

**SPEECH BY TUN DR MAHATHIR BIN MOHAMAD  
ON “ISLAMIC FINANCE AS THE MEANS TO REVIVAL OF  
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1. We talk a lot today about Islamic Finance – especially we who are Muslims. But Islamic finance is still in its infancy, in comparison with conventional banking. While it has been accepted even by non-Muslims, it has not as yet been able to displace significant portion of the conventional banking system.
2. Islamic banking is basically concerned with elimination of interest or riba in the repayment of loans. But quite obviously the lenders i.e. the banks must earn something from lending money – a process fraught with risks.
3. It is entirely possible for the whole loan to be lost. Without some means of getting a return from the business, the losses may lead to the bank failing or even closing down.
4. We are seeing today the most extensive financial catastrophe resulting from the conventional banking system and various practices which are associated with it being abused. We can claim that the Islamic financial system has not contributed to this catastrophe, that it is immune. But nevertheless we can learn much from the mistakes made by the conventional financial system which has resulted in the current crisis. We must take note of the mistakes of the conventional systems so that we will not be involved or be the cause of future crisis in our anxiety to provide all the services presently available with conventional banking and finance.
5. Basically, the causes of the present crisis is due to greed which led to abuses of the system in order to make easy money.
6. The banking system is principally intended to make money available for business i.e. the production and sale of goods and services to meet the ever growing needs of human society. The sale of goods and services constitute trade, an economic activity requiring financing – domestic and international. The production of goods and services and the trade in them causes wealth to be created and economies to grow. The benefits accrue to everyone from the poor workers to the suppliers and processors of raw material, the manufacturers, distributors, vendors and on to the investors and financiers. Everyone gains from the business involved in the production of goods and services and the trade which are all financed by the banks. The banking service is therefore an essential service to enable wealth to grow and be distributed within human society.

7. But the power of the banks to create and lend money should be exercised with prudence. Unfortunately the greedy saw in the power of the banks to create money i.e. the possibility of making almost unlimited amounts of money for themselves, not through production of goods, services and trade but through manipulating the banking and financial systems.

8. For example, without considering the capacities of the borrowers to repay the loans, the banks lent money to the high risk borrowers. To mitigate the risk they insured the loans or sell them to secondary mortgage companies. With this they believed the risky loans were secured. Eventually the amounts of unpaid (non-performing loans) became so big that they had to be recorded in the bank books as losses. Even the insurance and mortgage companies could not make good the losses, so that they too failed and became bankrupt.

9. It is much more difficult for Islamic banking to lend beyond prudence because of the requirement for risk sharing between the bank and the borrower. But even then, should Islamic banking, in the interest of greater profit consider and find ways and means of lending beyond prudence? This can happen if Islamic bankers succumb to greed and ignore the tenets of Islam which is clearly against excessive profits.

10. But there are other practices of conventional banking and finance which may tempt Islamic bankers to copy. Leveraging loans based on amounts invested may enable bigger profits to be made. The loan to hedge funds and currency traders can be 20 – 30 times more than the invested capital. With these bigger amounts, the profits from investment would also be much bigger. But what the managers often fail to stress is that when losses are made, the losses would also be much bigger. It can be so big that the whole amount invested may not be able to cover the losses. Failure of such transactions as carried out by hedge funds and currency traders will bankrupt the funds and the lending banks as well.

11. With that not only the investors but the fund managers and the banks would be bankrupt. The collapse of the big banks will lead to a financial crisis which can destroy even the richest economies.

12. Again, Islamic banks may not be open to high leverages because interest is not permitted and the requirement of risk sharing would expose the banks to high risks which they cannot take. Still, Islamic banks may be tempted to indulge in seemingly attractive proposals which promises high returns.

13. But is there a necessity for Islamic banks to offer the same products as the conventional banks? I don't think there is. Some products maybe. But when the products may have elements of gambling, Islamic banks should avoid offering matching products.

14. Islamic banks should confine themselves to financing real businesses i.e. the financing of the production and sale of goods and services, and of trade. It may be that limiting Islamic banks to real business will slow down growth and wealth creation. But it is better to have slower growth because of ethical practises than to have high growth which may end up in the kind of crisis we see the rich countries are experiencing today.

15. The need for capital to fund businesses led to the sale of shares. This in turn lead to the setting up of stock markets. While the stock market provides the means to raise funds for business, the demand for shares offered through it can be such that share prices would increase far above the offered prices. This lead to speculation in the expectation of capital gains.

16. The greater the demand the greater would be the capital gains. Good profits can be made simply by selling-off the shares bought after the prices appreciated. The buying and selling of shares have now developed into a big financial industry which may be quite unrelated to the real business being done.

17. Very quickly the greedy saw in them a way to make easy profit. If demands can make shares appreciate, it follows that if demands are artificially created by the investor repeatedly purchasing shares, the capital gains can be greatly increased. Then the shares can be sold to give high profits from capital gains. In addition, the investor can buy the lower-priced share to deliver to buyers who had bought at the high price from him.

18. From this came the concept of short selling when the manipulator goes through a process of selling shares which he does not possess to push up the prices until they are high enough to give a good return. Then the shares would be sold at this high price to make profits from capital gains.

19. With the dumping of the non-existent shares, the price would fall. Again the manipulator can purchase the shares to deliver to the investors who had bought at a higher price, previously.

20. The manipulator would benefit twice, once from selling the shares at the high price and collecting capital gains and once more by buying the shares after the fall in price in order to deliver to the investors who had purchased at a high price.

21. Much money will be made by the manipulator but it would be at the expense of the small investors who will be left with devalued shares due to the operations of the manipulator.

22. The same short selling method can be employed by currency traders. They will make much money from the sales.

23. Not only will the small investors lose money but the short selling activities create no wealth for anybody else, no jobs for anyone, no business spin-offs and no trade. Latest reports say that daily currency trading involves four (4) trillion dollars. Whereas the four trillion dollars create great wealth for Germany for one year, 4x365 trillion dollars of one year's currency trading create hardly any evidence of economic growth or increasing wealth.

24. Juggling with money to make money clearly benefits only the jugglers. All the others will lose. Whole economies could be destroyed. This was what happened during the East Asian financial crisis; this is also what is happening today – a crisis of enormous proportions.

25. Islamic banking in an attempt to compete with conventional banking must never be involved in schemes to use money for gambling to make money. Leveraging, short selling and operating hedge funds and currency trading must not be financed by Islamic banks. They should confine themselves to the real business of the production of goods and services and to trade in these items.

26. Islamic banks must always obey the injunctions of Islam not only in rejecting riba but also in any form of gambling or profiteering.

27. By staying strictly ethical Islamic banks may lose business. But in the long run the ethics that Islamic bank adheres to will win it loyal clients. Already we are seeing the clients of the conventional system switching to Islamic banking for certain financing needs. As Islamic banking becomes recognised as least likely to precipitate financial and economic crisis, the acceptance will increase.

28. The task of making Islamic finance accepted by the international community does not depend on ethical practises alone. Today we do not see many Muslim countries doing well in their administration and in particular the management of their wealth. There is today not a single Muslim country which can be classified as developed. Yet we know that never in the history of Islam, indeed in the history of the world, have the Muslim countries been so wealthy. But the wealth is fortuitous – conferred on the Muslim countries by Allah SWT through the abundance of natural resources, particularly oil. The Muslims themselves did not create the wealth.

29. Indeed the extraction of these resources is due to the technology, skills and capital of others. The Muslim people are mere rentiers – collecting royalty without knowing much about the prospecting for and production of their own resources. More than that, they are not capable of developing the usage of their natural products so as to improve sale. The growth of the automotive industry and other engineering products which depends on fossil fuel is not due to the oil-rich Muslims.

30. The wealth of the Muslims and their banking system should enable the Muslim countries to grow and become fully developed. If they have not been able to develop their countries it is due to their failure to acquire or innovate ways of using their resources and wealth in a productive way.

31. Wealth is not just for acquiring and enjoying the good things of life. Wealth is capable of creating more wealth through management skills, through investments, through application of the resources acquired to produce goods and services, and to trade. Wealth also can contribute to the development of good administration, the building of infrastructures etc. Wealth can of course banish poverty. Above all wealth can contribute to the acquisition of knowledge; the knowledge necessary for growing into a developed country.

32. In all these things the Islamic banks can be of tremendous help. Banks are particularly skilled in the management of wealth. This skill must be spread among Muslims in general and Muslim Governments in particular.

33. Islamic banking is particularly suitable for this task. Islamic banking is guided by the syariah and the ethics of the Islamic religion. What Muslim Governments need in order to develop their countries is the ethical and skilful management of their wealth. Islamic banking can provide this.

34. The relevance and potential of Islamic banking is very clear. What is needed is for just one rich Muslim country to use the expertise of Islamic banking in order to become a developed country. If only one country succeeds, then the Islamic Renaissance will surely take place.

35. Islamic bankers and financial experts must consider it their duty to ensure the success of Islamic banking and to help manage the wealth of the Muslims.

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