Jurnal AKTUAL Vol. 20, No. 1, 2022
ISSN : 1693-1688 e-ISSN : 2723-1690

LITERATURE STUDY: GLOBAL FINANCIAL CRISIS AND ISLAMIC FINANCE AS ASOLUTION

Dedy Dwi Arseto,[1] Nirmadarningsih Hiya,[2] M. Sabri Abd. Majid,[3] Marliyah,[4] Rita Handayani[5]
STIE Bina Karya, Tebing Tinggi[1]
Universitas Pembinaan Masyarakat Indonesia[2]
Universitas Islam Negeri Sumatera Utara, Medan[3,4,5]
Email : dedydwiarseto@gmail.com

Abstract: *Literature Study: Global Financial Crisis and Islamic Finance As A Solution. One of the basic tenets of Islamic finance is "no risk, no gain". This will help. Since interest-based transactions are prohibited, Islam encourages business and trade activities that generate fair and legitimate profits. In Islamic finance, therefore there is always a close relationship between financial flows and productivity. This intrinsic property of Islamic finance contributes to protecting it from the potential risks of over-leverage and speculative financial activities that are part of the root causes of the current financial crisis. Another fundamental principle of Islamic finance is the risk and profit sharing feature of Islamic financial transactions (such as Mudharabah or Musyarakah contracts). This feature of sharing the benefits and risks of Islamic financial transactions requires a high level of disclosure and transparency in the Islamic financial system. This disclosure allows the market to assign an appropriate risk premium to the company, thereby increasing the potential for applying market discipline. Its rapid evolution is mainly seen in the four dimensions of its development. First, Islamic finance is currently seen as a competitive form of financial intermediation, which attracts significant participation by non-Muslims. Second, with the emergence of more diversified Islamic financial institutions and the development of Islamic financial markets, the scope of the Islamic finance business has expanded to include private equity, project financing, origination and issuance of sukuk (bonds), and funds, assets. , and wealth management activities. The third place where there has been a significant evolution is within the regulatory and legal framework of Islamic finance, which is shaped by the different features of Islamic financial transactions. Fourth, the international dimension of Islamic finance is rapidly becoming important as it develops into an increasingly important part of the international financial system and as it is poised to contribute to greater global financial integration.*

Keywords*: Financial Crisis, Islamic Finance*

1. INTRODUCTION

In the late nineteenth century, the Ottomans introduced Western-style banking to the Islamic world to finance their expenses. While some Islamic jurists approve of the practice of modern banking, the majority find the practice a violation of the Islamic prohibition against usury (Arabic term: usury, equivalent to the Hebrew ribit, and interpreted in the classical biblical sense of any cost of interest on a loan, as opposed to the modern identification of usury). with exorbitant interest). This hatred continued into the European colonial period, which lasted until the middle of the 20th century. The rise of Islam played a central role in the intellectual and social foundations of the independence movement in the mid-20th century, which suggested an alternative partnership to interest-based loans under the name mudaraba, which is similar to the medieval European Commenda contract, and the Jewish Heter Isqa, designed similarly to avoid borrowing. usury in Judaism and Catholicism.

The main problems in the financial crisis are debt, derivatives, money, and lack of ethics in finance. The crisis on subprime mortgage loans in the United States in mid-2007, shocked all of us of the consequences that spread throughout the world. In early 2008, the crisis spread and became the trigger for a wider financial crisis including the capital market and banking. Indonesia also cannot deny this crisis, and has become one of the countries affected by it. Where the composite stock price index (CSPI) on the Indonesia Stock Exchange (IDX) fell in a row, and was finally closed for 3 days to prevent chaos and a bigger fall. An economic crisis is generally defined as a fall in the value of the domestic currency against a major foreign currency in this case usually the US dollar, which is accompanied by an increase in the overall price level. Meanwhile, Kaminsky, Lizondo and Reinhart (KLR) combined information on rising interest rates, declining foreign exchange reserves and large currency depreciation into an index as a symptom of a crisis. Meanwhile, the World Bank defines a financial crisis when the crisis index exceeds 1.5 times the standard. deviation from the mean. In this study, the crisis index only uses an indicator of the exchange rate of the rupiah against the US dollar with a limit of 2 times the standard deviation above the average. on the market The global financial crisis that occurred in 2008 was closely related to the deteriorating condition of the American economy. The shocks that occurred in the superpower countries will certainly have an impact on the world economy and affect global economic stability in several regions. Economic openness between countries allows a recession in one country to affect other countries. This is one that is discussed by Tariq Al Rifai in his book Islamic Finance and the New Financial System Chapter 3 "The Global Financial of 2008".

In a book released by Bappenas entitled "The Causes and Impacts of the Global Financial Crisis" also mentions that the financial crisis that occurred in the US began with the housing credit crisis in that country. Where the United States in 1925 enacted the Law on Mortgage (housing credit) or also known as the Subprime Mortgage, which is a regulation related to the property sector where home ownership loans provide convenience for creditors, so that many credit-giving financial institutions in the United States extend credit to creditors. people who are actually financially unworthy of credit. This situation triggered a case of bad credit in the property sector and this resulted in a domino effect that led to the bankruptcy of several major financial institutions in the US. This inability to pay obligations makes financial institutions that provide loans threatened with bankruptcy and the conditions faced by large financial institutions in the US affect the liquidity of other financial institutions both inside and outside the US, especially institutions that invest their money through large financial institutions in that country. . This is where the global financial crisis began. One of the major American financial institutions, an investment bank that went bankrupt, was Lehman Brothers Holding Incorporation (LBHI).

2. LITERATURE REVIEW

Global economic crisis

The global economic crisis is an event in which all sectors of the world market economy collapse (emergency) and affect other sectors throughout the world. As a result of the economic crisis that occurred in several developed countries such as the United States, it had a major impact on developing Asian countries, one of which was Indonesia in the export of oil palm, rubber and cocoa commodity plantations. This puts considerable pressure on the export performance of these commodities, in which the prices of various commodities plummeted due to the slowdown in the world economy, making it very difficult to market opportunities. According to economists, the definition of an economic crisis is simply a situation in which a country whose government is no longer trusted by its people, especially financial problems. The

ISSN : 1693-1688 e-ISSN : 2723-1690

people no longer want to save money in existing banks, so the banks are having cash difficulties. If that happens, the central bank will liquidate its assets to bail out all the banks. After that, prices rose along with the amount of cash in the community due to excess cash in banks.

The global economic crisis that began at the end of 2008 was caused by the United States experiencing financial problems, among others caused by the buildup of the national debt, reduction of corporate taxes, rising world oil prices, swelling costs of the wars in Iraq and Afghanistan, and most importantly the Subprime Mortgage (Loss of property securities). The Indonesian economy is affected by this situation, but the impact is not expected to be as severe as when the economic crisis occurred in 1998. This is due to Indonesia's better economic fundamentals, in addition to the readiness of the government and Bank Indonesia to respond to the global economic crisis as demonstrated by comprehensive stable policies (Directorate of Economic and Monetary Statistics, Bank Indonesia, 2008). The global financial crisis which caused a drastic decline in the performance of the world economy in 2008 is expected to continue, and will even increase in intensity in 2009.

The slowdown in world economic growth, in addition to causing the volume of global trade to fall sharply in 2009 will also have an impact on many large industries that are threatened with bankruptcy, a decline in production capacity, and a spike in the number of world unemployment. For developing countries, this situation can damage fundamentals. economy, and 12 triggering an economic crisis. The negative impact of the global crisis, the declining performance of the balance of payments, pressure on the exchange rate, and the impetus for the rate of inflation. The decline in people's purchasing power in America before the global crisis caused a decrease in import demand, especially from Indonesia, so that Indonesia's exports also declined. This is what causes the decline in Indonesia's balance of payments. Bank Indonesia recorded an overall balance of payments deficit of US$2.2 billion in 2008 (ojk.go.id). In addition, the cause of the decline in Indonesia's balance of payments was the rapid outflow of foreign capital from Indonesia, particularly the SUN (State Debt Instruments) and SBI (Bank Indonesia Certificates) markets.

3. DISCUSSION

Cause of Crisis

The global crisis that occurred in 2008 quickly spread and attacked other countries. In general, most of the world's economy has been affected by the global economic crisis through trade and finance. On the trade side, export performance was further depressed by falling prices. On the financial side, it was indicated by the decline in the stock market and the depreciation of the exchange rate due to the risk aversion behavior of foreign investors. The impact of the economic slowdown in developed countries affects the regional economy through a decline in the performance of the external sector, especially in countries that are dependent on the external sector. There are many causes of the Global Financial Crisis, but in his book Tariq Al Rifai tries to focus on 3 things as the causes of the global financial crisis, namely Subprime Mortgage Mortgages, securitization, and credit accumulation.

First: namely the Subprime Mortgage Mortgage Subprime Mortgage is defined as a mortgage or home ownership loan given to the public with low credit quality. The increase in mortgages is actually driven by the US government's policy that wants to make it easier for its citizens to own a house. Through this policy, banks are encouraged to extend credit to anyone, even to people whose economic capacity is below standard. The increase in mortgages was also driven by relatively low interest rates. In December 2001 the Fed lowered lending rates to 1.75 percent and in 2002 to 1.24 percent. As a result, the percentage of Subprime mortgages also increased from 10% to 20% of total mortgages in the period 2001 to 2006.

Second: namely securitization, namely the conversion of a group of credits into tradable

ISSN : 1693-1688 e-ISSN : 2723-1690

securities, including principal and interest receivables. Credits that have been secured by assets to be converted or asset-backed securities are then sold to investors. Investors view products that have been securitized as relatively safe and can return higher profits. This assumption made several investors such as Citibank, Bear Stearns, and Lenham Brothers to buy securitized loans. Third: the default situation, which is when the mortgage is unable to pay the credit along with the interest due to higher house prices which lead to credit accumulation. The two things described above have contributed to increasing credit accumulation in the US, thereby driving the financial system to work. And it turns out that the mortgage securitization does not stop there, there are complex financial engineering known as Collateralised Debt Obligations (CDOs). In line with the increase in MBS being resecuritated into CDOs, there has also been an increase. And so MBS was also resurrected in the form of other securities that are difficult to track in terms of form or amount….it was triggered by a change in the direction of US monetary policy in mid-2004 which resulted in many debtors experiencing default. all investors and institutions involved in the guarantee into liquidity problems.

Islamic Finance Facing Crisis

Islam has succeeded in balancing the financial structure with Islamic principles. The practice of Islamic finance in various aspects of operations, products, and delivery of financial services can manifest in three dimensions: structure, process, and documentation. Islamic finance relies heavily on three groups of individuals with 3 skills:

- Financial professionals familiar with conventional financial products, and the demand for “Islamic” analogues of these
  products in Muslim communities around the world.
- Islamic jurists (fuqha or classical fiqh experts flourished mainly) between the eighth and fourteenth centuries), who helped Islamic finance providers to find precedents in financial procedures in classical writings, after which contemporary analogues of conventional financial products could be built.
- Lawyers who assist both groups in structuring Islamic analogue financial products, while ensuring their compliance with all applicable and relevant laws and regulatory constraints.

The legal understanding of forbidden usury/riba suggests that Islamic finance should be “asset-based”, in the sense that one cannot collect or pay interest on rent, as is done in conventional banking. Therefore, the easiest transaction to Islamize is an operation-guaranteed loan, e.g. to finance the purchase of real estate, vehicles, business equipment, which can be the three main tools used for this type of financing. There are three factors that made the Financial Crisis possible.

- One of these is inadequate market discipline in the financial system that results from the absence of PLS.
- Second is the confusing expansion in size of derivatives, particularly credit default swaps (CDS),
- Third is the concept of “too big to fail”, which tends to provide assurance to big banks that the central bank will definitely come to their rescue and will not let them fail.

One of the basic tenets of Islamic finance is "no risk, no gain". This will help introduce greater discipline into the financial system by motivating financial institutions to assess risk more carefully and to effectively monitor borrowers' use of funds.

The Islamic financial system does not allow the creation of debt through direct borrowing. Its purpose is to enable individuals or companies to buy now much needed tangible goods and services according to their ability to make payments at a later date.

However, he has determined a number some of which are:

- Assets sold or leased must be real, and not imaginary or notional. . The seller or lessor must

ISSN : 1693-1688 e-ISSN : 2723-1690

own and control the goods sold orrented.

- The transaction must be a genuine trade transaction with full intent to give and take delivery.
- The debt cannot be sold and thus the risks associated with it must be borne by the lenders themselves

To this end, the Islamic financial system does not allow debt formation through direct lending and borrowing. Rather, it requires the creation of debt through the sale or leasing of tangible assets using its sales and leasing-based forms of financing (murabaha, ijara, salam, istisna and sukuk). The purpose is to enable a person or company to buy much needed real goods and services according to their future solvency.

The first condition will help eliminate a large number of non-gambling derivative transactions by third parties seeking to compensate for losses incurred by only the principal and not actually incurred by the principal.

The second condition will help ensure that the seller (or lessor) also shares a part of the risk to be able to get a share in the return. Once the seller (financier) acquires ownership and possession of the goods for sale or lease, he/she bears the risk. This condition also puts a constraint on short sales, thereby removing the possibility of a steep decline in asset prices during a downtown. The Shariah has, however, made an exception to this rule in the case of salam and istisna where the goods are not already available in the market and need to be produced or manufactured before delivery. Financing extended through the Islamic modes can thus expand only in step with the rise of the real economy and thereby help curb excessive credit expansion.

The third and the fourth conditions will not as it were spur the lender to be more cautious in assessing the credit chance but too anticipate an superfluous blast within the volume and esteem of exchanges. This will avoid the obligation from rising distant over the measure of the genuine economy additionally discharge a considerable volume of monetary assets for the genuine segment, in this manner making a difference extend work and self-employment openings and the generation of need-fulfilling merchandise and administrations. The discipline that Islam wishes to present within the monetary framework may not, in any case, appear unless governments reduce their borrowing from the central bank to a level that's in agreement with the objective of cost and monetary soundness.

Whereas a confinement on such exchanges will cut the commissions earned by the theorists amid an falsely produced boom, it'll offer assistance them deflect misfortunes and liquidation that ended up unavoidable amid the decrease and lead to a monetary emergency. The infusion of a more prominent teach into the monetary framework may tend to deny the subprime borrowers from get to to credit. In this manner, equity requests that a few appropriate innovation be presented within the framework to guarantee that even little borrowers are too able to urge satisfactory credit.

4. CONCLUSION

One of the basic tenets of Islamic finance is "no risk, no gain". This will help. Since interest-based transactions are prohibited, Islam encourages business and trade activities that generate fair and legitimate profits. In Islamic finance, therefore there is always a close relationship between financial flows and productivity. This intrinsic property of Islamic finance contributes to protecting it from the potential risks of over-leverage and speculative financial activities that are part of the root causes of the current financial crisis. Another fundamental principle of Islamic finance is the risk and profit sharing feature of Islamic financial transactions (such as Mudharabah or Musyarakah contracts). This feature of sharing the benefits and risks of Islamic financial transactions requires a high level of disclosure and transparency in the Islamic financial system. This disclosure allows the market to assign an appropriate risk premium to the company, thereby increasing the potential for applying market discipline. Its rapid evolution is

ISSN : 1693-1688 e-ISSN : 2723-1690

mainly seen in the four dimensions of its development.

- First, Islamic finance is currently seen as a competitive form of financial intermediation, which attracts significant participation by non-Muslims.
- Second, with the emergence of more diversified Islamic financial institutions and the development of Islamic financial markets, the scope of the Islamic finance business has expanded to include private equity, project financing, origination and issuance of sukuk (bonds), and funds, assets. , and wealth management activities.
- The third place where there has been a significant evolution is within the regulatory and legal framework of Islamic finance, which is shaped by the different features of Islamic financial transactions.
- Fourth, the international dimension of Islamic finance is rapidly becoming important as it develops into an increasingly important part of the international financial system and as it is poised to contribute to greater global financial integration.

REFERENCE

Alrifai, Tariq. 2015. Islamic Finance and the New Financial System: An Ethical Approach to Preventing Future Financial Crises. John Wiley & Sons.

Ainley, M., Mashayekhi, A., Hicks, R., Rahman, A. and Ravalia, A. (2007), "Islamic finance in the UK: regulation and challenges", Financial Services Authority, London.

Bahrain Monetary Agency (2002), Islamic Banking and Finance in the Kingdom of Bahrain (now the Central Bank of Bahrain), Bahrain Monetary Agency, Manama.

Choudhury, M.A. and Hussain, M.M. (2005), "A paradigm of Islamic money and banking", International

Journal of Social Economics, Vol. 32 No. 3, pp. 203-17.

Dusuki, A.W. and Abdullah, N.I. (2007), "Why do Malaysian customers patronise Islamic banks?", International Journal of Bank Marketing, Vol. 25 No. 3, pp. 142-60

Kahf, M. (2002), "Waqf and its socio political aspects", available at: www.awqafsa.org.za/

Pollard, J. and Samers, M. (2007), "Islamic banking and finance: postcolonial political economy and the decentring of economic geography", Transactions of the Institute of British Geographers, Vol. 32 No. 3, pp. 313-30.