

## **THE CAUSE AND SOLUTION OF GLOBAL FINANCIAL CRISIS: A PERSPECTIVE OF ISLAM**

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### **Abstract**

*Global financial crisis is basically the failure of the capitalist economic system. This system has been justified economic practices that conflict with Islamic economic system. Islam is an ideology derived from Allah SWT. Therefore, only the Islamic system which is able to save the world from destruction. Destruction of the global crisis that occurred in the beginning of the United States has an impact on all sectors, especially the financial sector. This can be resolved by removing the usury system, the implementation of the currency system based on gold and silver and that must be removed are non-real sector by closing the stock exchange and commodities transactions.*

**Keywords:** Global financial crisis; Islamic Economic System, and the financial sector

### **Introduction**

Four years after the global crisis, there is no agreement among development policy makers with research on the causes of changes in global financial imbalances (Merrouche and Nier , 2010) . Taylor (2007) and White (2009) stated that the global crisis affected capital flows where there is an imbalance of resources in developed countries. While the opinion of Acharya and Richardson (2009) and Obstfeld and Rogoff (2009) states that the global crisis may be caused by a combination of monetary development policy with the growth of global financial imbalances.

Taylor (2007) stated that the global crisis caused by the demand for house purchases affect the rate of development policy due to the U.S. central bank in 2001 . White (2009) added to the statement that the global crisis due to falling stock markets .

This statement is supported by Sudarsono (2009) which became one of the main reasons the subprime mortgage crises in the U.S. economy. Subprime mortgages or mortgage securities that low interest in the year 2001-2005 has led to increased demand for house (the boom in the housing market). Interest rates low in the year due to the U.S. central bank anticipates investment sluggishness due to the impact the collapse of technology stocks (the burst of the internet bubble) in March 2000. Regime of low interest rates in the U.S. in 2001-2005 to encourage people tend to be consumptive, but by relying on the financing of loans owed to banks. Interest rates Low also

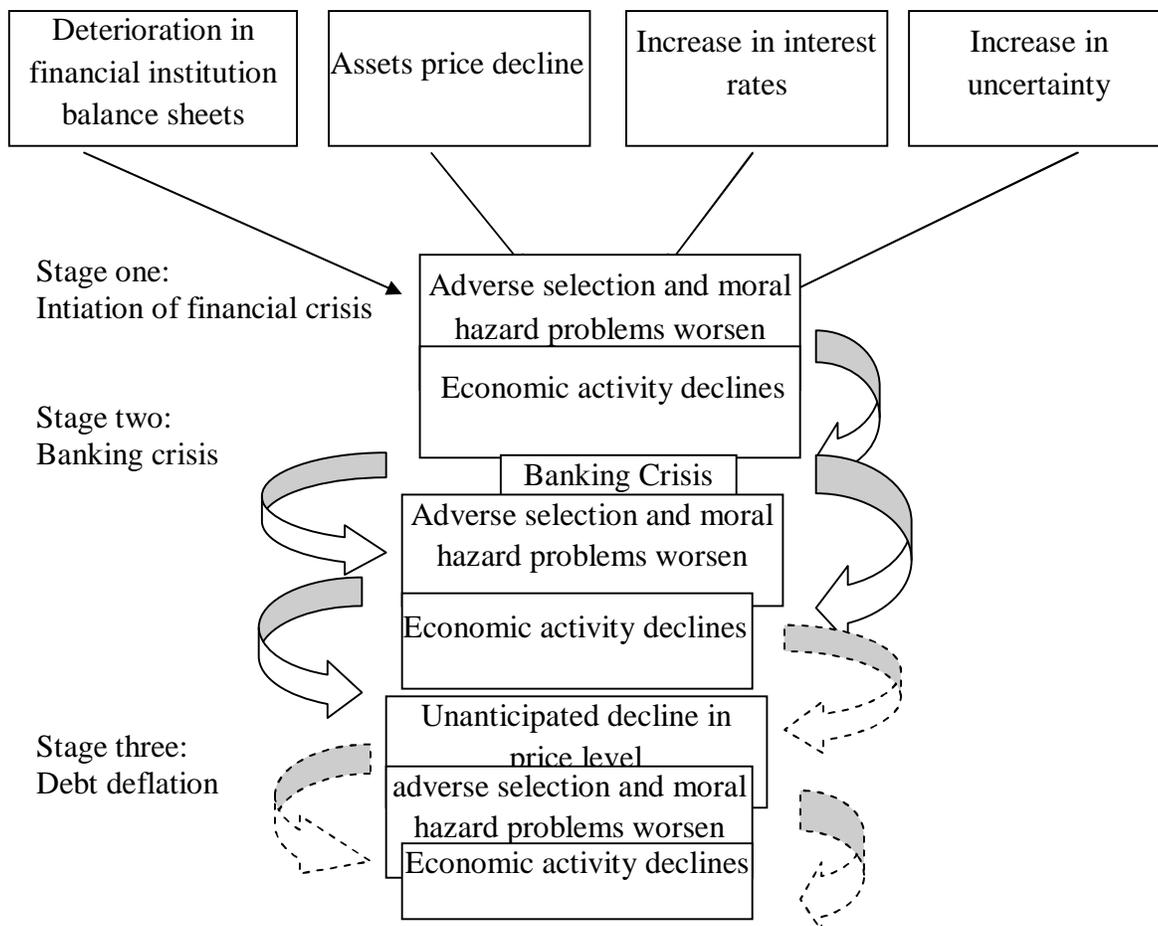
encourage corporate expansion and encourage the creation of financial instruments that have a high risk high return.

The global financial crisis of 2008 has led researchers to look at the impact on the financial industry as the research that has been conducted by Reynolds et al . (2000), Davydenko (2010), Sufian and Habibullah (2010) and Sufian (2011) found that the financial crisis has a negative effect on the financial sector performance. In addition to the global crisis effect on high-interest loans, job loss and loss of business (Agustin et al, 2012). This led to the financial crisis are likely to spread from one country to another, especially from developed countries.

Meanwhile, Analysis Mishkin (2012) that led to the financial crisis affecting the financial sector presented in Figure 1. According Miskhin there are four factors that affect the financial crisis. First, the balance sheet to be getting worse. This is caused by the influence of short-term financial innovation, where financial institutions may offer a product without fully understanding the risks of these products. Also added the insurance offered by the government would weaken market discipline and improve the moral hazard problem in which the banks will lend to a high risk because the banks do know that the government will rescue them if they encounter problems.

Second, an increase in interest rates will reduce investment and customers who take out a loan with a high interest rate, they may face problems to pay the debt because interest rates are rising and this will reduce bank profits. Third, the decline in value of an assets will affect the profits of the bank as if the asset value falls, the owner of the asset may not be able or not able to pay their loans. Fourth, the increased uncertainty in the financial crisis which began in the time of high uncertainty such as starting something imbalances, decline of the stock market or the value of assets. Fourth - four of these factors will increase the problems of moral hazard and adverse selection. So this will weaken economic activity and led to the financial crisis.

The financial crisis will increase the problems of adverse selection and moral hazard that results in a decline in economic activity. This will also cause an increase in the level of prices that cannot be predicted which will worsen the economic situation.



**Figure 1 - factors causing financial crisis and banking (Mishkin, 2012)**

From the above explanation shows that the global financial crisis caused by the financial sector. So how Islam regards the causes and solutions to the global financial crisis in spite of this?

**Discussion**

**Major causes of the Global Financial Crisis according to Islam**

In the view of Islamic economics major cause of the global financial crisis is to implement the system of capitalism that has failed in world economic activity. Technically the cause of the global crisis is as follows:

1. *Riba* and gambling. Both have formed a non - real sector in the capitalist economic system in the form of banking, insurance, and stock trading. In a capitalist system, money (capital also) is seen as private goods, both invested in the production process or not, all the capital has to make

money. In fact, the “investment ” in sectors rather than the production or in the non - real today is likely to continue to increase , far beyond the money circulating in the production sector.

2. The system used in the stock and capital markets, the sale of stocks, bonds and commodities without any conditions handover - related commodities can be traded even many times , without having to transfer the commodity from the original owner's hand - is a system of vanity and cause problems. All that triggers market speculation and shocks

3. Getting rid of gold as a reserve currency and the dollar as a companion include currency in the Bretton Woods Agreement - after the end of World War II , then as a substitute currency in the early seventies decade has led to dollar - dominated global economy. The abandonment of the gold and silver currency and replaced with paper currencies weaken the country's economy. As a result, no matter how small economic shocks that occurred in the United States would be a crushing blow to the economy of other countries.

4. Ignorance of the fact of ownership. Such ownership, The Eastern and Western thinkers, are public property controlled by the state and private ownership is dominated by a particular group. State will not intervene in accordance with the theory of Liberal Capitalism is based on the free market, privatization, coupled with globalization.

### **Solutions in Islamic economics**

Global crisis solution is to apply Islamic principles in accordance with the teachings of the Qur'an and *hadist* by running the Islamic *shariah*. Islam as a solution on the problem of the global economic crisis is to do some basic principles as follows:

#### 1 . Elimination of *Riba*.

The economic system of Islam has forbidden *riba* , both nasi'ah and Fadl . In contrast , the core of the economy Capitalism is usury and gambling , two things that are forbidden in Islam ( See : *al - Baqarah* [ 2 ] : 278 ) .

Based on this, we have to shut down and stop the usurious practices of conventional banking, including derivative transactions that are common in the financial markets and stock markets. Inflate stock prices and money is an act of *riba* .

#### 2. System currency should be based on gold and silver.

The second instrument is very strategic in the economy is a system of Islamic dinar and dirham currencies. It is given that the monetary system in Islam is based on gold and silver. Implementation of trading systems using gold and silver in the currency dinar ( Gold dinar ) and the dirham in the Islamic Caliphate has proved controllable inflation. The dinar and dirham currencies, nominal value and the intrinsic value of the currency will be fused. That is, the nominal value of the applicable currency will be maintained by the intrinsic value (the value of the money in goods, ie gold or silver itself), rather than by the exchange against other currencies. Therefore, no matter how much the U.S. dollar rise in value.

Januardi (2009) stated that the implementation of the dinar and dirham currencies will get some advantages, both in micro and macro economics include:

- Gold dinar has high stability whose value does not fluctuate so that if comparative with other currency will not depreciate even continue to appreciate. History has proven that at the time of the Prophet Muhammad, the price of a chicken worth one dirham, where the same money (one dirham is currently equivalent to three grams of silver), a chicken can still be purchased. This proves that the gold (dinar) and silver (dirham) is extraordinary currency ( anti- inflation) . So at the time of Muhammad's Saw - followed by the first four caliphs and the Caliph after administration in the management of very rare economic recession.
- Gold dinar is a commodity-based currency (commodity money), because of the balance between the intrinsic value of the nominal value contained in the gold dinar. Even the intrinsic value of gold dinar is a guarantee and protection if the external situation is not desirable.
- Implementation of the dinar and dirham will be cushioned from the effort to make money as a commodity. The current global economic crisis which occurred because the full functioning of money as it should as a medium of exchange , but has shifted into a traded commodity that is very profitable for speculators in various virtual transactions in the money market. These conditions will be favorable to the party who has a lot of funds to control the money market, and become involved in a country's dependence on unstable in terms of politics and economy of the country which has the power. so it is no longer dependent on the dominance of foreign countries. Due to the application of the economic system by using the gold dinar finance, means applying economic system based on justice (fairness), which is fairness factors not shared by any system other than the Islamic system.

### 3. Elimination of non - real sector of the economy.

The economic system of Islam prohibits the sale of commodities controlled by the seller before making unlawful selling items that do not belong to someone. Unlawful transfer commercial paper, bonds and shares resulting from contract - contract the vanity. Islam also forbids all means of deception and manipulation that allowed by capitalism, to claim freedom of ownership. This means we have to shut down the stock market.

The base of the current economic crisis is usury is one of the economic pillars of the importance of a stock exchange. Stock exchange is a transaction that must be closed forever vanity. Exchange and stock market activity is forbidden in Islam. Buying and selling stocks , bonds and commodities without any conditions handover - related commodities can be traded even commodities without having to divert them from the hands of the original owner of vanity - is system and cause problems. Prophet. said, " (not lawful) the sale of goods that are not owned by you. " (Abu Dawud).

## **Conclusions and Recommendations**

Failure of the system and the theory of sustainable capitalism and the crisis are now rightly removed. There is no option for Muslims but to take and implement the Economic System of Islam as the only solution to end the suffering of the impact of the economic system of capitalism. Islam is an ideology derived from the Creator, Allah SWT. Therefore, only the Islamic system which is able to save the world from destruction. Destruction of the global crisis that occurred in the beginning of the United States has an impact on all sectors, especially the financial sector. This can be resolved by removing the usury system; the implementation of the currency system based on gold and silver and should be abolished non real sector by closing the stock exchange and transactions that are commodities vanities. Before Islam economic system application, should state should application Islam system?

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