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Realising Pakistan's Soft Power Potential to Create a Truly Interest-Free Economy

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Abstract

Pakistan has set a goal of making all its banking assets sharia-compliant by 2027, and it could fail to meet this target. This research conceptually explores how "soft power" could expedite the process of conversion towards Islamic banking. Soft power, among other factors, includes good governance, strategic use of media, and educating society. In this case, educating and raising awareness on the role and benefits among non-users of Islamic banking is also included. Issues such as political and economic instability, ineffective governance, lack of rule of law, corruption and extremism are affecting Pakistan's soft power which in turn, affect the perception of Pakistan's religiosity, the cornerstone of Islamic banking. This may, therefore, impact the adoption of and conversion to Islamic Banking. There is scarce research on consumer behaviour with Islamic banking products. Soft power could be used to influence consumer behaviour to increase the adoption of Islamic banking and thereby, increase the conversion rate of more banks from convention towards Islamic banking using a pull factor and increased demand. Pakistan is otherwise considered a hard-power country because of its military strength. It is a country among others that have negative perceptions and image problems. This article highlights how Pakistan as a country, through its soft power potential and the strengths it possesses. A case study approach is utilised showing negative perceptions of different countries such as Qatar, Saudi Arabia and Malaysia and how, even with negative perceptions, these countries still hold a good rank in the soft power index and also rank higher than Pakistan in the Islamic Banking assets and number of consumers.

Keywords: Islamic banking, soft power, religiosity, consumer behaviour.
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1. Introduction

Pakistan has a strong constitutional structure whereby it is mandatory for its transition towards an interest-free economy as soon as possible and make it fully shariah compliant. These concerns/objectives are laid down in the Objectives Resolution making Islam the underlying foundation of Pakistan's Constitution enshrined in Article 2A. Indeed, article 38(f) requires the state to eliminate Riba (interest). In April 2022, a decision of the Federal Shariat Court required that the country shift from conventional banking to Islamic banking by 2007. Despite being an Islamic country, Islamic finance is still relatively young. Even in the 1990s, conventional banking was pervasive in Pakistan and Islamic banking options were not commonly and widely available (Hassan et al., 2018).

Just as some businesses in the fast-food sector have opted for halal food branches, similarly conventional banks opened Islamic windows and branches. Retail banking is old and commercial whereas Islamic banking is relatively young with the first Islamic commercial banking license in Pakistan issued in 2002 (to Meezan Bank) (Murad et al, 2021). Islamic finance growth in Pakistan can be attributed to several factors including religious beliefs of the country that is an Islamic state, that Islamic finance managed to withstand the global financial crises and, so while many banking institutions had to “restart” or suffered serious setbacks, Pakistan and other Islamic banking nations continued on an upward growth trend (Naveed et al., 2020). Finally, a wide range of Islamic finance banking options make Islamic banking more accessible for the average population, thus diverting customers away from the conventional banking system.

A country’s image or reputation may thrive or suffer, based on how that country is perceived by others (Somborn, 2014). Almost every country has negative perceptions of different magnitudes. These perceptions can be influenced by many factors, such as history, culture, politics, religion, governance, economy, handling of global issues, etc. Some countries with negative perceptions/images include China, the USA, Pakistan, India, North Korea, Israel, and Russia among others. Yet, despite these negative positions, how have these aforementioned countries managed to also build an image of superpowers in the world economy? It is because they have deployed a concerted and cohesive strategy of “image building”.

‘Image’ is a perception that can be spread to everybody with positive or negative connotations (Szondi, 2010). In the context of a nation, image building or branding is the use of tools and techniques by a country to improve its identity or perception in a positive way (Gudjonsson, 2005). The production of informative, rather than tangible, products that have perceptive implications in economic, political, or social contexts falls under the umbrella of media management (Mierzejewska, 2011).

As referenced, Pakistan is one such country with negative perceptions and will be the focus of this essay. This is because of the current economic and political situation and because the perception of its use of “hard power” i.e., its military strength alone has not lifted Pakistan out of its crises. Traditionally, a hard power, the nation is in dire need of structural overhaul to build upon its immense potential for soft power. It needs to try new approaches rather than just military might for a positive international perception (Cheema, 2017). Pakistan should leverage its strengths and potential for industries such as tourism, agriculture, heritage, technology, manpower and more. But how can Pakistan learn lessons from other countries and reform its image so that it becomes more relevant? Pakistan should revisit its international strategies for its personal interests. It needs to stay neutral and make decisions that benefit it instead of just pleasing its allies.

This essay analyses the strengths Pakistan possesses and the opportunities it has, followed by a richer analysis of a soft power model, concluding with recommendations for what could be Pakistan’s way out to direct itself to an interest-free economy.

2. Literature review

2.1. Islamic Banking

For Pakistan to reach its 2027 Islamic Banking target, it requires educating unbanked consumers and supporting existing conventional banks in their transition to Islamic finance. Pakistan has focused on, over time, Islamising the economy since 2000 (Murad et al, 2021), but still has a dual system to this day of conventional banking and Islamic banking. The State Bank of Pakistan announced its vision to make Islamic banking as the first choice for users of banking in Pakistan (SBP, 2021).

All three aspects of Pakistan are under the auspices of Islamic teachings, including financial, institutional, and constitutional. One such facet is Islamic Banking, which is a Shariah-compliant financial method of banking. Islamic banking offers services such as *Sukkuk*, *Mudarabah*, *Takaful*, *Ijarah*, *Qardh*, and more which are interest-free and financially ethical structures that facilitate a customer instead of crushing them in loan and interest debt. Research indicates that Islamic banks are not only more resilient in the face of economic crises with similar efficiency but offer better asset quality and capitalisation (Beck et al., 2013; Fuertes, 2016).

Table 2.1. Methods of Finance

Method	Mechanism/definition
Murabaha	cost-plus sale
Ijara	Leasing
Musharaka	Partnership
Mudaraba	profit-sharing
Salam	advance purchase
Istisna	manufacturing contract

Pakistan, being an Islamic state, offers a wide range of Islamic banking options that have innovated in recent years. In what is a booming sector, there are many banks. However, there is a distinction between "fully fledged" Islamic banks, and conventional banks that operate Islamic banking windows or branches. There are five fully-fledged Islamic banks and numerous Islamic branches and windows. According to Murad et al. (2021), Pakistan has approximately 268 Islamic branches under the banner of conventional banks listed. Islamic Banks have around 524 branches. This suggests that Islamic windows account for over 50% of the total of Islamic banking branches. This in turn suggests that Islamic Banking is a growing trend towards the sharia-compliant modus.

The State Bank of Pakistan mainly provides guidance for conventional Banking. Whereas the Islamic Banking system is guided by the Sharia Advisory Board. The board is responsible to develop and introduce new products and services under Islamic guidance and create demands and enhance the usage of such products and services.

The aim of both systems is to generate profit, however, the routes and products through which this is obtained are radically different. Conventional banks lend money using interest rates. Whereas, in Islamic banking, there is no interest (or Riba) and instead, the profit and loss are shared between the lender and the borrower. Loss shared by an Islamic bank is based on several instruments (see Table 2.2).

Table 2.2. Different Methods for Generating Profit

Category	Islamic Banking	Conventional Banking
How money is borrowed	Money in: loans and mudarabah (profit-sharing). Money out: only profits to depositors	Money in: deposits Money out: loans to people, the bank makes money on the interest rate that the bank charges on loans
Modes of Finance	Seen as investment 3 modes using • "Rental" (ijarah): • "Trade or sales" (Murabaha, Musawammah, Salam, Istisna& Tijarah) • "Partnerships" (Mudarabah and Musharakah)	Loans or debt
Risk	The bank and the borrower have joint risk in the outlay and rewards from the investment.	The bank bears the risk, and customers receive a fixed interest rate regardless of the bank's profit or loss.
Asset-Backed Financing	All transactions must be backed by tangible assets. Islamic banks avoid dealing in speculative or unethical activities, focusing on real economic transactions.	While collateral is often used, a significant portion of conventional banking involves debt-based transactions that may not be directly linked to tangible assets.

2.2. Why Soft Power

The slower-than-desired adoption rate of Pakistan towards Islamic Banking and potentially missing its 2027 target, could be partially explained by Pakistan's underutilised soft power.
A key focus of Islamic banking has been how to encourage non-users of Islamic Banking to convert from conventional banking, and to retain existing users and deepen their usage.

Soft power leverages the use of several factors to engage with a wider and diverse audience over a longer term. This includes the use of education, media, governance, and trust in the country (Nye, 1990). While Nye (1990) initially listed political values, culture, and foreign policy as the three pillars of soft power, according to Thomson (2020), there are seven pillars of soft power that are considered when publishing the soft power index/ranking. These pillars are listed in the image below.

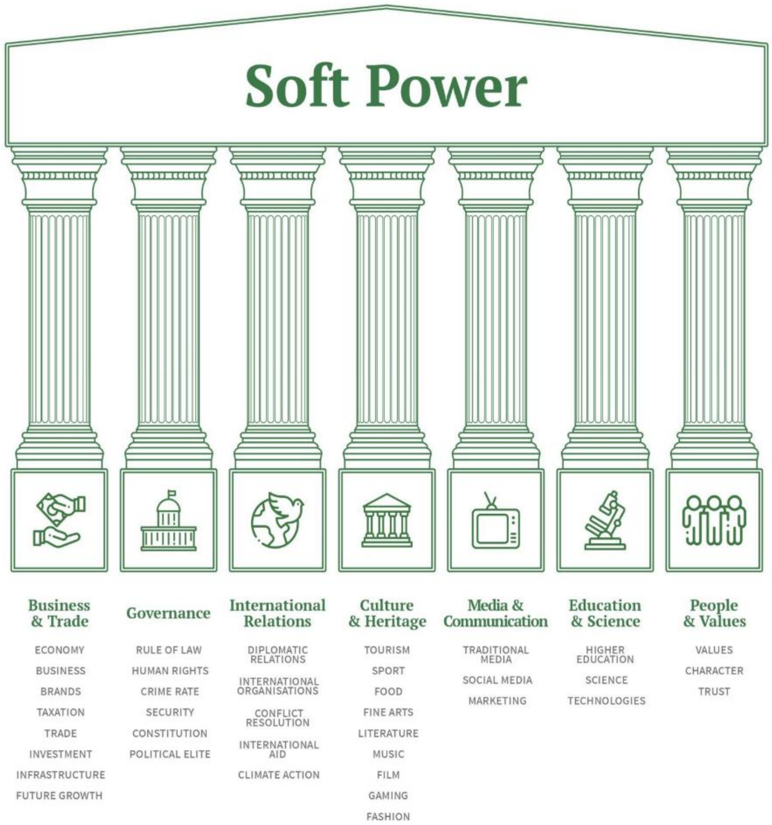

Figure 2.1. Research by Brand Finance (2022)

Pakistan is ranked 84th in the soft power index report published by (Brand Finance, 2022) while Saudi Arabia is ranked 2nd and Malaysia 11th.

This article underscores the significance of soft power in the context of Pakistan precisely because of the under-utilisation of the "soft power" in the country. Pakistan has traditionally been known for its "hard Power" i.e. military strength, nonetheless, it failed in promoting its soft power strengths. With little effort, Pakistan can still offer many opportunities amidst its crises. People in the corridors of power have failed a very resilient nation by allocating insufficient resources and endeavours to enhance Pakistan's soft power. Pakistan may suffer further losses if this soft power potential remains untapped. Lack of governance reduces trust which, as shown in the figure above, is crucial for achieving the increase in conversion and adoption of Islamic banking. Collectively, these factors reduce the "religiosity factor" (Hur et al., 2020), which, in turn, could reduce the adoption rate of Islamic banking. Media as well as marketing also play a huge role in educating the masses.

Islamic banks have invested considerably in training the public and their employees on Islamic products (Johnes et al., 2014). This has gone some way in improving reputation, achieving better customer experience in banking, and increased popularity for Islamic banking products. Interestingly, prior studies concluded religiosity has an essential role in consumers' preference in South Korea (Hur et al., 2020). There are a few studies that compare the motivation and intention of Muslims toward decisions to pursue conventional versus Islamic banks. Previous studies are also more likely to use correlation and cross-sectional techniques and survey regression analyses (Adil, 2021; Hassan et al., 2018). Therefore, a positive image built through soft power can enhance a country's reputation and render it more appealing for trade and investment. For sustainable and long-lasting international relationships, elements such as cultural diplomacy and educational strategies can encourage trust and goodwill which is the key to success generally but specifically for Islamic banking dominance.

2.3. Soft Power Analysis of Pakistan

A soft power analysis is conducted below based on a very brief SWOT Analysis.

2.3.1. Strengths

a. Strategic Geographical Location:

Pakistan's geographical location provides it with significant geographical importance. It is a gateway between Central Asia, South Asia, and the Middle East. Therefore, there could be strong collaboration in the soft power efforts and religiosity factor that could increase the pervasiveness of Islamic Banking in Pakistan.

b. Young Population:

Pakistan has a huge youth population. This is a very important factor as the youth have the power to transform a country's future. According to a report by Ahmad (2018), currently, 64 percent of the total population is younger than 30 and 29 percent are between 15 and 29. This means that with the use of technology, it is easier to educate this population on Islamic banking products.

2.3.2. Weaknesses

a. Economic Challenges:

Pakistan is currently facing many economic challenges such as high poverty rate, unemployment, fiscal deficits, inadequate infrastructure, energy shortages and corruption. These factors form a barrier to attracting foreign investments as well. As of 2022, Pakistan currently has external debt and liabilities of $126.3 billion (Chaudhury, 2023). This causes distress and distraction from its goals to achieve Islamic banking dominance.

b. Political Instability and Polarisation:

Pakistan has always been a victim of political instability, whether it is due to external interference, or internal through martial laws, or an immature democratic environment. According to economists, political instability is a key factor that may influence a country's economy (Aisen, 2011). Normally, the role of political parties entails them to ensure peace, prosperity, and progress towards economic development, but unfortunately, the political elites in Pakistan have divided and polarised the nation into ethnic, religious, and political lines (Rais, 2022).

c. Economic Crisis:

Bitar et al. (2017) say that "oil revenues, speedy economic development through the private banking sectors, the inaugural of the banking sector to foreign competition and the newly adopted financial reforms have pressure on Islamic banks".
This can result in newly created financial products and more expenses on research and development, as well as on staff training to guarantee efficient resource allocation and enhance productivity.

Pakistan's inflation rate increased to 38% in May 2023, which is the highest ever recorded in the country (Trading Economics, 2023). Historically, in the year 2000, Pakistan's inflation rate was 4.37%, while in 2022, it rose to 19.87%. Before the slowed processes of CPEC, the inflation rate was as low as 2.53% in 2015 and has been on an upward trajectory since then. The GDP has seen huge fluctuations since 2000, with a minor overall increase from 4.26% in 2000 to 6.19% in 2022, even falling to -1.27% in 2020 (Macrotrends, 2023).

The graph below shows that while Pakistan's GDP per capita has improved since 2000, India and Bangladesh have seen better economic growth. Pakistan currently has 1505 USD, India has 2256 USD, while Bangladesh has 2457 USD per capita in 2021 (Datacommons.org, n.d).

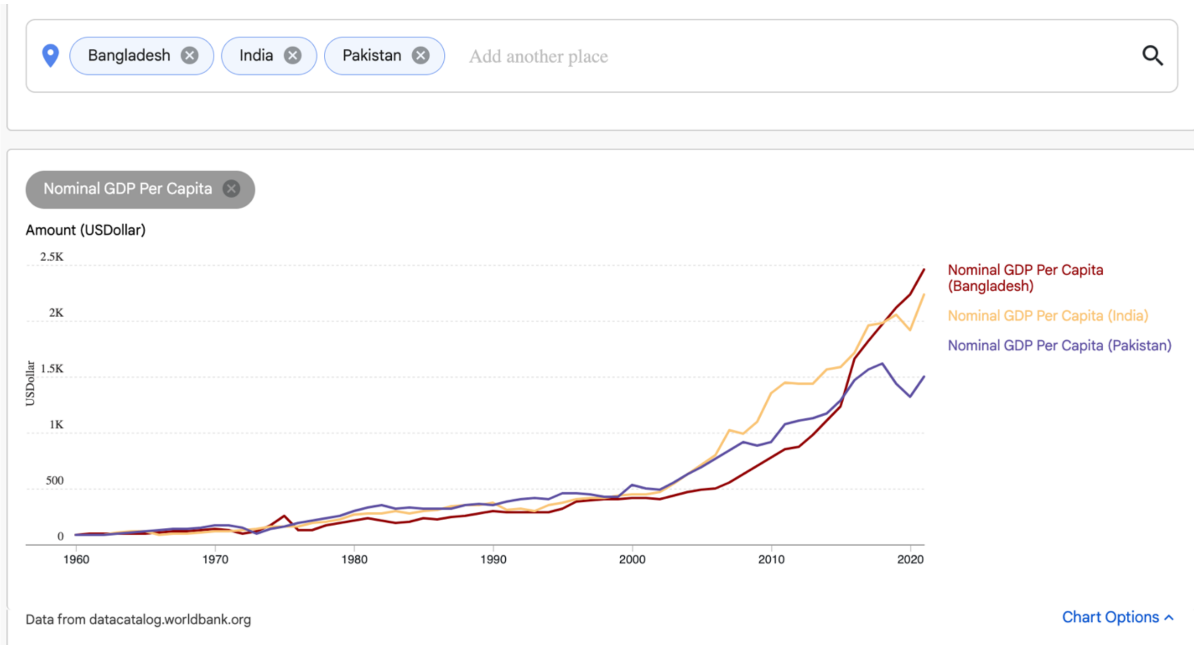

Figure 2. 2. Graphical Comparison of GDP Per Capita. Source: World Bank Data Source: World Bank (Datacommons.org, n.d.)

3. Soft Power in Practice

Some case studies on select countries have been curated below to illustrate how they are rebuilding their negative image. Lessons will be distilled for Pakistan.

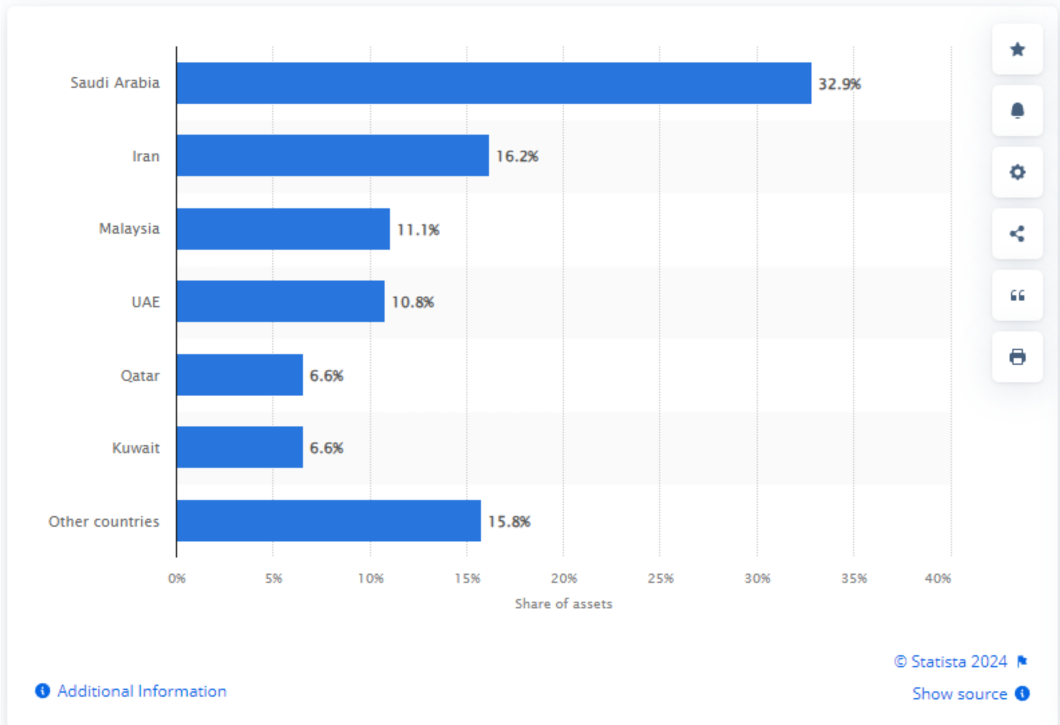

Figure 3.1: Distribution of global Islamic Banking Assets (2022)

Case Study 1 - Qatar:

Qatar has significantly exercised its soft power in ways unconnected with Islamic banking but has indirectly boosted Islamic banking. The ways in which Qatar extended their soft power include the hosting of the World Cup which has not only a positive impact on the nation's global soft image, it has also brought into limelight the predicament of low-skilled workers. However, instead of backing down from the challenge, Qatar reinforced its aspirations towards human rights by leveraging the criticism and showcasing its accountability towards the cause by employing policies to improve the conditions of the workers, thereby reinstating its soft image (Thani, 2022). Islamic bank assets achieved a higher growth rate of 18.8% compared to 6.2% for traditional commercial banks in Qatar (Bait Al-Mashura Finance Consultations, 2019). Qatar is simultaneously ranked highly in the Global Soft Power Index at 21st position, thereby suggesting a strong link between soft power and the increase in Islamic banking position.

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3.2. Case Study 2-Saudi Arabia:

While most of Saudi Arabia's influence is attributed to oil exports, it is not its only source of soft power. Saudia boasts the attention of the entire Muslim population of the world as it holds two of the holiest places of Islam, the Kaaba, and the Prophet's Mosque. Saudi Arabia's financial landscape consists of banking, insurance, finance companies, Suku´k, investment funds, and Waqf. The Saudi Islamic finance industry is the largest globally in terms of asset size. The "major components of the industry totaled $842 billion as of 2020" (Islamic Financial Services Board, 2019). Its soft power has played a huge role other than its religiosity. The Saudi administration has actively been a part of the UN peacekeeping missions, has globally employed mechanisms in support of UN Millennium Development Goals (MDGs), and has opened projects to target the UN Sustainable Development Goals (SDGs) to demonstrate its commitment towards soft power and global development (Farouk, 2023).

Through the new Vision 2030 of the Prime Minister and the Crown Prince Muhammad Bin Salman, Saudia's attention has focused on hosting a wide range of sports events to spruce up its image and worldwide influence. Actions such as the Tommy Fury vs. Jake Paul boxing match with a prize pool of over $13 million, hiring Cristiano Ronaldo to play for Al-Nassr (Saudi Football Club) and hosting the FIFA Club World Cup have boosted Saudia's soft power in the limelight in the world of sports and tourism (Chadwick, 2023). Saudi Arabia is also ranked highly in the Global Soft Power Index at 21st position, thereby suggesting a strong link between soft power and the increase in Islamic banking position.

3.3. Case Study 3 - Malaysia

Islamic banking in Malaysia began in September 1963 and now holds 11% of the global Islamic banking assets and is 3rd highest in global banking assets after Saudi Arabia and Iran. It ranks 2nd in the global soft power index which cannot be overlooked as an interesting correlation between soft power and its top 3 Islamic banking position globally. The current administration is well placed to use religious soft power to drive foreign investments and interest in the Malaysian economy. It has implemented the Shariah legal system even though many non-Muslims reside there. Malaysia's path shows that Islam is compatible with democracy and modern governance ideals.

4. Conclusion

It is not by chance that 3 of the top 5 countries with the highest Islamic banking assets also hold the top 25 positions in the Global Soft Power index, especially Malaysia which holds 11% of global Islamic banking assets and ranks 2nd on the Global Soft Power Index. These countries have sound marketing, governance and education strategies around their Islamic sharia-compliant products. They have exercised significantly more positive soft power than Pakistan. All countries have a reputation or an image on the global canvas. Some have a more colourful impact than others, both positive and negative. Actions, approaches, and beliefs of the countries fuel their international perception far more than they realise.

Pakistan itself has been on the receiving end of sanctions throughout its history, such as the Pressler Amendment or Symington Amendment (Pandey, 2018). This is where image building and perception management come into picture. Countries that can strategically control the narrative and improve upon their soft image can get away with even the most hostile actions while those unable to prioritise image building are not so lucky. Pakistan, falling under the latter, needs to up its game and take control of the international media. Pakistan has immense potential in almost every sector including tourism, energy, education, sports, diplomacy, media, business, agriculture, etc. The need of the hour is to leverage and exploit that potential to boost Pakistan's economy and raise awareness among current and non-users of Islamic Banking Products.

Pakistan does not need to reinvent or break the wheel; however, it does require the implementation of a well-defined strategy that helps it rise the soft power index to sow the seeds of economic development, good governance, strong education toward a country and economy that is interest-free just like other Islamic countries have successfully done like Malaysia which is a dual banking country and Saudi Arabia which are in the top 5 countries with the most global Islamic banking assets.

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