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Islamic banking can enhance stability: PM (HL)

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THE international financial system can adopt some aspects of the Islamic financial system that may be able to deliver greater stability in the face of current global economic uncertainty and inequities.

Prime Minister Datuk Seri Dr Mahathir Mohamad said Islamic financial injunctions were clearly meant to create an equitable and fair social and economic order with its prohibition on excessive profits through unprincipled manipulation of prices or supplies.

"The basic tenets of Islamic banking prescribe a financial system that rewards productivity. There can be innovative financial products which facilitate business and reduce risks," the Prime Minister said at the inauguration of the Islamic Financial Services Board (IFSB) in Kuala Lumpur yesterday.

He said Islamic banking principles required financial transactions to be supported by genuine trade or business-related activities and, therefore, financing for non-trade related activities such as currency speculation was excluded.

The Islamic financial system was also fundamentally based on the absolute prohibition of payment of any predetermined or guaranteed rate of return, therefore prohibiting the concept of interest (usury), he said.

Debt slavery, he said, had also clearly not been fully abolished in the international financial system, with countries unable to pay their foreign debts at the mercy of rich countries.

"Obviously, if Islamic banking is practised in international financial lending, this debt slavery of borrowing countries cannot happen. But, of course, the international community is not about to adopt Islamic banking.

"They are not going to lend if they cannot gain control over their borrowers in order to recover their loans, irrespective of the misery this might cause," he said.

Dr Mahathir said the fact that banks had been imprudent in their lending did not mean they should incur losses.

"Yet even in the ordinary banking system, it is common for banks to take hair cuts if for some unexpected reasons the loans go sour," he added.

In his keynote address entitled, "Reshaping the International Financial Architecture for Balanced and Stable Growth", the Prime Minister, who is also Finance Minister, said consumer confidence had been shaken by developments such as softening property markets and financial reporting problems.

Risks like more corporate scandal exposures or a deterioration in the Latin America situation could destabilise financial markets further, he added.

"There is a recognition that markets are subject to excesses, including deliberate manipulation, which generally work against the interests of developing countries," he said.

He said the option to use the Islamic financial system had to be open and voluntary to avoid turmoil and economic regression, something "which Islam does not wish to promote, which it in fact expressly forbids".

Under Islamic banking, he said, banks also had to share losses incurred by an entrepreneur, an arrangement that would enhance long-term commitment between them to work together as both sides would be accountable to each other.

"The issue of non-performing loans would not arise as any losses would

accrue immediately to the banks as well as the entrepreneurs," Dr Mahathir said, adding that this would result in Islamic banks going the extra mile to keep good companies afloat in good and bad times.

In addition to the strict regulatory precepts of conventional banking, Islamic banking principles were reinforced by the Syariah framework, thus strengthening the governance of banking operations.

All these principles, he said, promoted financial stability and governance, transparency with the absence of interest would ensure systemic risks could be avoided. "Players in the financial system would not react in an erratic manner or exhibit herd behaviour since players can evaluate individual fundamental strengths."

At the event yesterday, Dr Mahathir, Finance Ministry secretary-general Tan Sri Dr Samsudin Hitam, Harwood Timer chief executive Tan Sri Amar Bujang Mohd Nor and Institute of Strategic and International Studies chairman Tan Sri Dr Noordin Sopiee witnessed the signing of the Articles of Agreement of the IFSB, which is the international standards-setting body for Islamic financial institutions.

Bank Negara Malaysia Governor Tan Sri Dr Zeti Akhtar Aziz signed the Articles of Agreement along with the governors and senior officials of central banks and monetary authorities of Pakistan, Qatar, Iran, Indonesia, Kuwait, Saudi Arabia, Nigeria and Bahrain.

Dr Mahathir said the establishment of the IFSB, a result of two years of extensive work, would reinforce the potential for stability in the Islamic financial system and chart its future course as an integral part of the international financial system.

"Malaysia is honoured to have been entrusted with the responsibility to host the secretariat for the IFSB," he said, adding that he was confident the institution could become the pre-eminent global authority for international Islamic financial services.