

**SPEECH BY TUN DR MAHATHIR BIN MOHAMAD AT ISTANBUL, TURKEY
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**The Future of Islamic Finance: Creating Global Linkages and Connectivity
to the Real Economy to Promote Financial Stability Economic Growth,
Employment and Prosperity”**

1. I would like to say thank you to the Malaysian Central Bank or Bank Negara Malaysia for this invitation to speak before this distinguished gathering of financial experts and others.
2. I was given four subjects to speak on this occasion. All are about finance. I have chosen to speak on the future of finance not because I can see into the future or that I know much about the subject.
3. I have chosen this subject because I believe it is of current interest to everyone. We are still facing a financial crisis; the whole world is facing this crisis. It is of such a magnitude that no country and no business can escape from it. It is so complex that the best brains, the financial experts and Nobel Laureates of the world have not been able to come up with a real solution. Five years after it started, it is still rolling on, bringing to their knees, the great and the small. Indeed it is the mightiest of all which became the principle victim. When the mightiest fall, the others will be dragged down by it.
4. It would seem that the very financial institutions created to support the economies of the rich, to finance industries and trade, have now turned upon their creators to impoverish and destroy them. Why and how did this happen?
5. I am not a financier, not even an economist. I am a doctor of medicine. My views may therefore be quite unorthodox. It may reflect the thinking of a medical mind, rather than a financial or economic expert. I hope you will bear with me as I try to play doctor in a field I am not trained to diagnose and to cure.
6. To see into the future one must look at the past. What do we see in the past? We see the Euro-American invention of the industrial economy. The countries of Europe and North America grew rich through manufacturing the goods and providing the services to themselves and the world.
7. Having mastered their industrial economy they looked overseas for resources and markets. Not satisfied with merely purchasing raw materials and selling their products in the markets of their suppliers they conquered their trading partners so that they could build colonial empires and create captive markets girdling the world. They became even richer this way, importing cheap raw material from their colonies to be processed into high value added products

for their home markets and for their colonial markets. Imperial Preference devised by the British ensured that their empire preferred British products. Thus they began with closing their markets to other countries.

8. Great ships were built to carry their products. Powerful naval forces protected their trade routes. These in themselves became a big industry. Shipbuilding became a major part-of their industrial economy, with spin-offs into all kinds of metal fabrications.

9. They competed with each other for world trade and political hegemony. And finally they went to war with each other, killing 70 million people in their efforts to achieve dominance over the world and its economy.

10. The forces of justice and right of course won or so we are told. They believed they could now consolidate their hold on their empires, exploiting them further and expanding their markets.

11. But this was not to be. One by one they lost their colonies. They retreated to fortress Europe to face a world they no longer own. Still they were on track to rebuild their industries and enrich their economies.

12. But in the post war years new industrial powers emerged in the East. The products of these newly industrialised countries started to compete against those of Europe and America. To cut a long story short, Europe and America lost in this contest. Their products were almost totally pushed off the shelves in the world market.

13. Their defeat in the manufacturing, construction and service industries led to their switch to the financial markets. Beginning with investments in the share markets of the world they invented new financial products. As with the shares in the stock markets these products bear no relation to the real business done by the companies and corporations.

14. It is not the dividends which attracted their investments in stocks and shares. It is the possibilities of capital gains. Repeated and sustained purchases of shares would push up the share prices. Once appreciated, the shares would be dumped by them and capital gains collected. First the huge pension funds then the hedge funds began to do this. The size of their investments influenced market behaviour.

15. Why be concerned about whether the business is doing well or not. On a dollar share the dividend might be just 10 cents. But if the dollar share is pushed up to 5 dollars, the investment in one share at 1 dollar could yield 4 dollars in capital gains.

16. It is too bad for the ordinary investors who may have bought at 4 dollars. When the share price drops to below 4 dollars, there would be margin calls.

Failure to meet margin calls would result in losses. The company may fail altogether. But the dumping at the high price would have yielded huge profits for the financial market players before the company is bankrupted.

17. Then they invented short selling. Buy, buy and buy and push up share prices. The shares are not even necessary. They need not buy the shares which they propose to sell. They only go through the motion of selling and buying. Sell off the shares at the peak or thereabouts and then buy at lower prices to deliver to the buyers, who had bought at the higher prices, collecting not just capital gains but also from delivery of the cheap shares they had then acquired to the buyers who had bought at high prices when they began dumping.

18. It was a fantastic way to make money, lots of money. Even junk shares can give good yields through these manipulations. They also indulge in asset stripping of the failed companies they had bought at fire-sale prices.

19. But why stop at selling shares. Why not currencies or commodities. Sell non-existent currencies and commodities until the prices depreciated, then buy at the lowest price and deliver, collecting the difference between the buying and selling prices. The tin traders sold tin on the London Metal Exchange despite holding no tin stock themselves. When the time came for them to deliver, they could not. They should have been penalised. But the LME ruled that they need not deliver.

20. Currency trading alone can yield billions in profits. That in the process the businesses, the banks and the countries go bankrupt is not of concern to currency traders. Through leveraging they hold vast amounts of the currencies which can defeat any attempt by Central banks of the affected countries to defend their currencies.

21. They don't even have to pay taxes as they operate from tax havens. Nor do they have to submit accounts for auditing by the authorities. For some unknown reason their own countries exempt them from submitting their accounts.

22. Then came the hedge funds. Though leveraging by 20 or 30 times they could assure their investors huge returns. The hedge funds, their managers and the investors all made huge profits from their investments.

23. Greed knew no bounds. The banks began to lend money for housing and other assets even to borrowers who could not possibly repay their loans. If the borrowers fail to pay the loans, their properties can be repossessed and sold. They believed they could never lose on the loans made. To be doubly safe, the loans were bundled and sold to insurance companies or to Government-backed mortgage companies like Freddie Mac and Fannie May.

24. According to the lenders their loans have been securitised through insurance and secondary mortgage. They just could not lose even if the loans become non-performing.

25. There were numerous other quick profit schemes, some so complex that the investors would not understand what would happen to the money invested by them. But they were assured that they would be making tons of money. And for a long time they did get high returns on their investments.

26. Despite losing their traditional businesses of producing real goods, providing services and trading, the investors in Europe and America seemed to have become even richer through the financial market. After all why build cars, manage unruly workers, pay taxes and make a 10% profit when investments in the products of the financial market can give returns of 30% and more.

27. Then the secured investments somehow fail to remain secured. It began with the sub-prime loan. So huge were the non-performing loans that the losses had to appear in the books of the banks. Unable to make up the losses the banks collapsed, dragging down with them the insurances companies, the mortgage companies. As the distressed banks failed, the other borrowers, the hedge funds and currency traders, were forced to increase their collaterals or they, too, would fail. With that everything else came down like a house of cards. The whole financial market collapsed and like Humpty-Dumpty no one could put the broken pieces together again.

28. All these products have one thing in common. They did not involve real money. No cash, no currency notes or bank notes were involved, – nothing; only figures in the books of banks. The amounts were enormous, running into trillions. Incidentally a trillion dollars appear in the books as 1 followed by twelve zeros, i.e. twelve nothings. But 1 trillion in 100 USD notes would be impossible to handle. Whole rooms would be filled with them. Yet 1 trillion written in the books of the banks would still be worth 1 trillion in currency notes.

29. Statistically the earnings by managers and investors in the financial markets contribute to the per capita and GDP of the nation. These figures would obviously be high for nations with numerous millionaires and billionaires. But the activities in the financial markets create hardly any jobs; no spin-offs into real businesses, and no increase in trade within or between nations. The financial market contribute hardly anything to the prosperity of people and nations. The high per capita incomes can hide very high unemployment and poverty rates. This is because per capita income as a measure of national wealth is misleading. One millionaire among one thousand unemployed people gives an average income of 1000 for everyone in the group. With thousands of billionaires, the per capita of a rich nation would run into tens of thousands. But the unemployment rate could still be very high. And they the unemployed would be poor, needing

more Government handout at a time when Government revenues decrease due to recession.

30. Capitalism has given many nations prosperity. But when capitalism is combined with unbridled greed; the result is what we are seeing today. First the market of the greedy demanded to be freed of Government regulations or supervision. The market would regulate itself. But a market of greedy people cannot be expected to have ethics or even a sense of responsibility to themselves and even less to society. All the market cares for is to make money for the players regardless of what happens to other people or countries. They stretched the systems until they collapsed and precipitated the crisis.

31. So what future is there for finance? None if the present system or abuses are allowed to continue. Even if recovery can be achieved, through all kinds of stimulus packages Q. E. or Quantitative Easing, the financial crisis will recur, again and again. Each time it will be worse than the last.

32. What is needed is to introduce ethical codes back into the system and insist the market be regulated not by the players or the market but by third parties. The Government must reassert its authority over the market place and act to curb abuses and the introduction of financial products which involves no real business i.e. no production and sales of goods and services.

33. All the financial products should be scrutinised and if necessary rejected or modified. A commission should be set up to draft rules and regulations and laws if needed. There should be a regulatory authority.

34. Leveraging should be disallowed or limited. The amount beyond their assets that banks should be allowed to lend must be determined by the authorities from time to time. The assets of a bank must influence the total amount of loans extended by the banks. Banking business must be more transparent.

35. Speculations may be allowed but any evidence of manipulations such as short selling should be banned. The shares or the currencies traded must be real, not virtual. The sellers must have evidence of ownership of the shares or the currencies or commodities they wish to sell.

36. Here I would like to make some reference to Islamic banking. It is not only about rejecting riba, usury or interest. Islamic banking is also about obeying the Islamic ethical code in the market. In banking there should be Qard Al-Hassan – i.e. good loans. Not only should it be usury free but there should not be hidden costs or gambling involved.

37. In Islam making money from money is forbidden. So currency trading is not permitted. “Gharar” or risks, uncertainties and speculations are forbidden.

38. I am not suggesting that Islamic banking should replace the current banking system. But I do think that certain practices in Islamic banking should be studied so as to reshape current banking practices. It is not coincidental that Islamic banking has not been a cause of the present crisis.

39. There is no doubt that money will be needed for productive activities, for trade and for the development of nations. For all these financing would be needed. The banks and other financial institutions would therefore continue to be needed in the future.

40. But the finance industry must have rules, regulations and laws to which they all must subscribe. The Government must reassert its authority and oversee the activities of the institutions and the market. No one should be exempted from business audit. Accounts of business done must be open for inspection by responsible authorities.

41. The abuses which lead to the present crisis must be identified and stopped. As far as possible banking laws for all nations should be standardised.

42. All these would probably slow down economic expansion and wealth creation. But it is far better to be slow and steady in growth than to be subjected to booms and busts. It is even better that real wealth be created through real businesses and not through gambling, speculation and manipulation.

43. Speculative activities should be minimised if not abolished. Money should be made through the production of goods and provision of services, and also through trading and associated activities. From these real business activities, jobs will be created and small businesses to support the big businesses will help distribute wealth to a greater number of people. Wholesalers, retailers, insurance and transport businesses will complement the production and sales of goods. There will be healthy growth all round.

44. Even without the financial markets with their products the financial business can still thrive and prosper.

45. There is a Malay saying: When you lose your way, go back to the beginning.

46. It is time that the financial businesses go back to the beginning.