‘Default’ in Dubai

For all the fuss about the so-called “default” in Dubai, few if any Euro-American commentators have paid attention to have noticed the significance of the Islamic character of the financial instruments on which payment is being deferred. *Sukuk* bonds are best understood as *Shari’a*-compliant letters of credit: hence they are by definition they *riba* (interest) free. Like their early Christian counterparts, Islamic theologians regard the prospect of making money without effort, and without even taking on a share of the risk when the funds in question were deployed for commercial purposes, as morally unacceptable. Hence instead of piling all the risk onto the debtor/entrepreneur, who is saddled with an inescapable obligation to making interest payments come what may, as is now the Euro-American norm, *Sukuk* bonds render investors and entrepreneurs *partners* in the enterprise in question, such that both profits and losses are shared between them. In other words the risks which are inherent in all such financial enterprises are *shared* between both parties.

In recent years a steadily increasing number of *Sukuk* bonds have been issued, believed to be in excess of $ 100 billion at a global scale. The bonds which are currently causing such alarm were issued by Nakheel, the property development arm of Dubai World, as means of financing its many spectacular initiatives in this field. As is typically the case, these bonds are structured in such a way that investors’ returns are derived from tangible rent-generating assets, which are vested in a third party vehicle owned by the Sukuk-holders for the duration of the bond. In Nakheel’s case these assets are land, islands and property developments along the foreshore of Dubai.

One can only presume that the Bankers who invested billions in these bonds did so on the assumption that property values in Dubai would continue to soar for the foreseeable future, and that they were consequently guaranteed a virtually risk free return on their investment. But now that Dubai’s property bubble has burst, those ‘risk free’ profits are turning out to be a mirage, at least in the short term. As a result they have rushed to prophesy further global financial doom, most especially when they found that Emirate of Dubai, and worse still that Abu Dhabi, that land of Croesus just up the coast, were unwilling to reach into their massive resources of sovereign wealth to take these unlucky investors off the hook.

Do the complainants have a case? It seems unlikely. Besides wrong-footing themselves by failing to realise that investing in Dubai’s property bubble was anything but risk free, they also overlooked the most distinctive feature of Islamic finance: its *moral* grounding. The *Shari’a* looks askance on deals which allow those rich in capital both to have their cake and eat it. That is what profit *and loss*-sharing is all about.

From this perspective the ‘Dubai crisis’ is best viewed as yet another example of profit-seeking Banks being caught out by their own myopic greed, such that they made a serious miscalculation of risk. But this time round they will not be able to get off the hook by foreclosing on their creditors, whilst also expecting lenders of last resort to bail them out. Investing in *Sukuk* is intrinsically a risk-sharing exercise. But before sympathising with investment bankers as they prepare, once again, to weep into their bonuses as they face up to the fact that these ‘exotic’ financial instruments offer them no greater protection from risk than did higher mathematics, perhaps we should be asking some rather more searching questions about these developments.

Taken seriously, risk-sharing generates a very different mind-set from that generated when capital is invested on a fixed-interest basis. An explicit commitment to risk-sharing – as opposed to the construction of houses of cards within in which it was alleged that risk could be eliminated thanks to the application of complex mathematical formulae – has the advantage, at least in principal, of keeping investors’ eyes on the ball, rather than sitting back in the expectation that it will in due course find its way into the net. Active risk-sharing by investors has positive systemic consequences: as real engineers (as opposed to financial wizards) will readily appreciate, such situations generate powerful negative feed-back loops which provide a powerful constraint against the prospect of irrational exuberance and hence systemic failure. That is why bankers' demands for sticking plasters to with which to restore their burnt fingers to health should be resisted. The creation of positive feed-back loops merely encourages the foolish to do it all over again.

But unfortunately far too many the financial wizards who have bought *Sukuk* bonds did so with Euro-American financial expectations in mind. Hence instead of realising that the logic of *Sukuk* bonds assumed that they would take a positive interest in the success or otherwise of the projects in which their funds were invested, they promptly treated them as 'securities', which could be traded in the market as readily as pork bellies and financial futures, not least in the expectation that if anything went wrong they would be able to evade downside risks by mounting pass-the-parcel exercises of kind of which they have become such expert exponents. If so, they have only themselves to blame.

Could it be that these crocodiles have at long last met their match: a morally grounded form of capital investment which, if properly implemented, would have a built-in tendency to restrict rather than to amplify the growth of financial bubbles?

There are undoubtedly lessons to be learned here, in the City no less than in Dubai. It goes without saying that c*aveat emptor* has always been a premise of crucial significance, no matter how much the wealthy may regularly have sought to bend financial systems in such a ways as it evade its consequences. However as the Prophet also appreciated, it is a proposition which only reaches its full force when set alongside another equally vital proposition: that there is no prospect of generating a just and stable socio-economic order without a commitment to share and share alike, especially with respect to unforeseen and unforeseeable risk. By contrast the allegedly more progressive financial methodologies developed in Euro-America have become steadily, and insidiously, undermined morally grounded propositions of this kind, such that they are now routinely out-trumped by the view that the devil must always be allowed to take the hindmost, if only *pour encourager les autres* – with the necessary exception of authors of the whole edifice: Investment Bankers.

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