Reforming Money and Banking – How a full-reserve, interest-free system can eliminate government debt, deficits, and inflation

Introduction

Money is defined as "a commodity accepted by general consent as a medium of economic exchange. It is the medium in which prices and values are expressed; as currency, it circulates anonymously from person to person and country to country, thus facilitating trade, and it is the principal measure of wealth"[1].In other words we can say the basic mean by which goods and services can be exchanged is the money. As bank is the legalized and authorized financial institute to accept deposit and make loans but it also do other financial services. So the banking is defined as "It is the business of protecting money for others. Banks lend this money, generating interest that creates profits for the bank and its customers".[2]The brief history of banking is essential to understand the need of reformation of money and banking. It was common practice till the mid of 16 and 17 century that as gold was basically used for trade purpose or we may say that it was international currency of that time but at the same time it was difficult to handle and transfer, so guarantee slips (fiat money) were issued by goldsmith of that time on the base of gold that they used to kept, then that slips were further used for business purpose and so on[3]. In 1840 there arose a great issue of Inflation and the main reason behind was that more slips were issued as compared to gold present ,in other words sovereign money wasn't present but guarantee slips were issued. Then British Government took this decision that only central government would have authority to issue guarantee slips on the base of gold and that time British govt. was controlling authority so it was globally accepted[4].

Problem Recognition

It is clear that the start of banking was just to keep gold as deposits and issuance of guarantee slips using some markup ratio. And then a great financial setback was witnessed because goldsmith issued more slips. In the modern world, according to

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1 .Friedman, M. and Meltzer, A. H. (2025, December 12). money. Encyclopedia Britannica. https://www.britannica.com/money/money. Accessed dated on 29 Nov-25

2 . Annuity.org. (2025, November 21). Banking definition: What is banking & how does it work? https://www.annuity.org/personal-finance/banking/. Accessed dated on 05 Nov-25

3 . https://www.youtube.com/shorts/9aYrs8s6KUE. Accessed dated on 12 Nov-25

4 . https://www.youtube.com/shorts/S8LRk0oI8B4. Accessed dated on 27 Nov-25

policy of bank of England All Commercial (Private) Banks are allowed to give debt up to 95% of what they have while keeping just 5% in the central bank for interbank settlements and cash withdraw purposes[5].

i.e.,A depositor deposit 1000pkr in Meezan bank, according to policy bank has to deposit 50pkr in central bank account which is State bank of Pakistan and remaining 950pkr, bank can give as a loan to other customer. When a 3rd person comes for loan bank offers him loan on markup rate according to SBP, and bank shows 950pkr.in his account ,now 1000pkr is still in the account of 1st depositor , 50pkr in SBP and 950pkr in the account of 3rd person. Now the money in the form of digits is almost doubled and this cycle goes on further and it is amazing that the double money is nor the fait money nor the commodity, it's the magic money as Khalilullah, Q says[6] in the modern banking system whenever bank gives loan, magic money is generated and in the world its ratio is up to 20X while in Pakistan its ratio is up to 10X, this is the major fault of Fractional reserve banking system , on which all modern banks operate. That's why markup rate is kept high to keep the debt giving or money creation in control, it's like a valve to control the inflation[7].

Actual Problem

In Pakistan commercial banks out of 95% what they have, 70-75% they give as a debt to Government at the specific markup (may vary 17-24%) and the remaining 20- 25% they give as a debt to local machinery[8]. Due to very high interest rate, Government is continuously taking more loans to pay the debt. In every month government is taking 400Billionpkr as a debt from local banks[9]. As a result of which due to current banking system default (creation of money and debt at high interest rate), almost 90% of total interest cost of Pakistani government is being used to return internal debt only[10]; automatically making 1/3 (80 Million People) of total population of Pakistan out of economy circle as well our coming generation liable to unending debts and fire of Inflation[11].

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[5] . https://pensiontrusts.cartwright.co.uk/news-feature-money/news-feature-understanding-modern-banking-a-clear-perspective-feb-2024.pdf. Accessed dated on 12 Nov-25

[6] . (Khalilullah, Q. (2024, May 8). Full reserve banking: Part – I. The News International. https://www.thenews.com.pk/print/1186811-full-reserve-banking-part-i). Accessed dated on 07 Nov-25

[7] . https://www.youtube.com/shorts/a_pc3S2TRnE. Accessed dated on 09 Nov-25

[8] . https://www.youtube.com/shorts/8z9hjCK87kE. Accessed dated on 20 Nov-25

[9] . https://www.youtube.com/shorts/oJThWJqdJ1U. Accessed dated on 26 Nov-25

[10] . https://www.youtube.com/shorts/29HQj_i45e4. Accessed dated on 12 Nov-25

[11]. https://www.youtube.com/shorts/oJThWJqdJ1U. Accessed dated on 19 Nov-2

Creation of Money and Fractional reserve banking System

In the start of banking when slips were issued by local small individual bank on the base of gold, goldsmiths observed that people usually don't need all gold at a time so they began to earn on the base of interest[12] and later on when more slips were issued without having gold at back, it was considered fraud because it resulted high inflation in 1840, that's why Government of England ordered that the only authority that can issue slips would be central government. Those slips were like the same as today we have currency in our hands that we call Fait money. It is a guarantee slip by the government that you can make transaction or buy things by using this[13]. Up to 1930, Central bank of the Government was considered the only authority for printing Fait money on the basis of reserves of Gold but later on gold wasn't present behind the money. Instead of Gold it was linked with GDP (sum of gross services + product of country)[14] at the meantime not only the bank of England but all over the world this was accepted as a law that all Commercial/Private banks can give up to 95% as debt to customers on demand[15]. And it is clear and all large banks like Bank of Chicago, Bank of England, Bank of China, Bank of Canada even bank of IMF accept it that when a bank give loan money is created[16]; like Khaliluh.Q says quoting the Bank of England Quarterly Bulletin, 2014 Q1 "When a bank makes a loan, for example, to someone taking out a mortgage to buy a house, it does not typically do so by giving them thousands of pounds worth of banknotes. Instead, it credits their bank account with a bank deposit of the size of the mortgage. At that moment, new money is created"[17]. So the very major fault of present banking system is the creation of money because it is collectively agreed upon by all economist that when there is more money it loses its value and resulted into inflation, moreover this banking system is associated with bumps of economy like we witnessed economy crisis in

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[12] . Annuity.org. (2025, November 21). Banking definition: What is banking & how does it work? https://www.annuity.org/personal-finance/banking/

[13] . https://www.youtube.com/shorts/D_dGwK_qhrY.

[14] . https://www.youtube.com/shorts/D_dGwK_qhrY.

[15] . https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp.

[16] . https://www.youtube.com/watch?v=j7lkUe-bwBQ.

[17] . (Khalilullah, Q. (2024, May 8). Full reserve banking: Part – I. The News International. https://www.thenews.com.pk/print/1186811-full-reserve-banking-part-i.

2008, when only one bank in Dubai dismissed 75thousands employees in a single day[18].

Multiplier effect of Money and its Hazards

As mentioned in the start, under the policy of Bank of England, Banks can create money by giving debt and this can be up to 20X of original deposit they have. It means if more than 5% of depositors ask the bank for money in cash bank would run up automatically[19]. In the case bank is run up, the depositor can get only 5% of its deposits at once while remaining he would be able to get on proportional bases when the assets of bank would be sold[20]. So the deposits in the banking system are not save but also the banking system is causing the inflation as Khalilullah, Q says "inflation resulting from their money expansion is controlled by the central bank through a high-interest rate policy to discourage loan-taking activity. As mentioned above, a high-rate policy is not effective in Pakistan since the largest borrower from commercial banks is the government itself, which is not in a position to repay the loans"[21].

Debt situation of Pakistan and correlation with expenditures of Govt.

As Pakistan avail up to 75% of total debts of commercial banks at very high markup rate up to 24%. There are two types of basically debts on Pakistan; 1.Foreign debt (debt from China with markup rate 4% ,Saudi Arabia with markup rate 4% and IMF with markup rate 2.5%), it is collectively about 10% of total debt of Pakistan, 2. Internal debt, it is 880 Trillion pkr.that is almost 90% of total debt of Pakistan [22] but the markup rate at internal debt is 17-24% that is the basic apple of discord ,making the things more worse. Actually economy of any country holds a complex attributes, in it the expenditures of one become the income of other but due to debt condition and very high markup rate currently almost 60% govt.revenue is being consumed

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[18] . https://www.youtube.com/shorts/AmCfPN9QJ0Y. Accessed dated on 13 Nov-25
[19] . https://www.youtube.com/shorts/a_pc3S2TRnE. Accessed dated on 18 Nov-25

[20] . https://www.youtube.com/shorts/IVYDbwd8lyQ. Accessed dated on 20 Nov-25

[21] . (Khalilullah, Q. (2024, May 8). Full reserve banking: Part – I. The News International. https://www.thenews.com.pk/print/1186811-full-reserve-banking-part-i. Accessed dated on 01 Nov-25
[22] . https://www.youtube.com/shorts/N_RU2TleNBM. Accessed dated on 19 Nov-25

for the payments of internal debts and markup rates[23](in 2023-24 almost7300 billion rupees were given to pay internal debt+ markup rate, this cost was almost 50 times higher than total progressive projects of Pakistan)[24]; directly we aren't allowing almost 80 Million people (1/3 of total population) to participate in economy, that's why they are living under the line of poverty; In Pakistan GDP is 2.5% and 40% people are living as poor so our GDP is already 40% deficient. If expenditure becomes low then firms will not produce more, lesser employees would be required that directly results into unemployment. This is the reason why various governments transfer heavy funds to poor (daily wanderers) because the knew if they don't transfer poor wouldn't able to buy and firms would collapse[25].

Pakistan's Debt and Liabilities-Summary
(In Billion Rupees)

		R	R	R	R	P
	Jun-24	**Sep-24**	**Dec-24**	**Mar-25**	**Jun-25**	**Sep-25**
I. Government Domestic Debt[7]	47,160	47,536	49,883	51,518	54,472	53,424
II. Government External Debt	21,754	22,034	21,764	22,170	23,417	23,181
III. Debt from IMF	2,332	2,568	2,366	2,319	2,630	2,542
IV. External Liabilities[1]	3,266	3,345	3,262	3,312	3,392	3,378
V. Private Sector External Debt	5,467	5,500	5,406	4,930	5,024	4,989
VI. PSEs External Debt	2,068	2,042	2,034	2,127	2,200	2,149
VII. PSEs Domestic Debt	2,105	2,089	2,068	2,107	2,016	2,009
VIII. Commodity Operations[2]	1,378	1,139	1,163	1,075	1,067	1,059
IX. Intercompany External Debt from Direct Investor abroad	1,592	1,670	1,597	1,591	1,618	1,591
A. Gross Public Debt (sum I to III)	**71,246**	**72,139**	**74,013**	**76,007**	**80,518**	**79,147**
B. Total Debt of the Government - FRDLA Definition[3]	**65,105**	**64,100**	**67,066**	**69,223**	**73,267**	**71,661**
C. Total External Debt & Liabilities (sum II to VI+IX)	**36,479**	**37,159**	**36,429**	**36,450**	**38,281**	**37,829**

[26]Majority of taxes about 50 % by government is gathered by 3 basics modes according to 2024-25 budget;

1 .Indirect taxes (Sale tax+ED) 33% which is about 5867 billion pkr

2. custom duty 9% which is about 1591 billion pkr

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23 . Khalilullah, Q. (2024b, May 9). Full reserve banking: Part - II. The News International. https://www.thenews.com.pk/print/1187235-full-reserve-banking-part-ii. Accessed dated on 22 Nov-25

24 . Khalilullah, Q. (2024, May 8). Full reserve banking: Part – I. The News International. https://www.thenews.com.pk/print/1186811-full-reserve-banking-part-i. Accessed dated on 12 Nov-25

25 . https://www.youtube.com/shorts/ixB0p9HiNpA.
Accessed dated on 28 Nov-25

26 . Pakistan's Debt and Liabilities-Summary. (2025). In https://www.sbp.org.pk/ecodata/Summary.pdf. State bank of Pakistan. Retrieved December 12, 2025, from https://www.sbp.org.pk/ecodata/Summary.pdf. Accessed dated on 20- Dec-25

3. Petroleum Levy 7% which is about 1281 billion pkr

While loans contributed remaining 50% which is about 8500billion pkr.50% govt. revenue comes from debt and 60% of its income is used to pay back debt with markup rate.

Hindrance in Economy

As in Pakistan banks give almost 75% of its debt to govt. as a result local progressive institute wouldn't progress because they didn't get initial loans; moreover internal debt has increased during last 10 years from 4.7 Trillion to 47 Trillion due to high markup rate so this is the basic hindrance that where debt is required , isn't provided as needed and where it is given, at that again debt is taken to pay that debt due to very high markup rate ; resulting 40% living under poverty line.

Concept of Full-Reserve banking System

This system operates on the very basic model from where banking started. This system allows commercial bank to offer debt to customers according to what they actually have reserves in the form of fait money or commodity money, that's why it is also called 100% reserve banking system. In other words each bank would have account in the central bank, where it would have to show or deposit 100% of its reserves; for intra-bank settlements permission of central bank wouldn't be required and for interbank settlements Central bank would be involved. This banking system would only permit central bank to create money according to GDP as well as creation of money by commercial banks would be ended; resultantly inflation would stop. This system is very close to Islamic teaching as there is no deceit in the form of magic money and it is clear in Islam the one who deceits doesn't follow the path of Islam. Moreover this system puts a blockage against the exploitation of poor. The banking system would be comprises of two system: 1. Money/deposit section (as described band would be only able to give debt if it would have real money), 2. Investment section (In this system depositor wouldn't get fixed profit rate on their deposits rather bank would work on profit- loss base) so this system actually would finish the markup or Riba that is clearly and violently declared haram in Islam. So far the question is how banks would manage their expenditures? It can be sort out by charging 1% of reserves that may be given by Central bank or users and it would be about 400-500 billion rupees that would be 50% of current bank profit ratio.

Why full reserve banking system?

Because until 1840 it was only banking system working properly, In Switzerland with 1% markup rate 0.1 Million people gave their vote in its okay form later on it couldn't be applied because they said we already have world best economy[27]. Two economists Benes & Kumhof (2012) set up a DSGE model to test the full reserve banking model (IMF research paper). The real USA data encompassing four sectors: banks, households, manufacturers and government used in the model. According to the outputs, the full reserve banking would:

1. Significantly reduce business cycle volatility caused by rapid changes in banks attitudes towards credit risk, 2. Eliminate bank runs, 3.A large reduction in both government and private debt, 4. The results don't seem to indicate a restrictive credit supply[28]

There is no technical error in launching this system. By this system we can also get rid of worst system of taxation because the 60% of govt. revenue would be used for public instead of paying debt.

Pakistan and Full-reserve banking system

If this banking system is applied in Pakistan then "the State Bank of Pakistan (SBP) gaining complete control over money creation and supply, the need for a monetary rather than interest rate policy of the SBP, which is a main issue, would cease to exist"[29]. All the commercial banks would be ordered to raise their reserves up to 100% in the central bank. For that banks have to return the treasury bills, sukooks and bonds. When all of these are returned to SBP , ministry of Pakistan then would have right to DE notify all of that , as a result internal debt would be ended. And state bank of Pakistan would have 40 trillion rupees as deposits[30]. In full reserve govt. usually wouldn't require debt from internal banks because government debt

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[27] . https://www.youtube.com/shorts/7gEE7O7WMmg. Accessed dated on 28 Nov-25

[28] . https://www.youtube.com/watch?v=j7lkUe-bwBQ. Accessed dated on 28 Nov-25

[29] . .(Khalilullah, Q. (2024b, May 9). Full reserve banking: Part - II. The News International. https://www.thenews.com.pk/print/1187235-full-reserve-banking-part-ii. Accessed dated on 20 Nov-25

[30] . https://www.youtube.com/shorts/QVZR. Accessed dated on 28 Nov-25

would be zero already and now we are already paying 600 billion pkr. as interest rate and every month govt. is going to bank to take loan of 400 billion rupee to pay interest but if any govt. ask for debt then if there is inflation that would be only for that generation or for that year not like now that our coming generations are going down the debt, moreover SBP would be able to create money up to 4% as our goods ratio as note of 5000 cost of mfg. just 2.5pkr so money would be create to do equilibrium; money issuance power will be only SPB and money would be issued according to growth rate so equilibrium would be maintained. One more gain would be as khalilulah. Q says "The banks currently perform two conflicting functions simultaneously: money deposit for safekeeping and transaction purposes; and investment to earn profits and returns on behalf of the investors as an intermediary. Full Reserve Banking would remove the conflict that is inherently built into the current system. The separation of core functions (payment services and Investment/lending) would allow specialized institutions/sections to focus on each, potentially increasing competitiveness in the sector"[31]. In full reserve banking system investment section will operate only on profit loss base, bank would invest your money on P-L base same as suggested by symon fron Chicago school of thought [32], as in fractional system you get fixed 10% profit but inflation damages more[33]; also in case of bank run ,your money would be protected; as claimed by modern big economist like fischer[34] So far external debt is concerned it is clear external debt is actually deficit of import and export, if we are able to balance import and export then if we assume as it is 100billion $ external debt, currently from foreign Pakistanis we are receiving 2.5 billion $ per month. So external debt would be end up in 4 years.

Economy with real Islamic spirit

In Islamic state there are 2 types of taxes; 1:2.5% as zakat and 2nd is10 or 20% as Ushar while now we are having almost 50 % of our income in taxes an indirect taxes

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[31] . .(Khalilullah, Q. (2024b, May 9). Full reserve banking: Part - II. The News International. https://www.thenews.com.pk/print/1187235-full-reserve-banking-part-ii. Accessed dated on 20 Nov-25

[32] . https://www.youtube.com/shorts/p_UM6vuB8DI. Accessed dated on 20 Nov-25

[33] . https://www.youtube.com/shorts/6zRkGlc1AFg. Accessed dated on 20 Nov-25

[34] . https://www.youtube.com/shorts/3gIIN0TlinM. Accessed dated on 20 Nov-25

and it is the most worst of all taxes as in it the poor even had to pay[35]. As our all debt is interest based , Impact of only 1% interest rate on govt. debt is around Rs 300 Billion almost equal to the total amount allocated Ten Crore Poor People (Only Rs 400 per person per month). According to an IMF paper: 1. Household debt almost zero in 1950, has reached to around 1/3rd of world GDP in 2022, 2. Total private debt, including household and business debt, has increased from 35% in 1950 to 146% of GDP in 2022. 3. Global debt including public debt has increased from 100% of world GDP in 1950 to 238% of GDP in 2022[36]. Milton Friedman and Irving fisher; both believe that full-reserve system is the only solution and can be applied easily as fisher says "I have come to believe that the (Full Reserve Banking) plan, properly worked out and applied, is incomparably the best proposal ever offered for speedily and permanently solving the problem of depressions"[37]. Moreover he suggested that unification of module of Money and recapturing of govt. all of its institute are the bright aspects of this model. Khaliluh.Q says "The transition process to 100 per cent reserves is easy, reasonably speedy, and without severe repercussions for financial or economic markets, as confirmed by renowned monetary economist Milton Friedman"[38].

Objections on Full-Reserve Banking system

It was objected that this system would limit economy as money supply would be slowed down[39]. Economists Sheila Dow, Guðrún Johnsen, & Alberto Montagnoli (University of Stirling / Sheffield) critically examine full-reserve proposals and objected that Central bank usually lake data to control money printing this could make things worse[40]. Paul Krugman objected that this could cause shadow banking system that lack deposit insurance and higher systemetic risk [41]. It was also objected that the nature of this system is full of uncertainity as most stable econonmy holders

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[35] . https://www.youtube.com/shorts/NdJ06qK_VEI. Accessed dated on 20 Nov-25

[36] . https://www.youtube.com/watch?v=j7lkUe-bwBQ. Accessed dated on 20 Nov-25

[37] . https://www.youtube.com/watch?v=j7lkUe-bwBQ. Accessed dated on 20 Nov-25

[38] . Khalilullah, Q. (2024c, May 11). Full reserve banking: Part - III. The News International. https://www.thenews.com.pk/print/1187636-full-reserve-banking. Accessed dated on 20 Nov-25

[39] . https://www.wallstreetmojo.com/full-reserve-banking/?utm(source=chatgpt.com). Accessed dated on 25-Dec-25

[40] . https://ideas.repec.org/p/shf/wpaper/2015008.html?utm(source=chatgpt.com). Accessed dated on 25-Dec-25

[41] . https://grokipedia.com/page/Full-reserve_banking?utm(source=chatgpt.com). Accessed dated on 25-Dec-25

reject it with 75% opposing it[42]. One more objection was as If money supply or money creation can't respond according to economic shocks, prices or output must adjust through other channels, possibly it may cause economic pain like deflation or wage rigidity problems.

Counter Reply of professional Economist

Irving Fisher (Chicago Plan),Benes & Kumhof (IMF Working Paper) and Laurence Kotlikoff said this system can never limit economy nor the shortage of money can happen installment funds continue to recover credit and volatility of output falls significantly[43]. Milton Friedman says answering the 2nd objection that Central bank is already managing the money indirectly, through this system by direct access it would be more easier[44]. Martin Wolf and Positive Money says arguing the shadow banking that in full- reserve system rich will be relocated not would be made hidden so it is not possible[45]. So far the concern of Swiss masses was that was natural and even at that time economist of Swiss were in favor of that. For the last objection Fisher says that at the money layer leverage is removed by full reserve system so it can easily check the need of market[46].

Conclusion

Full- reserve banking system holds very close resemblance to Islamic principles and it has ability to end up not ally all debt of Pakistan but also it can thrive the 40% GDP.

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[42] . https://www.rabobank.com/knowledge/d011318599-swiss-say-nein-to-vollgeld?utm(source=chatgpt.com). Accessed dated on 25-Dec-25

[43] . https://www.imf.org/external/pubs/ft/wp/2012/wp12202.PDF.

[44] . Mishkin, F. (2011). Monetary Policy Strategy: Lessons from the Crisis. https://doi.org/10.3386/w16755. Accessed dated on 25-Dec-25

[45] . Wolf, M. (2014). The shifts and the shocks: what we've learned--and have still to learn--from the financial crisis. Choice Reviews Online, 52(05), 52–2671. https://doi.org/10.5860/choice.187292. Accessed dated on 25-Dec-25

[46] . https://www.imf.org/external/pubs/ft/fandd/2014/09/pdf/wolf.pdf. Accessed dated on 25-Dec-25