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Dubai: Global Economy

"A leader should lead, and be able to lead his people by positioning himself in front of them and not behind them. A leader should take control and tell his people: 'Here is our goal, follow me towards it, and not: Go ahead, and we will be right behind you.'"

—His Highness Sheikh Mohammed Bin Rashid Al Maktoum

Introduction

In January 2009, Dubai faced considerable economic challenges. The impact of the global financial crisis had reached its shores, but its severity was still unknown. On January 20th, the national government pushed a new media law past the first legislative hurdle. If approved by the cabinet and president, the new law would restrict freedom of press. Any journalist who criticized the royal family or published information damaging the economy would be fined up to one million dirhams[a].[1] The proposed law highlighted a lack of transparency and raised questions of economic vulnerability. Nonetheless, Dubai had seen an average annual growth rate reportedly in excess of 13% between 2000 and 2006 and had become an international financial and logistical hub in less than 10 years.[2] The question now was whether the foundation of development had created a sustainable model.

Dubai is located on the southern coast of the Persian Gulf, on the Arabian Peninsula. The city-state was one of seven emirates comprising the United Arab Emirates (UAE). The UAE was established as a constitutional federal state in 1971. The Supreme Council of Rulers, composed of the emirate Sheikhs, elected a President for a five-year term. A Prime Minister also led a council of ministers. A Federal National Council served as advisors to this combined leadership. At approximately 2,414 square miles, Dubai is second in size only to the emirate of Abu Dhabi. Dubai and Abu Dhabi, an emirate rich in oil, were the most influential in UAE decision-making. Since 2006, the constitutional ruler of Dubai was Sheikh Mohammed bin Rashid Al Maktoum. In 2009, he continued to serve as the U.A.E. Vice-President as well as Prime Minister.

According to one expatriate businessman, "the United States was a melting pot and Dubai was a salad bowl."[3] The official language was Arabic although most businesspeople spoke English. The official religion was Islam. Other religions coexisted with both Christian churches and Hindu temples within Dubai. Israeli passport holders, however, were not permitted entry to the UAE. Emiratis,

[a] Dirham is the Dubai currency fixed at 3.67 to the dollar.

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mostly Sunni Muslims, generally adhered to traditional Islamic and cultural norms, with women in *abayas* and men in *dishdashas*. In stark contrast, it was not uncommon to see women in miniskirts next to women in *abayas* – one not much noticing the other. The Islamic influence was evident in daily practices such as broadcasting the call for prayer (*athaan*) in shopping malls. Although cultural and religious restrictions remained, all women were allowed to drive. Nightclubs, movie theaters and alcohol catering to foreigners were permitted. As the population expanded and the demographics shifted, the emirate attempted to "globalize, not westernize."[4] The Dubai population had increased from 183,200 in 1975 to 1.5 million in 2008.[5] Emiratis composed less than 10% of the local population. Indians, Pakistanis, Iranians, and dozens of other nationalities had migrated in large numbers. (**Exhibit 2**) Labor protection presented a challenge to the government. Dubai had signed agreements with labor exporting countries to ensure some labor protection, but was still working to meet the United Nations' recommendations regarding human rights.

Economy

For much of the 1900's, Dubai was a trading post dealing primarily with pearls. Trade brought early international influence from Persia, East Africa, India, Pakistan and even the United Kingdom but the economy remained weak prior to UAE unification. Oil was discovered in Dubai in 1966 and the exports followed in 1969. In the late 1970's, HH Sheikh Rashid bin Saeed Al Maktoum – who remained ruler until his demise in 1990 – used this oil revenue to expand the city's global orientation and set out to create a "hub of hubs" by liberalizing local laws.[6] He initially focused on hydrocarbons and petrochemicals. In 1985, oil still comprised almost half of Dubai's GDP. His successor, HH Sheikh Maktoum bin Rashid Al Maktoum who was Vice President and Prime Minister of the UAE and rule of Dubai until 2006, followed the same policy towards greater diversification. By 1993, oil revenue had dropped to a less than a quarter of GDP.[7]

Strategically located between Asian and European economic centers and near rapidly emerging markets, Dubai was well positioned geographically to become a regional powerhouse. The Dubai government created Emirates Airlines in 1985 to augment superior coastal connectivity. In the early 1990's, the government adopted Michael Porter's cluster strategy for development. In addition to becoming a logistics and transportation hub, the government established free trade zones that concentrated similar industry activity. These clusters contained synergistic companies and co-located regulators and support services. Laws within these zones provided customized incentives to attract entrepreneurial, as well as established, foreign companies. Among the most prominent were Dubai Media City and the Jebel Ali Fee Zone for manufacturing. By 2008, Dubai had become the third largest re-export center in the world.[8]

The Dubai International Financial Center (DIFC) capitalized on emerging market activity in the region stretching from the western tip of North Africa to the eastern part of South Asia, comprising North and East Africa, the Levant, the Caspian, the Indian subcontinent, and the GCC states. In a time zone between the well-established Hong Kong and London markets, DIFC offered a local financial services base for privatization/IPO's, brokerage, wealth management and Islamic finance. The zone adopted a legal system modeled after that of the United Kingdom. It offered opportunities for 100% foreign ownership and a 0% tax rate of income and profits for fifty years. The Dubai Financial Services Authority (DFSA) and the Nasdaq Dubai stock market were also created. By 2009, the DIFC hosted over 750 companies, of which over 450 were in the financial services sector.[9]

The physicality of the clusters was remarkable. One hundred and ten acres downtown, for instance, were dedicated to the DIFC. Approximately four million square feet of office space were expected to be constructed for this zone, alone.[10] The proliferation of the clusters led to a radical, physical transformation of Dubai. Concentrated economic growth, combined with a 2002 real estate law permitting freehold ownership for foreigners, ignited a construction boom. Since then, the real estate boom has produced almost $500 billion in construction. In 2009, developers were constructing the tallest building in the world. The previous year, the Dubai Mall became world's largest shopping center at 12 million square feet. The real estate industry became an economic driver itself; it was the largest sector of the Dubai economy at 8% of GDP.[11] According to the Dubai Statistical Center, the number of companies in the construction sector increased 32% per year between 2003 and 2006.[12]

Dubai's vitality and transformation further drove tourism. At a 22% annual growth rate in 2006, it was the fastest growing sector of the economy.[13] Of six million tourists in 2007, 34% were Europeans and 27% from the Middle East.[14] Dubai developed extravagant attractions, such as indoor skiing, to cater to wealthy tourists. To meet this need, substantial infrastructure had been constructed. The international airport boasted the largest terminal in the world at over 16 million square feet. Living in Dubai was expensive and frequently required two incomes. Some expatriates were sending their families back home due to the cost of living rise.[15]

The local banking industry's orientation towards the Middle East partially mitigated the impact of the 2008 global financial crisis. Exposure to assets from the United States was limited. Dubai, nevertheless, was not immune to economic vulnerability. Foreign Direct Investment fueled much of the growth over the past decade. The erosion of global wealth was expected to reduce this figure. Despite a 33% year-on-year increase in real estate villa prices and a 16% year-on-year increase for apartments, property prices declined 23% for the last quarter of 2008.[16] Various sources estimated a further drop of 20% to 60%. The stock for Emaar Properties, one of the largest real estate developers in the Middle East, plummeted 62% from the beginning of 2008 to November of the same year.[17] Many construction cranes had stopped moving altogether and buildings stood unoccupied. Some Dubai contractors faced possible bankruptcy due to unpaid fees and dwindling work. "Contracts are not worth the paper they are written on… There is a sense among the big developers that because they are linked to the government, they can do what they want."[18]

Debt levels caused the economy to suffer further. Dubai's foreign currency debt was $120 billion, or 152% of GDP, in 2008. High leverage had been used to finance the burgeoning economy, real estate and infrastructure. With the fall in real estate and a 48% decline in the stock market over 2008, underlying asset values were questionable. Constricted credit markets and local illiquidity threatened the ability to refinance and restructure this debt. The extent of the challenge was unclear given opaque lines of public-private ownership and limited information flow. For example, $74.5 billion of Dubai's foreign currency debt was "contracted by non-bank quasi-sovereign entities." Many private companies were indeed majority owned by the government. Individual consumer debt levels were also high. Some analysts predicted that Dubai would need to turn to the central bank in Abu Dhabi for capital, although the government of Dubai had denied the need to do so.

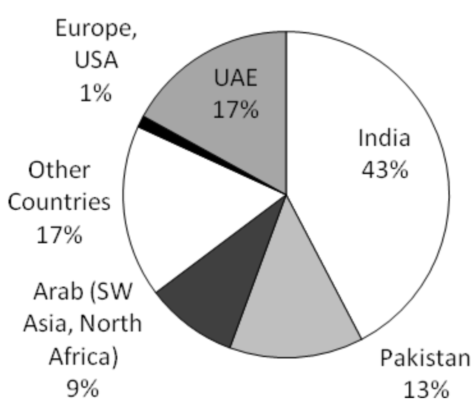
Official economic figures had been contradictory. Dubai's GDP rose somewhere between 13% and 16% in nominal terms, between 6% and 7% in real terms. Wholesale and retail contributed 37%.[19] Oil revenue represented only 3% of GDP in 2008.[20] But, in February 2009, HSBC reported that $75 billion worth of construction projects had been cancelled or delayed; Morgan Stanley reported the number to be $263 billion.[21] "The market is largely being driven by panic, mainly due to lack of transparency and information, which is preventing people from making a good assessment of the market situation, and is stopping them from facing economic recession with confidence."[22]

Dubai needed to demonstrate the sustainability and viability of its development plan. The government planned to increase spending by 11%, including a 42% increase in infrastructure, transportation, and social services.[23] Would this still be possible? Would it be enough to stem an exodus of human capital and foreign investment? Or, would over-leverage and lack of transparency prove the emirate too vulnerable?

Exhibit 1 Map

Source: Courtesy of the University of Texas Libraries, The University of Texas at Austin, http://www.lib.utexas.edu/maps/cia08/united_arab_emirates_sm_2008.gif, accessed February 2009.

Exhibit 2 Country of Origin as Percent of Total Population, 2005 Census



Source: Adapted from George Washington Center for the Study of Globalization, http://www.gstudynet.org/gum/UAE/Dubai2005.htm, accessed February 2009. References: UAE Ministry of Labor. Emirati % of total population is disputed. Number of expatriates in country has reportedly increased between 2005 and 2009 although updated census numbers have not been collected.

Exhibit 3 GDP Growth, Estimates and Projections (United Arab Emirates)

	2008	2009
Citigroup	6.7%	2.7%
EFG-Hermes	6.6%	0.04%
Economist Intelligence Unit	7.7%	1.5%
Standard Chartered	n/a	0.5%

Source: Compiled from Haseeb Haider, "UAE Economy to Record 2.7pc Growth: Citigroup," Khaleej Times, 29 January 2009. Issac John, "UAE Economy to Shrink this Year, Rebound in 2010: EFG-Hermes," Khaleej Times, 12 January 2009. Economist Intelligence Unit. Travis Pantin, "Gulf growth forecasts cut down," The National, 8 January 2009.

Exhibit 4 Financial Indicators (United Arab Emirates)

US$ million (unless noted)	**1990**	**1995**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008e**
Nominal GDP (mn dirham)	123,600	156,902	257,979	254,236	272,856	321,752	386,535	485,513	624,623	729,732	815,318
Real GDP (mn dirham)	162,959	188,845	257,979	262,353	269,304	301,351	330,582	357,690	391,160	421,073	453,578
GDP (% real change pa)	17.5	6.7	12.3	3.5	2.6	11.9	9.7	8.2	9.4	7.6	7.7
GDP per head ($ at PPP)	20,390	20,530	22,690	22,410	21,740	23,080	24,370	25,520	26,970	27,840	29,060
Exchange rate AED:US$ (av)	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
Stock of money M1	10,762	20,824	34,067	39,464	47,054	58,262	80,818	104,449	120,020	181,664	279,944
Consumer prices (% change pa; av)		4.32	1.35	2.70	2.90	3.24	7.00	12.50	13.50	13.30	14.40
Goods: exports	21,664	30,400	49,600	47,605	52,199	67,137	90,997	117,287	145,586	180,897	200,420
Goods: imports	(10,181)	(24,871)	(30,800)	(33,500)	(37,559)	(45,843)	(63,458)	(74,526)	(88,086)	(116,642)	(141,137)
Trade balance	11,483	5,529	18,800	14,105	14,640	21,294	27,539	42,762	57,500	64,255	59,283
Services: balance	(1,553)	(3,100)	(6,430)	(6,127)	(7,721)	(9,058)	(12,074)	(14,575)	(18,031)	(23,854)	(27,887)
Income: credit	3,154	5,696	5,500	6,414	3,197	2,340	4,476	9,025	14,129	16,458	18,926
Income: debit	(1,084)	(896)	(1,700)	(1,350)	(2,271)	(2,379)	(4,321)	(6,139)	(8,384)	(10,604)	(10,026)
Income: balance	2,070	4,800	3,800	5,064	926	(38)	155	2,886	5,745	5,854	8,900
Current transfers: balance	(5,138)	(3,389)	(5,138)	(7,230)	(3,413)	(3,383)	(3,359)	(3,389)	(8,747)	(9,875)	(10,740)
Current-account balance	6,863	3,841	11,032	5,812	4,431	8,814	12,262	27,684	36,468	36,380	29,555
Inward direct investment	n/a	399	500	1,200	95	4,255	10,002	10,900	12,806	13,253	11,150
Outward direct investment	n/a	(10)	(2,100)	(400)	(441)	(991)	(2,208)	(3,750)	(10,892)	(6,625)	(4,000)
Inward foreign direct investment/gross fixed	*n/a*	*3%*	*3%*	*7%*	*0.5%*	*21%*	*45%*	*43%*	*39%*	*33%*	*23%*
Net portfolio investment flows	n/a	n/a	(10,500)	(6,980)	(4,850)	(14,400)	(18,900)	(33,700)	(37,500)	(885)	(56,800)
All Other Capital Flows	n/a	n/a	7,028	992	1,838	2,100	2,286	1,346	5,725	7,499	(10,905)
Stock of International Reserves	4,765	7,653	13,613	14,237	15,310	15,088	18,530	21,010	27,617	77,239	46,239

Dirham million	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Total Revenues	44,738	74,386	68,633	57,218	77,012	94,751	143,905	201,166	228,750
Tax Revenues	6	5,035	6,274	6,881	7,044	9,566	6,810	8,027	13,833
Non-Tax Revenues	38,900	69,351	62,359	50,337	69,968	85,158	137,095	193,139	214,917
Oil & Gas	28,054	59,978	51,648	40,926	56,738	73,322	111,377	164,775	176,265
Other	10,846	9,373	10,711	9,411	13,230	11,836	25,718	28,364	38,652
Total Expenditures	74,265	84,066	95,459	86,616	91,433	96,274	104,430	125,977	159,726
Current	57,666	71,187	77,005	72,602	74,253	80,984	84,255	103,907	121,314
Development	13,692	11,156	13,283	12,470	16,028	15,207	14,042	15,225	17,271
Loans & Equity	2,907	1,723	5,171	1,544	1,152	83	6,133	6,845	21,141
Overall Surplus/Deficit	(29,527)	(9,680)	(26,826)	(29,398)	(14,421)	(1,523)	39,475	75,189	69,024

Source: First table compiled from Economist Intelligence Unit, www.eiu.com, accessed February 2009. References: UN, UAE Central Bank, and IMF. Second table compiled from Table 40, page 58, data from Ministry of Finance and Industry and Local Finance Departments, www.uae.gov.ae/mofi/default.htm, accessed February 2009.

Note: 2008 numbers are estimates.

Exhibit 5 Debt Financing

	Official reserves ($bn)	External debt ($bn)	External debt/GDP	Reserves/ external debt
UAE	46	211	84%	22%
UAE (incl. SWF's)	396	211	84%	188%
Dubai	n/a	115	152%	na

Dubai: Non-bank foreign currency debt ($bn)	
Total	74.4
Quasi-sovereign publicly guaranteed	3.2
Nonbank private	20.9
Non bank quasi-sovereign*	50.2

Source: Compiled from "UAE: The Dubai debt problem," Barclays Capital, 9 January 2009, pp. 1 and 3. References: Deal Logic, Bloomberg, Barclays Capital, and Central Bank of UAE.

*Quasi-sovereign refers to entities in which Dubai or wholly owned entities have a majority stake.

Endnotes

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