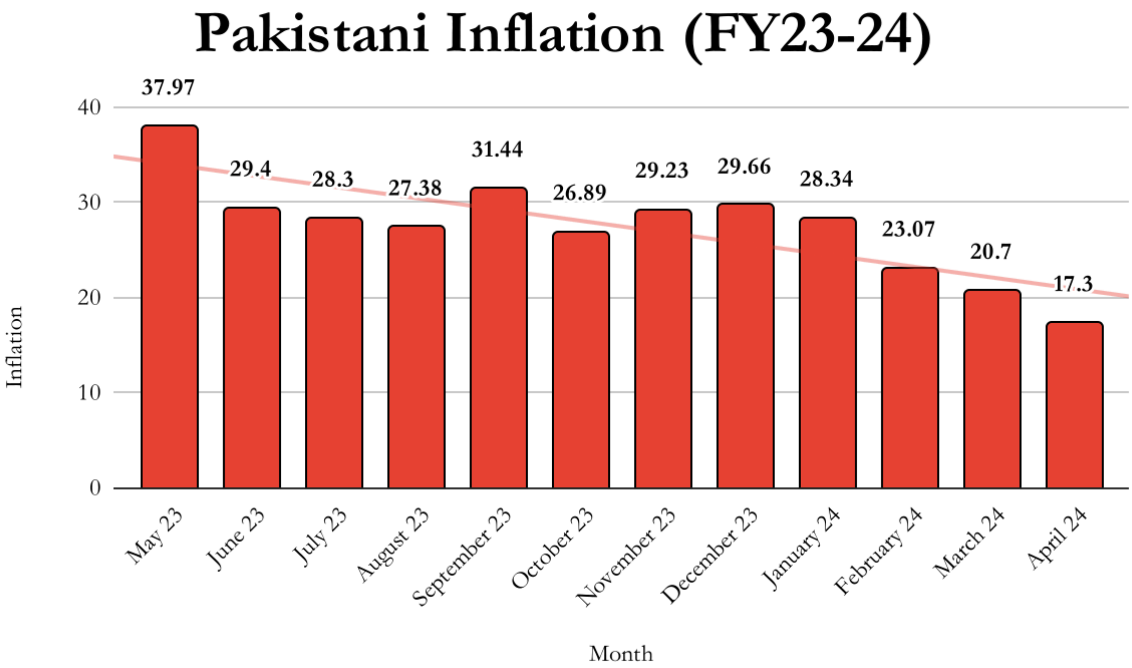
19. Role of the International Association of Islamic Banks (IAIB)

The IAIB (now evolved into bodies like CIBAFI and IFSB) strengthens ties among Islamic banks, affirms their Islamic character, and provides technical assistance for new ones. It coordinates data exchange, conducts research on banking/finance/insurance, promotes public awareness of principles, and represents common interests nationally/internationally.

In 2025, the IFSB's Stability Report and CIBAFI's GIBS focus on AI adoption and climate finance. This role supports full reserves by advocating interest-free instruments, helping eliminate debt/deficits/inflation through ethical global standards.

20. Effects on Debt, Deficits, and Inflation

Islamic banking, with its emphasis on riba-free, asset-backed finance and risk-sharing, has demonstrated positive effects on reducing government debt, fiscal deficits, and inflation in adopting countries. By prohibiting interest and tying money to real economic activity, it approximates full reserve principles—holding 100% reserves on deposits to prevent unbacked money creation. This curbs inflationary pressures from fractional lending, as seen in Sudan's 1983 full Islamic reform, where loan growth (from 960 million Sudanese Pounds in 1983 to 14,027 million in 1991) occurred without riba-induced expansion. In Malaysia, Islamic banking development positively impacts GDP growth without contributing to inflation, as empirical studies show no inflationary pressures from its expansion. Globally, Islamic finance's resilient growth (projected high single-digit in 2025-2026) amid headwinds like geopolitical tensions supports stability, with total assets rising double-digit in 2025 across sectors.



On debt, Islamic modes like Mudarabah and Musharakah replace interest bonds with equity-like Sukuk, sharing risks and profits to avoid compounding burdens. In Sudan, this has facilitated socio-economic development despite high external debt and inflation (economy shrinking with high inflation in 2020), by promoting efficiency in funding without riba. Malaysia's public debt-GDP dynamics in its Islamic economy show balanced growth, with diversification enhancing stability during crises.

For deficits, PLS ensures performance-based allocation, evaluating results before support, reducing wasteful spending. Sudan's Islamic system, despite budget deficits, uses profit margins based on project returns, limiting debt-financed gaps. Malaysia's Islamic banks respond to monetary policy without inflating deficits, as inflation rates remain moderate.

Inflation is mitigated by asset-backing, preventing unbacked money supply. In Sudan, Islamic banking stimulates growth without direct inflationary effects, though macroeconomic instability persists. Malaysia's empirical evidence shows Islamic financing does not contribute to inflation, with positive nonlinear ties to macroeconomic variables and GDP-per-capita growth. Full reserve models in Islamic finance, as proposed for 2025, eliminate domestic debt and enable non-inflationary growth by aligning supply with real output. Overall, these effects foster equitable economies, as per the Hadith: "Profit is according to agreement, loss according to capital" (Ali ibn Abi Talib), promoting justice over exploitation.

21. Challenges and Boundaries

The issues with this kind of banking can be attributed to its prohibition to “riba” or interest, making it hard to implement FRB in such an atmosphere where conventional banking systems dominate. The boundaries help ensure that everything remains within parameters that are halal, stated in Surah Al-Baqarah 2:275.

1. Practical Transition Issues

There are theory pratfalls; literacy concerns; and illicit practices in the process of transformation, and this necessitates phased transitions like the Pakistani recovery in the period from 1979 to 1985. There is macroeconomic turmoil in the Sudan' s economy, which is hampered by indebtedness even with inefficiency gains. There are AI challenges in Malaysia in 2025 concerning human capital.

2. Shariah Compliance & Ethical Boundaries

The Compliance also demands the prudent use of modes, such as secondary Murabaha, where Murabaha is used for “riba backdoor” purposes, with Shariah boards seen to neither allow gharaar nor Maysir. Shar'iah also does not allow practices bordering welfare because of ethical standards. The religious regulatory boards in Sudan rectify this, but geopolitical risks remain. Integrity is maintained by the United Shariah Board in Malaysia, but there are differences in standardization in 2025 surveys.

22. Conclusion

Reforming Money and Banking: Implementing a Full Reserve System Through an Islamic Lens to Eliminate Government Debt, Deficits, and Inflation

In total, an application of an Islamic Full Reserve Banking System, based upon the principles of justice, equity, and risk sharing in the Islamic Shariat, provides an attractive alternative to the universal problems associated with governmental debt, the budget deficit, and inflation that undermine contemporary economies. By requiring 100% reserves against deposited funds and forbidding riba, such an Islamic banking alternative provides for the correlating of money creation with real assets in productive activity, rather than the artificial increase in the money supply that destabilizes an economy. As it not only satisfies the Quranic Verse in Surah al-Baqarah, Chapter 2, Verse 275 “Allah has permitted trade but forbidden riba” it also utilizes the associated prophetic tradition: “Gold for gold, Silver for Silver. Like for like, Equal for Equal, Hand to Hand.”

1.Advantages and Future Potential

The benefits are diverse and proven. In relation to government borrowings, a move away from riba-based bonds to asset-based Sukuk securities involves governments that recorded 58% in 2025 to supplement their budget deficits in financing existing borrowings worth $105 billion in 2025. This lowers the compound effect seen in the history of Pakistani borrowings from $10 billion in 1980 to $42 billion in 1998; further bogged down by 60% required for financing because PLS models in Islamic banking systems show efficacy in resource utilization as there are no fixed returns. As regards budget deficits, resource utilization performance-based in Islamic banking systems screens performance prior to disbursement so as to ensure projects benefit from well-considered resource allocation in order to reduce wastage in spending. Sudan's complete implementation since 1983 showcases effectiveness in increasing loans from 960 million Sudanese Pounds in 1983 to 14,027 in 1991 without any interruptions from riba into projects.

The presence of inflation, a hidden tax that results from unbacked money, is regulated by asset backing, and there are no direct inflationary forces from the development of Islamic banking, as seen in countries such as Malaysia, where Islamic banking has a positive effect on GDP with negligible nonlinear macroeconomic inefficiencies. The future outlook for Islamic finance is bright and encouraging: world assets stand at almost $4 trillion as of 2025, and there is expected growth of $9.7 trillion by 2029, with the number of Islamic banks increasing to 104 in sub-Saharan Africa within 28 countries and expected to grow significantly based on current performance. The Malaysian economy, faced with difficulties and headwinds during 2025 and 2026, exhibits high single-digit growth driven by AI and GF, and their continued innovation and development overall preserve future hope and promise of growth and resilience. The OIC Economic Outlook 2025 estimates that there would be a deficit of 43 billion USD and 0.5% of GDP, and finance and insurance or Takaful within Islam provide means of mitigated growth through comparison and progress within leading countries' development.

2.Call to Action for Implementation

With these advantages in mind, governments, central banks, and institutions must make action their top priority. They need to adopt extensive reforms, as done in the Pakistani 1999 Supreme Court guidelines on the elimination of riba, they should also work on the development of interest-free financial tools in the in-house specialized units, as suggested in the guidelines concerning liquidity crises, and they should also promote global cooperation through IAIB, as well as in the form of global collaborations such as DMI. Islamic nations should exempt Islamic banking, remove shareholding caps, and apply AI to give Islamic banks an upgraded look in addition to earmarking resources in the welfare sector, including Zakat, Waqf, and others. With this Islamic full reserve approach, debt spirals will become history, fiscal sobriety will be strictly imposed, and commodity price stability will be achievable, satisfying the Prophetic ordering on riba because 'working on riba' signifies a declaration of warfare from Allah & His Messenger. It is high time to act on this Islamic full reserve approach to establish economies based on righteousness & piety in our quest for a prosperous & just future.

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