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# CRISIS UNDER THE ISLAMIC FINANCIAL SYSTEM: CASE STUDIES OF DUBAI AND QATAR

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## ABSTRACT

*Financial crises are defined by a liquidation of credit and a decrease in stock prices resulting from the forced sale of assets by over-indebted firms. For at least four centuries, financial crises have been a regular feature of Western capitalist economies. But can a financial crisis occur in a system with no interest rates? In this paper, we assess the possibility of a financial crisis occurring under the tenets of Islamic finance, which eschews interest. In doing so, we will be using the cases of financial crises and the collapse of real estate bubbles in Dubai, which is then contrasted with the consistent growth in Qatar. By examining the cases of Dubai and Qatar, we will show that a financial crisis can occur under a system of Islamic finance and that the financial regulations of a central banking mechanism can prevent or mitigate the occurrence of a financial crisis. What matters is the framework of strong financial regulations of a central banking mechanism, as indicated by Qatar's economy. Their central bank's adherence to stronger banking regulations and to the tenets of Islamic finance has not only reduced risk, but also curtailed uncertainty and speculation in financial transactions and contracts.*

***KEYWORDS***: *Real Estate Bubble, Western Capitalist Economies, Dubai Financial Crisis, Islamic Finance.*
**JEL Classification Codes**: 6C, 110P, 11C, 151P, 4P, 2C, 3C

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### Introduction

In his book "Manias, Panics and Crashes: A History of Financial Crisis", Charles P. Kindleberger provides an extensive historical account of financial crises analyzed within Minsky's framework. It starts from an autonomous shock to the economic system that alters profit opportunities. The shock can either be the outbreak of war or a technological advancement or an oil shock, which creates a feeling of buoyancy and leads to a reordering of investment priorities. Consequently, an investment boom is started which may go too far resulting in "Euphoria" and "Overtrading". That is, positive (and even outlandish) expectations about the future drive up prices, followed by more investors entering the market to speculate and earn profits. But the boom may subside by itself when expectations of its subsidence are caused by the inability of a few investors to repay, which sets in motion a stampede for liquidity. This rush back into money triggers panic, seizure of credit and eventually crisis.

Financial crises are defined by a liquidation of credit and a decrease in stock prices resulting from the forced sale of assets by over-indebted firms. The crisis spreads when there is a decrease in the financial environment surrounding several firms. Low expectations for future profits result in creditors

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