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**ISLAMIC FINANCE – NEW HOPE FOR THE FUTURE OF
THE MUSLIM WORLD**

1. Firstly I would like to thank this conference of the Islamic Financial Services for the invitation to speak on “Islamic Finance - New Hope for the Future of the Muslim World.”
2. Before proceeding I would like to point out that I am neither a financial man nor even an economist. So please forgive me if what I say is unconventional or I suggest something that you are already doing.
3. We all know that finance plays a big role in the creation of wealth in human society. Financing enables businesses to grow and wealth to be multiplied in the process. Where finance is not available even the countries with rich natural resources can remain poor.
4. In the distant past financing was undertaken by money-lenders. But their capacity was limited because they deal mostly in cash in the form of coins of precious metals. There were other constraints which prevented the money-lenders from making available enough money to finance big transactions.
5. It was a money lender, Mayer Amschel Bauer who founded the House of Rothschild in mid-eighteenth century, which started the modern banking industry. This was followed by the adoption of fiat money-initially by the banks issuing banknotes. With this development it became possible for very large amounts of money to be issued by banks and made available for the financing of wars in Europe and big business transactions.
6. When banks were allowed to issue banknotes, they could create more money than the cash and assets they held. Governments apparently did not control the amount of banknotes issued. In fact Governments actually borrowed this money. Businesses too benefited as they could finance all their transactions through big loans, practically unlimited, by the banks. In some countries the banks still create money but mostly Governments now issue currency notes.
7. The result was the rapid economic growth of the European countries. Their people become more and more prosperous as money rather than landed assets became the basis of wealth.

8. To facilitate financing further the banks invented cheques. Any amount of money can be written on the cheques and they can be used for payments without need for banknotes or currency notes. With this the amount of money available, all kinds of transactions, including international trade was increased further. The economic strength of the countries with banking facilities grew and along with it their military strength.

9. It seems to have taken a long time for the Muslim and their countries to appreciate the role of banks in wealth creation. This must be because of the injunction against usury which prevented the Muslims from simply adopting the Western banking system. Nevertheless as their dealings with the Western countries grew they were forced to use the usury-based banks of the west. In fact many Muslim countries decided to set up their own usury-based banks despite the injunctions of Islam.

10. To assuage their conscience some Muslims decided to forego the interest earned from their use of the Western banks. This actually means that they were increasing the profits and helping the growth of the usury-based banking.

11. Almost 300 years passed before the Muslims could think of setting up banks which conforms to Islamic teachings on rejection of interest. By this time the people who invented and utilised the interest-based banking system had drawn far ahead of the Muslim countries in terms of wealth, economic development and military power.

12. Now that we, the Muslims, have our own banking system can we use it to prosper our country the way the European countries had? Can we catch up with their development? True our banking system is constrained by the injunction against interest. But still the system can provide funds for more and bigger wealth-creating businesses and other economic activities.

13. It is to be admitted however that despite the availability of Islamic finance and banking the Muslim world has not shown the kind of progress the western countries have. In fact till today the Muslims have not produced even a single country which can be classified as developed. Why is this so?

14. The Islamic finance system has in fact grown tremendously. The figures show this. Total Islamic assets worldwide have exceeded US\$1 trillion. Islamic assets under management by Islamic banks and conventional banks offering Islamic banking services are reported to exceed US\$500 billion. Islamic mutual funds are estimated to exceed US\$300 billion, while Takaful or Shariah-compliant insurances are estimated to be in excess of US\$5 billion. Overall growth rate of Islamic finance is about 15% - 29% per annum. But Islamic finance is still very tiny compared with the conventional Western usury-based systems. This is even more remarkable considering that so many Muslim countries have become extremely rich from the proceeds of the sale of their huge

reserves of petroleum. Can we say that it is the prohibition of usury which is stifling the growth of Islamic finance and the prosperity and development in the Muslim world. I don't think anyone can blame the teachings of Islam.

15. It has become clear that despite the availability of Islamic financial institutions, including banks, the Muslims seem not to have utilised them fully. The reason is perhaps lack of knowledge in the management of wealth for growth. But it may be due to lack of will also.

16. The very rich Muslim countries have shown an unwillingness to invest their money in a way that could improve the situation in the Muslim world. For many all that had been done is to buy bonds, which apart from being un-Islamic as the earnings are through interests give only minute returns. Investing in this way denies the investor any say in the management of the money. In fact as pointed out earlier the funds so invested can be used by the borrowers for things totally forbidden by Islam. The funds could actually be earning interest for the borrower. It is bad enough to invest in interest-bearing bonds, but it is worse when the money lent through bonds go towards financing loans which bear interest. Of course there can be other uses for the money such as investment in non-shariah compliant businesses and for the production of weapons to be used against Muslims.

17. If the availability of Islamic finance is to help create a better future for the Muslim world then the financial institutions themselves must come up and aggressively promote Islamic compatible ways of investing the great wealth of the Muslims. This the Islamic financial institutions can do by identifying secure investment opportunities which give a fair return but transgress no Islamic injunctions. They can advice on these but they can also set up investment arms and trust funds.

18. While the investments should be shariah compliant, it need not be confined to businesses owned or operated by Muslims. There are hundreds of thousands of businesses operated in the non-Muslim world which are compatible with the tenets of Islam. Choosing the best with good yield may not be easy. But Islamic financial institutions must be prepared to expand money on investigating and rating the businesses. The actual investors themselves would not be able to do this.

19. Islamic banks have not shown aggressiveness in promoting their services. Certainly they have not gone all out to gain access to the money owned by the very rich Muslim countries. Perhaps there are religious constrains but if they are keen enough ways can be found to attract the billions and trillions of dollars belonging to the rich countries. After all the Muslim financial experts have found ways to provide banking and financial services and products which comply with Islamic ethics and laws. What is needed is for the products to be aggressively promoted in the Muslim world.

20. It is noted that there is not a single Muslim country which is fully industrialised. The wealthy nations of the world are without exception the industrialised nations. Some of these have no natural resources to support industrialisation. But they make up by having the most valuable resources of all. They have people who are intelligent, knowledgeable and skilled in the development of industries. They have management skills especially capital management. And they are backed by their banking systems.

21. If indeed we want to see a better future for the Muslim world we need to industrialise. In this the Islamic financial institutions, like their counterpart in the non-Muslim countries, have again a major role to play. Islamic banks and institutions must have on their staff people qualified not just in financial management but in the technology and intricacies of setting up and managing numerous industries which can create wealth and employment.

22. Assuming that the Islamic banks have these expertises they can help with the industrialisation of Muslim countries through the promotion of selected industries and businesses and through introducing innovative ways of financing the enterprises.

23. Together with the Government the Islamic financial institutions can help with the education of the people to man the new industries. Scholarships and loans can be given by the Islamic banks designed to produce the necessary manpower.

24. Perhaps these would put too much burden on the Islamic banks. But it is not so long ago when the western banks concentrated exclusively on the business of lending money. They employed staff which were trained only in this field. Today their banks employ economists who study the trends in the country's and the world's economy, who hold seminars on economic subjects and publish academic papers. There is no doubt that the banks have benefited from having economists on their staff to tell them what to expect in the near and distant future.

25. The role of banks in the industrialisation of the developed countries of Europe and East Asia cannot be understated. There is no reason why Muslim banks and financial institutions cannot play the same role. In fact considering the lack of knowledge and initiative in this area among Muslims generally, and Muslim investors frequently the Islamic bank must play an even bigger and more aggressive role than the conventional banks. While they can make use of foreign consultants and experts, they must quickly develop their own expertise so that they can judiciously evaluate the advice they have been given by consultants. It must be stressed that the future of the Muslim World will depend much on its ability to industrialise firstly in basic industries but also to keep up with the new industries of Information Technology and knowledge age.

26. We see a trend today for Islamic Banks and Institutions to match the products of Western banking with their own, while keeping them compatible with the teachings of Islam. This is as it should be. But we have seen lately how the financial products available in the Western Banking system have been so abused as to cause the great financial crisis that we are experiencing today.

27. We may congratulate ourselves that by and large the collapse of the Western systems has not affected the Islamic financial system much. But before we do so and before we talk of the Islamic system replacing Western banking, it is necessary for us to understand why their systems collapse.

28. There have been many changes and many new financial products introduced by Western bankers and market players which lend themselves to easy abuse. In fact the original Western banking system itself is not immune to abuses.

29. We know that Western banks can lend more than the assets they possess in terms of their capital or the deposits they hold. When Governments decide to abdicate their role as the regulators and overseers of banking practices and the enforcement of banking laws; leaving these roles to the market and market forces, the way was opened for imprudent practices. Bank lending exceeded the assets held by them by very many times. Leveraging can be as much as thirty times the invested capital. While this can increase the yield, it can also increase greatly the losses when the investments fail. The losses would be as many times as the amount borrowed. There is no way for the investor to meet margin calls,

30. Accounting practice make it appear that the money lent goes into the books of the banks as assets. The more the amount lent the bigger will apparently be the assets of the bank.

31. With this the banks went all out to lend money without considering the ability of the borrowers to repay. To ensure that the loans do not go bad, they were bundled and sold to insurance companies and secondary mortgage companies.

32. As we now know the majority of the housing loans became non-performing and neither the insurance companies nor the mortgage companies were able to cover the losses. And so we see the sub-prime crisis which lead to banking failures. Since the banks also finance hedge funds and the derivatives, their failures and the accompanying collapse of the market turned all these financial products sour. The result is the collapse of the whole financial system.

33. I am speaking from the layman's point of view. I am not a banker or a financier. But this is how I see the present crises and the abuses of the financial, monetary and banking systems.

34. There is obviously a need for the Western banking, financial and monetary systems to be reviewed and changes made to prevent recurrence of the abuses. There is a need for the Governments to come back and oversee as well as regulate the activities in the financial markets. Unfortunately we see a reluctance to do this. Perhaps it is because much money can be made in the financial market through the abuses.

35. But for the Islamic financial and banking systems it would be good if they don't try to match every product of the Western banking system. There is no doubt that the Western financial market had created much wealth. Many investors have become millionaires and billionaires investing or speculating on the financial market before the crisis. But their wealth had been acquired not through real business but through gambling. Speculating is no different from gambling. If the speculator wins, only he would benefit. There would be no spin-offs in terms of jobs or supporting businesses. Yet as we can see when the speculators fail they dragged down the whole society and the other businesses. In the present case the whole world has been forced to face a financial crisis of unimaginable proportions. What is more, it is the people who have to bail out with public funds.

36. The Islamic banking and financial system should not follow in the footsteps of the Western financial system in terms of Islamic financial market products. Admittedly it is not the Western system which has gone wrong. It is the abuses perpetrated by the market players, the speculators and the gamblers who have done this.

37. We cannot ensure there are no rogues in the Islamic financial market or in the Islamic world. We hope that Islamic injunctions will restrain them. But we cannot be sure. Greed assails us all. When opportunities appear for making quick money the rogues would not be deterred by mere religious prohibition.

38. The banking and financial system in the Muslim world must be regulated and must remain under Government supervision even if this stifles the performance and the role of the banks in ensuring a better future for the Muslim World. This is because whatever contribution the abuses may seem to make for the Muslim World, it will be nothing compared to the disaster that would follow when the bubble bursts.

39. If I may repeat many Muslim countries are extremely rich. But we also know that many Muslim countries and Muslim people are extremely poor. We should really be able to spread the wealth to the poor not just through charity but also through investments. But unfortunately the capacity of Muslims to invest is quite limited. They are short on industrial expertise, particularly manufacturing. When they invest it is often only in property development. These cannot create

jobs and the spin-offs are quite limited. Their added value is really artificial, being dependent on speculative demands.

40. The banks should be able to advise their clients on the fragility of such markets. Unfortunately they appear not to have done this.

41. It is the same with the stock markets in Muslim countries. They go through the cycle of booms and busts frequently, apparently without the investors learning anything.

42. The growth of industrial capacity in some Muslim countries is almost-entirely due to investment from foreign non-Muslims. Where Muslims invest in the industries of developed countries, they seldom take part in management. In fact even in business belonging to Muslims in Muslim countries, they are likely to be run by foreigners, usually from Europe.

43. The very rich Muslims and Muslim countries appear not to value their wealth or to care about the management of wealth. This has been taken advantage of by others. We may have unlimited sources of wealth but we can never assume that the resources will always yield wealth forever.

44. We see in the West great businesses which fail because they failed to see the changes taking place around them. The great automotive giants are a case in point. Not so long ago General Motors topped the list of Fortune 500 companies in the world. Today it is bankrupt.

45. Rubber used to be the cash cow for Malaysia. But then came synthetic and the bottom fell out of the rubber market. It is entirely possible that one day the same would happen to the oil market. When it does the impact would not be so serious if there are other industries to cushion the effect. Unfortunately there aren't.

46. What is the role of the banks in all these? Banks should be able to foresee this and to advise countries on diversification as well as develop models to deal with various eventualities. It is in the interest of the banks to do so. The collapse of the economy for whatever reason will certainly result in the collapse of the banks if not the whole financial system.

47. There is a grave need to develop capacities in as many fields as possible in this Muslim World. Depending on others to extract and market our resources is dangerous. The Muslim economy are of course a part of the world's economy but whether the Muslims get their fair share of the wealth of their countries depends on their ability to extract it themselves.

48. The Islamic banks and financial institutions can help in raising awareness of the dangers of being dependent on others. It is very comfortable to let others

do our work when we are rich. But in the process we will not acquire the skills to sustain our wealth when a crisis hits us.

49. Islamic finance in itself will not ensure a better future for the Muslim World. But it will certainly help if the Muslims learn how to use these institutions to manage the wealth of the Muslim, to aggressively promote the services they can offer, to have a sense of responsibility for strengthening the Muslim community and to make the Government of Muslim countries aware of the potential contribution of banking and other financial institutions.

50. It is only if the Islamic Financial institutions are aware of the full extent of the role they can play and they are willing to look beyond merely making money available to those who need it, will they be able to represent hope for a better future for the Muslim World.
