

# **IMPACT OF ISLAMIC FINANCE ON ECONOMIC GROWTH – Empirical Evidence from Pakistan**

**By**

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A thesis presented to Bahria University, Islamabad in partial fulfilment of the  
requirements for the degree of Masters of Science

**April 2016**

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## **ACKNOWLEDGEMENTS**

I am thankful to Almighty Allah for bestowing me health, knowledge and resources to complete this dissertation I would like to extend my gratitude to my beloved supervisor Dr Muhammad Hanif for an untiring assistance and guidance which was necessary for producing this piece of research.

(Kamran Ahmad)

## **Dedication**

**This thesis is dedicated to my mother.**

For their endless love, support and encouragement

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## Abbreviations & Terminologies

**Gharar:** Uncertainty in Investment

**Riba:** Interest which is strictly prohibited in Islam

**Usury:** High-Interest Rate

**Bai:** sale

**Bai salam:** It's type of Sharia Complaint Financing in which selling product is Agriculture

**Bai Majjal:** It's similar to Murahaba but Selling price is not necessary to be disclosed

**Istisna:** An Instrument used for Project financing

**Murahaba:** Sale of a product on predetermined rate of Profit.

**Ijarah:** Rent base IFI

**Mudarabah:** One Party contributes Capital and other Skills.

**Musharakah:** A kind of partnership in which both parties share capital and skills.

**Diminishing Musharakah:** Islamic House Financing

**Sukuk:** Islamic Bond

**Rub ul Maal:** IN Mudarabah Contract, The person who contribute Capital

**Mudarib:** In Mudarabah Contract, the person who contribute Skills

**AAOIFI:** Accounting & Auditing Organization of Islamic Financial Institution

**CII:** Council of Islamic Ideology

**Qias:** Individual Opinion on Islamic Issue

**Ijama:** Consensus of Clerics on Islamic Issue

**Shirka:** Arabic Word meaning partnership

**Shirkat ul Aqad:** Partnership by contract

**Shirkat ul Milk:** It's kind of partnership basis on capital

**Sharia Board:** A committee developed to make sure the operation of Islamic banks under the guidance of Sharia

## **Abstract**

After the Global financial crisis, Islamic finance gets worldwide attention and it increased with fast pace especially in Pakistan where total assets of Islamic Banks crossed Rs. 1.7 Trillion. This paper explores empirically the relationship between the development of Islamic banking system and economic growth in the Islamic Republic of Pakistan. Using econometric analysis, quarterly time-series data of economic growth and Islamic banks' financing from 2006 to 2015 were used. We use Islamic Banks' private lending and total assets as a proxy for the development of Islamic Finance and GDP and GFCF as a proxy for Economic Growth. For the analysis, the unit root test, descriptive stats, regression analysis, co-integration test, and Granger causality tests were done. Our empirical results generally signify that in the long run Islamic banks' financing is positive and significantly correlated with economic growth in Pakistan which reinforces the idea that a well-functioning Islamic banking system promotes economic growth. Meanwhile, there is no short-term relationship exist in between Islamic banking and economic growth.