Greek Debt Crisis: EU Should Learn from UAE

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Dubai's total debt to GDP is about 132 percent of GDP. Greek debt as a percentage of its GDP is 177 percent. Both countries are over leveraged. Neither has the means to service its debt, without help. Yet, the markets are not overly concerned about Dubai's debt, but are in utter turmoil over Greek debt. The reason? Dubai, as a member of the United Arab Emirates (UAE), was given debt relief by Abu Dhabi, another member of the federation. Greece as a member of the EU was not given debt relief by any members of its federation. The inference? The EU should be more creative, think outside the standard emaciated IMF model, and consider a solution based on Islamic finance principles that takes the form of generous debt relief.

The EU and UAE are both federations

Like the EU, the UAE is a federation of separate states that are economically integrated with a common market and single currency. Unlike the EU, the UAE is far more politically integrated with a common foreign and defense policy. The country is made up of seven emirates, each governed by an emir. The seven emirs make up the Federal Supreme Council, which is the federal government of the UAE. All responsibilities not granted to the national government are reserved to the emirates. The president of the UAE is the Emir of Abu Dhabi and the prime minister is the emir of Dubai.

Abu Dhabi has sizeable oil and gas reserves and its economy is driven by those two sectors, though it is attempting to diversify into tourism, air transport and services. In contrast, Dubai has far smaller oil reserves and largely depends on tourism for revenues. It is the fifth most popular tourism destination in the world, a position the emirate established through aggressive expansion into infrastructure, hotels, financial services and property development, all promoted by its world-class airline, Emirates, that even Singapore Airlines envies.

Dubai's bailout

In late 2009, as a result of the global financial crisis, Dubai was unable to service the substantial debts it accumulated in its expansionist drive. The announcement of its imminent debt default caused sharp falls in Asian stock markets. Abu Dhabi acted swiftly, providing a $10 billion bailout to Dubai. Markets recovered, as did Dubai's economy, thanks to improving tourist numbers and growing trade. Economic growth is averaging 4.6 percent a year between 2012 and 2015. The bailout made it easier for various indebted government related entities (GREs) to restructure their short-term obligations. With the financial heft of Abu Dhabi behind it, Dubai successfully issued $1.25 billion of five-year Islamic bonds (sukuk) in 2009 with a profit rate of 6.396 percent, according to data compiled by Bloomberg. In 2013, Dubai raised another $750 million in 10-year notes at 3.875 percent. These efforts helped, though overleveraging is a problem that lingers.

Fortunately, Abu Dhabi continues to assist Dubai with lightening its debt burden. Last March, the emirate signed an agreement with Abu Dhabi and the UAE central bank to roll over $20 billion of debt for five years. The liabilities consist of $10 billion of bonds owed to the central bank and another $10 billion to the Abu Dhabi government. The fixed interest of the liabilities is 1 percent, which compares with an interest rate of 4 percent on the original loan from 2009. The terms of the new facility are more favorable and the loan is renewable after five years. Note also the flexibility of thought in the deal: it is structured as conventional, interest bearing obligations. Quite a contrast from the intransigence of the EU politicians and their IMF collaborators.

Austerity versus growth

Unlike the EU and IMF, which insist on imposing austerity on forlorn Greece, Abu Dhabi and the UAE bailed out Dubai to promote economic growth for the emirate and the federation. The rollover of debt in 2014 has enabled Dubai to continue spending heavily to develop itself as a regional, if not global, center for finance, trade and tourism. The different economic strategy used by the UAE in its bail out of Dubai seems to be working better than the austerity regime of the EU and IMF. Dubai's residential property prices increased over 20 percent, and its stock market is up strongly since the end of 2012. Meanwhile, the generous debt relief allows the GREs to work through debt restructurings, selling assets to meet repayment in the next few years. The IMF estimated in January 2014 that Dubai and its GREs had about $78 billion of maturing debt between 2014 and 2017. The rollover of the initial bailout relieves more than a quarter of this amount.

Islamic principles of finance

There are both pragmatic and Islamic reasons for the generous debt relief offered by Abu Dhabi. The government of the UAE most likely did not want foreign holders of Dubai debt to lay claim to some of the most valuable properties in what until 1971 was a desert wasteland called the "Trucial States." Further, the decision to bail out Dubai, and then offer more debt relief, is driven by principles that underlie Islamic finance.

In conventional modern finance, the (unstated and not intentionally pursued) purpose of finance is to increase economic efficiency. This purpose is achieved through rational self-interest and profit maximization. Benefits, if any, to the community and the social good are by-products and unintended. Conventional finance is silent on the ethics of finance and on its teleology. Economic efficiency is not a stated or desired purpose. Efficiency simply is the outcome of all financial activity.

In contrast, the fundamental purpose of Islamic finance is derived from the Shari'a. The Shari'a is the religious law Allah directly gave to his Prophet (PBUH). As such, the purpose of Islamic finance is *ethically driven,* because the aim of the Shari'a is also the aim of Islamic finance. Finance is only one part of life and society. The objective of Shari'a is the happiness and well being of the people in this worldly life, as well as in the life Hereafter. Accordingly, the objective of Islamic finance is that people flourish now and on the Day of Judgment before Allah. *Islamic finance must contribute to the development and good of the Islamic community*. How finance achieves this purpose is guided by principles written down in the Holy Qur'an and other key sources of the Shari'a. Not surprisingly, therefore, the fundamental feature of Islamic finance is socio-economic and distributive justice. As Shari'a is the guide to Islamic finance, the latter contains a comprehensive system of ethics and moral values.

Moral alternative instead of moral hazard

Perhaps not surprisingly, Islamic finance principles state clearly individuals who have trouble repaying their debts should have their obligations made easier for them and not more difficult. It is immoral for a lender to harass or pressure a person who has borrowed money and is unable to repay the loan, if that person has fallen on hard times. Instead, such individuals are deserving of charity.

Accordingly, the bail out and subsequent debt relief for Dubai was done for the good of the community, or in Christian terms, for the common good. Perhaps, therefore, the EU and IMF should stop thinking of Greek debt in terms of mere moral hazard and economic efficiency, and start considering more generous debt relief as a moral alternative.

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