ISLAMIC FINANCING SERVICES FOR STIMULATING COVID AFFECTED ECONOMIES - A THEORETICAL ANALYSIS

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Abstract:

The Covid 19 pandemic has disrupted life in all countries and communities, affecting global economic growth in 2020 in ways that have not been seen in a century. Governments responded to the extraordinary reduction in economic activity by enacting several policies, which included monetary policies aimed at stabilizing financial markets and ensuring the flow of credit. Governments used quarantines and social isolation in the second phase, while policy activities moved to budgetary measures aimed at sustaining economic growth. To response to repeated crises and pandemic-induced global economic stagnation, a new paradigm is required. This qualitative study intended to examine various Islamic financing techniques and services that can help the economy recover from the pandemic crisis' disruption. Countries that follow Islamic economic principles in their economic transactions, such as Indonesia, have begun to adopt some of these principles, and it is believed that the application of the Islamic economic system can be a golden momentum to restore economic recession of these countries following the effects of national policies aimed at combating the effects of Covid pandemic. This study examines different stages of economic challenges that have occurred because of the Covid 19 pandemic to examine different Islamic financial services and their application to minimize the crisis developed at each stage.

Keywords: Covid 19 pandemic, global economies, Islamic financial services, recession, budgetary measures

JEL classification: E60, P40, P41, P51 and P52

1. INTRODUCTION

The Covid-19 pandemic and the resulting shutdown have had a negative impact on global economic activity. The pandemic has brought unparalleled crisis and repercussions in the economic activities of the world nations in modern history. It has disrupted lives across all countries and communities and negatively affected global economic growth in 2020 beyond anything experienced in nearly a century.

The impact has been quite different in different sectors of the economy. According to estimates, the virus slowed global economic growth by -3.4 percent to -7.6 percent in 2020. The global trade is estimated to have fallen by 5.3 percent in the same year. Major industrialized economies, which account for 60% of global economic activity, are expected to run below their potential output level until at least 2024, implying weaker national and individual economic well-being than before the epidemic. The economic repercussions from the epidemic has disproportionately impacted specific industrial sectors and demographic groups, and there is a risk of prolonged labor dislocations because of persistently high unemployment levels not seen since the Great Depression of the 1930s. In addition to the costs of greater poverty, lives upended, careers wrecked, and heightened social unrest, the human costs in terms of lives lost will have a long-term impact on global economic growth. According to some projections, 95 million people may have fallen into extreme poverty by 2021, with 80 million more undernourished than before the pandemic. As several developed economies begin to recover, central banks and national governments are weighing the implications of reducing monetary and fiscal support due to concerns about potential inflationary pressures, as well as the possibility of slowing the recovery's speed.

According to the International Monetary Fund's World Economic Outlook, global GDP could drop by more than $9 trillion between 2020 and 2021. To mitigate the severity of the crisis, the global economy has already infused more than $5 trillion as a bailout and liquidity booster. The potential economic consequences of the current crisis are greater than any other in recorded history. The current situation is vastly different from that which existed during World War II, where the unemployment rate grew by 2% because of the ensuing recession after the war. Because of demand and supply shocks, as well as the restricted economic instruments available, the current crisis appears to be worse. Even though governments have launched various stimulus packages, there is limited room in these packages to deal with damages of this magnitude. There is a lot of material on the COVID-19 epidemic that talks about how big the economic problem is and how it is affecting unemployment, poverty, and business destruction. However, only few of them talk about how to deal with the crisis. A new mechanism is being sought to help minimize and alleviate the severity of the current economic crisis. It was a fact that the conventional banking system was not effective to survive the financial crisis of 2007–2008, which was far less severe than the current global economic adversity, as the system is woefully unprepared and inadequate to save the world from its current economic destiny. This is the context in which Islamic financing could be used to address the current economic crisis. Islamic financial system brings greater stability and discipline in the economy by promoting risk sharing, prohibiting interest-based transactions, restricting short sales, deception and gambling.

2. LITERATURE REVIEW

Abdul-Rahman & Gholami (2020) describe the clear ideas of Islamic finance through the business of mutual profit and loss partnership as a way of capital in assisting the commercial community to recover from the COVID-19 pandemic-related economic crisis. Hanoatubun (2020) studies the impact COVID-19 on the Indonesian economy and financial recession. The study discusses how the Islamic economy is significant momentum to restore the economic recession affected by the pandemic disruption in Indonesia. Jureid (2020) describes how the sharia economic system is an alternative to the community's economic welfare. He concluded that the sharia economy, with its principles founded on the Quran and Sunnah, could be a solution for the community's welfare, especially after COVID-19 wreaked havoc on the old economic structure. Ali.O.P (2014) highlights the potential and prospective of Islamic banking in India. Though the Islamic banking industry is rapidly expanding around the world, attracting customers of all faiths, it is still struggling to establish itself in the Indian banking sector due to the misconception that it is a religious charitable project limited to the economically oppressed Muslim community. There is a need to educate the public and raise awareness about the system's benefits. Pitluck.A.Z (2012) shares the opinion of several Islamic scholars that Islamic banking is capable of not only combating the economic implications of a pandemic like Covid, but also of emerging as an alternative financial system capable of challenging the traditional financial system.

Mirakhor A (2010**)** explains that the Islamic financial system is built on risk-sharing, ethics, and morality principles, allowing it to function as a potential warrior in times of crisis, protecting the interests of the poor and defenseless.

Bashir Mohammed Sharif (2010) examines whether Islamic finance could help to provide an alternative approach to the problems that led to the crisis that would prevent the repetition of a similar crisis in the future and highlights the strengths of Islamic finance in the context of the current financial and economic crisis.

Some financial experts consider the current global financial crisis as a huge opportunity for Islamic finance, which has the capacity to bring market stability**.** (Aziz, 2009**).** According to a working paper published by the International Monetary Fund (IMF) in 2008, organizations providing Islamic financial services account for a significant and growing share of the financial system in several countries. It emphasized Islamic banks' relative financial strength and revealed that tiny Islamic banks are more financially sound than small commercial banks. (Cihak, M., & Hesse.H 2008)

3.OBJECTIVE OF THE STUDY

The purpose of this study is to examine the economic crisis brought on by COVID-19 and to provide alternative financial crisis management solutions based on Islamic teachings and principles. The economic crisis brought by covid 19 pandemic can be categorized under four stages. This research aims to look at distinct Islamic financial services by analyzing these different stages of economic problems that have arisen because of the pandemic. The research focuses on basic Islamic principles such as Zakat, Waqf, Sadaqah and other financial services, to potentially mitigate economic losses caused by the epidemic.

4. RESEARCH METHODOLOGY

The current paper emphasizes the significance of the Islamic financial system in combating COVID-19's economic effects, as well as the function of Islamic financial services in overcoming COVID-19's aftershocks. The study tries to demonstrate the importance of Islamic financial services and tools and its role in open innovation, social inclusion, and entrepreneurial innovation during and after COVID-19 using a content analysis approach. The researcher searched for relevant studies related to Islamic economics and financial services and extracted the relevant information to propose a framework of Islamic financial services and its application for dealing the repercussions of Covid affected economies and enterprises.

5. BASIC IDEAS OF ISLAMIC FINANCIAL SYSTEM

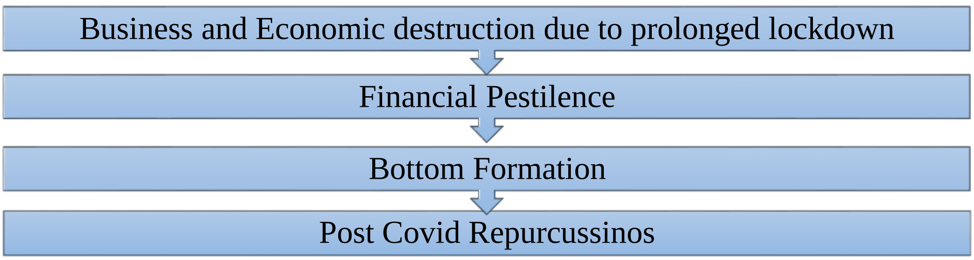
Islamic finance is the only economic system founded on the ethical precepts of a major religion, offering not only investment guidelines but also a variety of unique investment and financing solutions. There are five fundamental 'pillars' that oversee the regulation and religious validity (sharia compliance) of any Islamic economic and financial activity.

1. Prohibition of *riba* (charging of interest);
2. Profit and Loss Sharing—PLS principle;
3. Ban on speculating (*maysir*) and introducing elements of uncertainty in contracts (*gharar*);
4. Prohibition of the use of trade and investment in forbidden assets or activities (*haram*);
5. The obligation to have real assets underlying all financial transactions

Interest, or '*riba*' in Arabic is forbidden in Islam. The explicit justification for this ban may be found in the Holy Quran, which provides shape to the fundamental goal that characterizes the Islamic economic system, namely, that there can be no gains without the assumption of associated risks, and that earnings must always come from man's active labor. As a result, any positive, fixed, and planned return rate that is guaranteed regardless of the nature or results of the investment is prohibited. Because *riba* is prohibited, the Islamic economic system allows for Profit and Loss Sharing (PLS). The goal of this principle is to ensure that the participants to a transaction (the capital holder and the capital user) assume their duties in both successful and risky situations. Profit based on uncertainty (*gharar*) is expressly forbidden in the Quran. The prohibition on *gharar* is primarily concerned with the characteristics and aims of Islamic financial instrument contracts. Contracts must not contain elements of uncertainty in respect to the important aspects of the contract, such as the uncertainty of the contract's purpose or nature, or the price of the products that are the subject of the trade, in order to be legitimate. As a result, so-called aleatory contracts, which are characterized by the uncertainty of their implications, are not permitted in Islamic finance. Thus, transactions that determine enrichment by chance and involve speculative features are prohibited. Similarly, it is illegal to use, consume, trade, or invest in certain items or activities, which is treated as '*Haram*' as per Islamic *sharia* such as production and sale of alcoholic beverages, pork, tobacco, pornography, gambling etc. Investments in shares of companies that are directly or indirectly involved in the trading or production of the abovementioned goods are also prohibited. The essential features of activities that might be the topic of financial investments and transactions are defined by Islam. As a result, all financial transactions must be based on real activity rather than just the exchange of money or the buying and selling of financial debts.

6. ECONOMIC IMPACT OF COVID 19

Here, an attempt is made to investigate the different stages of the COVID-19 pandemic, as well as the economic impact it will have on people's lives and institutions around the world. The unique COVID-19 pandemic's economic impact can be divided into four stages. The first stage is characterized by business and economic destruction; the second stage is characterized by financial pestilence; the third stage is characterized by bottom formation; and the fourth stage is characterized by post-COVID-19 repercussions.



Source: The Open Social Innovation of the Financial System. *J. Open Innov.Technol. Mark. Complex.* 2021, *7*, 85.

In the first stage when the COVID-19 virus infects a country, there was lockdown of commercial activities and business establishments all over the world. As a result, supply and demand was disrupted. Because it has the potential to be fatal, it instills anxiety in the market, hurting both the production and service sectors. For a small and vulnerable economy, this is a particularly dangerous condition. Large and stable economies, such as the United States, China, Russia, and a few Gulf countries, were able to cope at this time.

Second stage was the stage of financial contagion. This stage occurs after economic activity has been disrupted and has been experienced by several economies around mid-March or early April 2020. Sharp negative movement in equity and crypto markets, forced leverage, and panic selling define this stage. Liquidity begins to decline, markets for fresh money begin to freeze, and central banks are forced to inject liquidity during this stage. Small businesses, households with limited liquidity, and households with bigger debt obligations are at risk at this stage. Governments announce stimulus packages, but they are merely a temporary and short-term fix.

When it comes to the economic consequences of the epidemic, the third stage is the most critical. This period was experienced by some countries in May 2020, including Italy, Iran, India, and the United Kingdom. The fact that the financial markets appear to have reached rock bottom demonstrates this. The underlying reason of the bottoming out must be addressed, and economies must strive for a long-term, sustainable solution.

In the fourth stage, the impact of this epidemic on our economy is expected to stay for a long time. It is projected that deglobalization would be pushed even harder, resulting in decreased travel and migration. It is expected that the world will not be the same after COVID-19, as businesses will begin to consider the danger of global supply chains and seek more efficiency.

7. ISLAMIC FINANCIAL SERVICES FOR COVID AFFECTED ECONOMIES/ENTERPRISES/ INDIVIDUALS

Islamic finance offers various tools and services to deal with economic recession and crisis which can be used as an alternative for traditional economic system. The adoption of some of the elements of the Islamic financial system is vital to solve the current crisis and ensure the stability of the global financial system. The following elements can be specified and identified as policy implications.

7.1 MUSHARAKA

Musharaka is a common Islamic financial service that is utilized to finance individuals and organizations by Islamic financial institutions and banks. It refers to two or more people pooling their resources to start a business and sharing profits and losses on mutually agreed-upon terms. *Musharaka* is a significant Islamic financial service that helps to expand welfare and alleviate poverty. This Islamic financial service has some basic features such as each partner contributes a portion of the funds (joint ownership), the partnership establishes rights and obligations of each parties, and profit and loss will be shared among the partners according to the profit–loss sharing ratio that has been agreed upon etc. In the absence of any ratio, the profit is divided according to their capital ratio. A sleeping partner is only allowed to benefit up to the amount of the capital contribution. Similarly, the *Musharaka* partnership is run in accordance with the terms of the partnership agreement. One person can be an active partner, while the others can be silent or sleeping companions. Active or managing partners are entitled to a profit that exceeds their capital investment.

Musharaka has the potential to be one of the most effective instruments for combating COVID-19's economic repercussions. It can be employed in the COVID-19 fourth stage, i.e. post COVID-19 effects. After the pandemic has passed and financial specialists have begun to assess the losses and damages incurred by individuals and small businesses, Musharaka has the potential to emerge as true social finance tools. By sharing risk and providing money, Islamic banks can enter into *Musharaka* contracts with individuals and SMEs. Investor morale is bound to be low during crises and these times, as we learnt from the global financial crisis, and they need someone to share risk with them.

7.2 MUDARABA

Another popular Islamic financial services, according to both ancient and contemporary Islamic finance scholars is *mudaraba*. A party who contributes funds to the *Mudaraba* contract is known as *Rabb-Ul-Maal*, while the other party who administers the *Mudaraba* contract's business is known as *Mudarib*. This Islamic financial service has features such as the *Mudaraba* contract involves two key parties-Rabbu-Ul-Maal, the capital provider, and Mudarib, the business manager. The Mudarib and Rabb-Ul-Maal have an agency connection, just as the parties have a master–agent relationship. The Rabb-Ul-Mall contributes all the capital, with the Mudarib contributing capital in some situations, resulting in a combination of Musharaha and Mudaraba. The profit is divided between the parties in accordance with the terms and conditions agreed upon. Mudaraba contracts can be used in a variety of modern commercial situations. Mudaraba is most used to open Islamic bank savings and current deposit accounts. The Islamic bank in this case is the Mudarib, and the depositor is Rabb-Ul-Mall.

Mudaraba has the potential to be one of the most efficient funding instruments for individuals and SMEs affected by COVID19. Our society's income distribution is already exceedingly unequal; the wealthy are extremely wealthy, while the poor are extremely poor, and COVID-19 will simply deepen the gap between the wealthy and the poor. It is necessary to build an Islamic finance model that can leverage the Mudaraba contract to help close the gap by mobilizing resources from the wealthy and assisting the poor and talented in starting their own firms. Because millions of individuals have already lost their employment and many more are projected to lose their jobs as a result of COVID-19 [18], they may be offered a second chance. Mudaraba is most effective in the COVID-19's fourth stage.

7.3 MURABAHA

Murabaha is an Islamic finance contract of sale rather than a financing technique. A *Murabaha* transaction is completed on a cost-plus basis. A standard sale and an Islamic sale, i.e. a Murabaha, are clearly distinguished in Islamic finance. In Islamic finance, a sale is defined as the exchange of products between parties who have reached an agreement.

Murabaha contracts have the potential to be an effective strategy in Islamic finance for combating the COVID-19's economic implications. COVID-19-affected people and SMEs can benefit from a Murabaha contract like BBA Murabaha (Bai-Bitamin Ajil). BBA Murabaha (delayed payment) is a sort of sale in Islamic finance similar to personal finance or vehicle finance in conventional finance, with the exception that products funded by the bank or financer are owned by the bank in the case of BBA Murabaha. The liquidity problems of covid affected individuals and small-scale enterprises can be addressed to a great extend using this financial service.

7.4 IJARAH

Ijarah refers to the act of giving something to someone in exchange for a fee, rent, or fare. In conventional finance, ijarah is the sharia-compliant counterpart of a lease. Granting someone the permission to utilize a property for a charge, rent, or fare is known as ijarah. Ijarah has two applications. The first type is when a person's services are hired for a charge, and the second type is when an item or property is used for a fee or payment. In traditional finance, a lease can be either an operating lease or a capital lease. An operating lease gives you the right to use an asset while a capital lease gives you ownership of the item.

Islamic financial services like Ijarah have become a potential combatant against the crisis because of recent developments in Islamic finance. The demand for Ijarah contracts has increased because of the reforms. To meet the demands of COVID-19-affected persons and organizations, user-friendly Ijarah contracts must be developed. Individuals and SMEs should be able to get Ijarah agreements from Islamic banks based on their needs. At phases 3 and 4 of COVID-19, Ijarah is the best Islamic finance tool.

7.5 SALAM

Salam is a sale in which the seller agrees to give particular products to the buyer later in exchange for a completely paid advance fee. The Salam seller has a moral obligation to deliver the items as a result of the Salam contract. Salam's contract cannot be terminated unilaterally after it has been signed. It is an Islamic financial service mainly intended to help the farmers. Salam contracts are only permitted for a limited number of commodities, such as rice, wheat, dates, and so on and it can finance the immediate need of the farmers.

COVID-19 has had the greatest impact on agriculture. Salam contracts, which are farmer-friendly, might give already dying farmers a new lease on life. Salam is a much-needed contract for our farmers, and Islamic banks and governments must employ it extensively to meet their financing needs. COVID-19-affected farmers can enter into a contract to get necessary capital and deliver the items whenever they are ready. It will contribute to great extend to solve the liquidity crisis in the agricultural sector.

7.6 ISTISNA

The term '*Istisna*' comes from the word *sana'a*, which means, "to make, manufacture, or construct something. Istisna is a long-term sales contract between a customer and an Islamic bank in which the bank undertakes to build and deliver an asset at a pre-determined future date and at a pre-determined price. The consumer then pays the bank in installments, at delivery, or at the end of the project.

In Islamic finance, Istisna is another exemption to the ordinary selling contract. In the instance of Istisna, a contract for goods that require manufacturing is permitted as an exemption to the sale contract. It is logical, because the manufacturer will not be able to start production until he has a commitment from the buyer.

Most business owners that are qualified for an Istisna contract work in industries such as carpentry and baking, and they are small business owners who are the most affected by the COVID-19's implications. They can benefit from this wonderful Islamic finance concept by receiving advance money to develop a product. It will help them survive and revive their business by increasing their liquidity during the pandemic. This service will be useful to survive the effects of post Covid crisis.

7.7 QARDH-AL-HASAN

Qardh-Al-Hasan is one of the most elegant financing techniques in Islamic finance; it offers funds at the lowest feasible cost to stimulate demand while also pushing the supply curve upward, resulting in increased output and lower overall price levels. Because an increase in demand is offset by an increase in output, Qardh-Al-Hasan maintains the price level. Qarḍ Hasan - commonly defined as an interest-free loan, is a benevolent economic behavior, an outlet for the placement of savings, an instrument of finance and an institution for bona fide lending. The lender extends a Qardh-Al-Hasan loan to the borrower out of benevolence. The borrower repays the lender the principal amount, interest-free, in accordance with sharia principles. It is primarily used to give a borrower with short-term liquidity. Borrowers can get a loan from Islamic banks without paying interest. Islamic finance is built on ethical and moral principles, which state that only those with a pressing need should ask for a loan, and it is the lender's responsibility to offer monies to the person in need.

The most appealing aspect of Qardh-Al-Hasan is that it must be paid at the borrower's leisure. Qardh-Al-Hasan is best suited for financing in COVID-19's first and second stages, where millions of poor people are suffering as a result of the lockdown, and it can also be used to assist migrant workers.

7.8 ZAKAT

Zakat is an important form of religiously mandated charity under Islam, which is the third pillar of Isalm. It is another beautiful concept in Islamic finance, which is purely based on the principle of ethics, morality and empathy. The objective of the zakat payment is focused on the economic development of the *ummah* (society) and *baldah* (nation) and not only confined to the ritual practices. Zakat is calculated depending on one's wealth more than a specific level known as Nisab. Every commercial or business transaction involving a Muslim's business asset is subject to zakat, as well as banking zakat.

According to the Holy Quraan and Sunnah, zakat is one of the most reliable strategies of poverty alleviation. It has the potential to be an essential Islamic finance weapon in combating the COVID-19's negative impacts. Zakat is a religious responsibility for rich Muslims to pay as part of their religious obligations. COVID-19-affected people, particularly the impoverished, can be given basic products and/or money as a form of relief. It is excellent for helping the impoverished during stage 1 and 2 of lockdown, when daily wage laborers and migrant workers are unable to feed their families.

7.9 WAQF

Waqf refers to a religious endowment i.e. a voluntary and irrevocable dedication of one’s wealth or a portion of it- in cash or in kind, and its disbursement for shariah-compliant projects. Over the years, waqaf has been seen as a social finance tool, and it has played a critical role in securing long-term funding for a variety of poverty-relief projects, including education, health, and disaster relief. Waqaf can be a significant funding strategy during COVID-19 since the wealth collected can be used for the welfare of COVID-19-affected persons and the bigger community participation goal can be met. Waqaf is best suited for combatting the economic impacts of Covid 19 in the fourth stage.

7.10 SADAQA

Sadaqa is another Islamic finance technique based on the principle of kindness and generosity. Sadaqa is a voluntary offering, and the amount is up to the benefactor's discretion. Sadaqa is only given to certain persons under certain circumstances. Like Zakat and Waqf, Sadaqa is also been contributing significantly in achieving the Islamic financing goals to mitigate poverty, provide better infrastructure of school and hospital, and preserve life and the environment.

Sadaqa is most suited to be used as a finance mechanism during the COVID-19 era and its effects subsequently, as its basic nature suggests. It is best used to assist people who are caught in lockdown and those who have lost their businesses and property because of COVID-19. Sadaqa distribution might be delegated to Islamic banks and financial entities to increase efficiency and transparency.

8. CONCLUSION

The COVID-19 epidemic has not only damaged human health and life, but it has also disturbed global economic processes. Different economies have been experiencing the different stages of the COVID-19-induced economic disaster. The capitalist approach of industrialized countries and the semi-socialistic approach of developing countries' have both failed to address the economic crisis. A social and open innovations are relevant in this pandemic period, to find out alternative ways and innovative solutions to combat the economic shocks of the pandemic. Islamic financial services are a sort of ethical finance that is primarily centered on ethical and moral principles and accepts any innovation to improve financial services. The Islamic banking industry's remarkable success is due in part to its embracing of innovation, especially social and open innovation, and it has previously played a vital role in its expansion. The fight against the COVID-19 pandemic's economic effects will be won through social and open innovation in Islamic finance.

In this environment, Islamic financial services like Zakat and Sadaqa are needed to help economically deprived groups by producing a flow of money that encourages consumption. Mudaraba and Murabaha assist start-ups and small businesses in regaining employment or starting a business. This encouragement boosts individual's morale and creates jobs, resulting in a rise in consumption. Islamic finance promotes societal development by distributing and sharing excess money via Zakat, Waqf, and Sadaqa. These ideas can help people get their businesses back on track and develop fair trading practices. Thus, it can be concluded that Islamic finance has enormous potential in terms of inclusivity, stability, and sustainability. Zakat, Sadaqah, Waqaf, and Qardh-Al-Hasan are only a few of the many financial services given by Islamic financial organizations that can be used to effectively combat COVID-19's economic challenges.

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