Reforming Money and Banking

How a Full-Reserve, Interest-Free System Can Eliminate Government Debt, Deficits and Inflation

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Introduction:

The opening line of *Pride and Prejudice* is the most famous opening in English Literature: It is the truth universally acknowledged, that a single man in possession of a good fortune must be in want of a wife,
Karl Marx from his political economy would have said the truth more bleakly: It is a truth universally acknowledged that capital or monetary funds, once in possession of state or power, must be in want of disparity to live!

Money, Power, and Crisis:

History for this reason serves a valuable purpose. From Nero's debasement of Roman coinage to unrestrained grandiosity of empires, to Henry VIII's silver currency funding wars, every era has shown that erroneous monetary structure eventually consumes the society that built it.
Modern economies are also no exception and Pakistan is born with such underlying errors either it being 1990's Depreciation or recent IMF bailouts, while collapse may arrive abruptly but we hereby know its mounting existence in coming years, an alarming state of affairs that might lead to another era of The Great Depression!
This article postulates how a full reserve interest free monetary system eradicates debts and deficits most importantly inflation in Pakistan!

Pakistan's Monetary History and Current Crises:

- ***Currency Depreciation***
  (Trading economics 2025) The USD/PKR exchange rate fell to *280.1610* on *December 26, 2025,* down *0.00%* from the previous session. Over the past month, the Pakistan Rupee has strengthened *0.84%,* but it's down by *0.64%* over the last 12 months.
  This may be Slightly good for temporary stability or support mainly due to IMF tranche, remittances and central bank intervention, however, on longer term would result in high imports , low exports , weak economy and debt pressure.

- ***High Inflation***
  (Trading economics 2025) Inflation remains one of Pakistan's most persistent economic challenges. Pakistan's annual inflation surged to **5.6%** in **September**, the highest since October 2024, up from **3.0%** in **August**. Driven primarily by a notable rebound in food and non-alcoholic *beverages* (5.0% vs. -1.8% in August), alongside faster price growth in *housing and utilities* (3.7% vs. 3.6%), transport (4.2% vs. 2.5%), *furnishing and*

household equipment maintenance (4.1% vs. 3.5%) and *miscellaneous goods and services* (14.9% vs. 14.4%).
Fiscal year 2023 : average 29.%,
This is merely not a temporary shock but showcases a structural weakness in monetary and fiscal framework.

- ***Fiscal Deficits***
  Pakistan's government has consistently spent more than it earns, consequently resulting in borrowing from commercial banks to cover the gap and increasing public debt
  (Source: SBP Annual Reports, World Bank reports.)

- ***IMF Bailouts***
  Pakistan has **approached the IMF multiple times** to stabilize the economy.
  Example: 2001, 2008, 2013, 2019, 2022–2024 programs. This is an alarming situation all round, long term debt obligations will increase.
  (Source: IMF Pakistan reports.)

- ***Growing Debt***
  Public debt has steadily increased, often exceeding **70–80%** of GDP in recent years.
  Interest payments consume a huge portion of federal revenue.
  (Source: State Bank of Pakistan, World Bank, IMF.)

- ***Structural Weaknesses of Interest-Based Banking***
  Money is **debt driven**, so debt always grows faster than the economy.
  Borrowers bear most of the risk; lenders get fixed returns regardless of economic performance. In result it encourages **speculation** and **asset bubbles** rather than productive investment eventually leading to **wealth concentration** and inequality.

To counter the problems we need to dive into understanding the two systems in question - Interest and Interest free system.

Understanding the *Interest* Based Monetary and Banking System:

In conventional banking, profit is generated by charging borrowers a higher rate of interest on loans than what is paid to depositors. This difference commonly expressed as the annual percentage rate (APR) forms the core revenue model of modern banks. At first glance, the system appears simple: money is borrowed, interest is charged, and financial activity continues.

Yet in Pakistan, this interest based framework has produced deep structural consequences. Heavy reliance on debt financing has led to persistent growth in public debt, intensifying fiscal pressure on the state. As debt servicing absorbs an increasing share of government revenues, fewer resources remain available for essential public needs such as health, education, and infrastructure. Over time, this dynamic contributes to economic stagnation and entrenches social inequality.

Islamic and Full-Reserve Monetary Systems

To address the flaws of our current system, we must rethink money not just as a tool, but as a social trust. This idea is **economic, not religious**.
M. Umer Chapra, in *Towards a Just Monetary System*, argues that money should facilitate real trade and production. When money itself becomes a commodity to be rented at interest, it stops serving society and begins to dominate it.

Similarly, Irving Fisher, in *100% Money*, highlighted the dangers of fractional reserve banking. A full-reserve system separates two critical functions:

- **Money creation**, which becomes a public responsibility.
- **Financial intermediation**, which remains a private activity.

Zafar Iqbal, in his Pakistan specific legal context, notes that although Islamic banking products exist under the State Bank of Pakistan, most money is still created through debt and interest linked instruments. In other words, Islamic banks operate ethically within a fundamentally interest driven system.

The constitution of Pakistan in **Article 38(f)** states:

"The state shall ...,

f. Eliminate riba as early as possible"

Yet, without reforming the way money is created and reserved, this remains symbolic rather than transformative.

What emerges from Chapra, Fisher, and King is a rare convergence: different traditions diagnosing the same disease.

For Pakistan, the question is no longer whether reform is needed, but whether it will be **structural or superficial**. Cosmetic fixes cannot correct foundational flaws. Only a system that **limits money creation, shares risk fairly, and anchors finance to real economic activity** can deliver lasting stability and prosperity.

Islamic Finance Mechanisms and Instruments:

Islamic finance is often misunderstood as a *mere prohibition of interest*. In reality, it represents a different philosophy of money itself. The Qur'an does not merely forbid riba; it consistently links wealth with responsibility, circulation, and accountability. The Qur'anic principle *"so that* *wealth does not circulate only among the rich"* (Qur'an 59:7) introduces an economic logic that modern systems struggle to achieve: preventing concentration without suppressing productivity. This is where Islamic financial mechanisms differ fundamentally from conventional banking.

The Landmark FSC Judgment (1988): Riba as a Constitutional, Not Merely Religious, Issue

The elimination of riba cannot be approached as a symbolic religious exercise or a superficial replacement of financial contracts. It must be understood as a constitutional, institutional, and economic imperative. This position finds firm legal grounding in the landmark **Federal Shariat Court (FSC) judgment of 1988**, which declared interest (riba) in all its forms to be unIslamic and incompatible with Pakistan's constitutional framework. Crucially, the Court rejected narrow interpretations that limited riba to excessive or exploitative rates, affirming instead that any **predetermined and risk free return on lending** falls within the prohibited domain. By doing so, the FSC directly challenged the foundational logic of interest based banking rather than isolated practices within it.

Equally important was the Court's recognition that the elimination of riba required **structural transformation**, not cosmetic adjustments.

The Way Forward: Structural Reform Beyond Symbolic Islamization

Reform Contemporary debates on Islamic banking often collapse *riba* into a narrow contractual concern, focusing on interest substitution rather than systemic injustice.R*iba* is fundamentally an instrument of exploitation, not merely a pricing mechanism. From this perspective, an Islamic financial system cannot be evaluated by the absence of interest alone, but by whether it dismantles structures that concentrate **risk upward and vulnerability downward.**

I. De-Elite-ization of Credit Allocation

Problem.
In Pakistan's banking system, credit flows disproportionately toward the government and large conglomerates, while small and productive sectors such as SMEs, agriculture, youth entrepreneurship, and women led enterprises remain structurally excluded. This creates a system where risk is socialized and profit is privatized, a condition incompatible with Islamic economic ethics.

Reform.
An Islamic financial order must begin with credit justice, not cosmetic contract replacement. This requires:

- Mandatory sectoral credit quotas for agriculture, SMEs, and women led enterprises.
- Withdrawal of tax privileges and central bank liquidity access from banks that fail to meet these quotas.

Without democratizing access to credit, Islamic banking remains functionally indistinguishable from its conventional counterpart.

II. Zakat as an Anti Corruption Monetary Instrument

Problem.
Zakat is commonly framed as a *poverty alleviation* tool. While this is partially true, such a framing limits its systemic potential. In practice, poverty persists not due to the absence of charity, but due to the unchecked accumulation and immobilization of wealth.

Reform.
Zakat must be reconceptualized as a disciplinary mechanism on power, not merely a comfort for the poor:

- Integration of Zakat into formal financial surveillance frameworks.
- Mandatory asset declarations for high-net-worth individuals.
- Zakat assessment on idle and speculative wealth.
- Penalties for non-compliance, including loss of eligibility for government contracts.

III. Abolishing Risk Free Government Borrowing

Problem.
Banks earn guaranteed returns while inflation and taxation transfer the burden to the public. This mirrors the very logic *riba* seeks to eliminate.

Reform.
No Islamic financial system can exist while the state itself is insulated from risk. Therefore:

- Treasury bills must be replaced with asset linked infrastructure sukuk.
- Returns should be tied to real project performance rather than guaranteed yields.
- Parliamentary oversight must be mandatory to ensure transparency and accountability.

IV. Islamic Finance Without Islamic Elites

Problem.
Islamic finance in many Muslim countries is governed by the same financial elites who benefited most from interest based systems. This reproduces inequality under religious branding.

Reform.
Institutional governance must be structurally independent:

- Establishment of an Independent Islamic Monetary Council comprising economists, Shariah scholars, and civil society representatives.

- Explicit exclusion of bank executives to prevent regulatory capture.

Elite driven reform cannot dismantle elite privilege. Structural injustice requires structural disruption.

Concluding Synthesis

Islamic banking cannot succeed through symbolic Islamization of contracts while preserving extractive financial architecture. As Dr. Ghamidi's interpretation of *riba* suggests, the prohibition is not against interest as a number, but against financial arrangements that guarantee return without shared risk and productive contribution. The way forward, therefore, is not incremental adjustment but institutional reengineering, one that redistributes risk, disciplines accumulation, and reanchors finance in real economic activity. Without this shift, Islamic banking remains Islamic in name, but conventional in power, outcome, and injustice.

Pakistan's economic crisis is not merely interest-based; it is an elite designed debt architecture protected by political power, legal immunity, and institutional asymmetry.Riba in Pakistan is not just a financial contract it is a governance failure.

Elite reform cannot reform itself.

History rarely collapses without warning; it signals its distress through patterns we choose either to confront or to ignore. From imperial debasements to modern debt crises, monetary instability has never been a matter of technical failure alone, but of institutional design. Pakistan's recurring inflation, currency depreciation, and dependence on external financing are not episodic shocks; they are symptoms of a system structurally inclined toward debt, risk asymmetry, and monetary expansion detached from real economic activity. This article has argued that reforming money and banking is not a *theological* aspiration but an economic necessity. The convergence between Islamic monetary ethics and Western economic thought from Chapra's moral economy, to Fisher's full reserve proposal, to King's critique of modern finance reveals a shared diagnosis:

when money becomes a source of private profit rather than a public utility, instability becomes inevitable.

Interest free, full reserve frameworks offer more than ethical appeal. A full reserve system requires banks to hold 100% reserves against deposits, preventing money creation through debt. The choice before Pakistan is therefore not between reform and continuity, but between structural correction and repeated crisis management.

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