Dubai's Model of Economic Diversification

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CHAPTER 5

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Introduction

Dubai has made significant progress in its economic development since the early twenty-first century. Analysts attribute much of Dubai's economic success story to its unique business environment that is very attractive to businesses, shoppers and more recently to academics and researchers. What makes Dubai unique is the scale of its economic activities, the efficiency of business and financial services and tourism facilities. This is apparent in its ambitious plans to become the main trading hub in the Gulf region, and turn some of its major companies and facilities in airline, aviation, ports, logistics, construction, real estate and finance into world-class services providers (Nyarko 2010). In contrast with Abu Dhabi, where oil contributes approximately 90 per cent of the UAE's oil revenues and annual production and explains much of its economic development, Dubai has very little oil reserves and its oil contribution to GDP has declined from 5.48 per cent in 2000 to only 1.4 per cent in 2013. As a result, Dubai has little to do with the rentier state model of economic development. Despite the uniqueness of this case, little attention has yet been paid to this success story in the heart of the oil-rich GCC countries. Only a handful of scholarly works cover this development approach such as those

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written by Al-Sayegh (1998), Davidson (2007a, b), Hvidt (2009) and Schiliro (2013), at the time when GCC countries are seeking innovative approaches to diversify their economies.

This study argues that part of the success of Dubai's economic development is owed to its small, open and well-integrated economy into the global economic and financial system. The city-state may have received substantial financial support of its oil-rich sister city, Abu Dhabi, during the 2008–2009 global financial crisis; hence, oil is still an important factor in its long-term sustainable development. What is crucial here to stress is the misperception that oil is the driving force for Dubai's economic development. Indeed, Dubai is centrally positioned in a region that is well endowed with hydrocarbon resources, and this may have allowed many to believe that its economic prosperity, almost by default, is ascribed to abundant oil revenues. Perhaps that is the reason why the Dubai model has not received due attention from the academic community despite apparent economic and business success. While much of literature on the GCC economies focuses on the availability and role of natural resources in economic development, the rentier state theory offers little to explain Dubai's development drivers, motivations and outcomes. We also argue that the rentier state theory is somewhat deterministic, and its pejorative nature may have, in fact, inadvertently contributed to inadequate research of Dubai's economic model. Moreover, the posturing connotation of Dubai with the rentier state theory has obscured many strengths of its development paradigm; hence, the limitations and various lessons of Dubai's economic model are not examined well enough.

In this chapter, we attempt to show that Dubai has successfully diversified away its economy from the natural resource dependence, with oil revenues contributing less than 1.5 per cent of the GDP. We are not intending here to investigate how Dubai has diversified its main economic sectors. The aim is to identify and examine the drivers of Dubai's economic development, highlighting salient features and economic structures that enabled this development model to yield a highly diversified economy. We show that the success of Dubai is not accidental and hence it is important to understand the merits of its developmental approach and its relevance to regional economies. However, we find that in-depth comprehensive analysis of Dubai's economic trajectory is a daunting task for several reasons: (1) official data is scarce and not very reliable; (2) the boundaries between local vs. federal policies are often blurred, as Dubai is a city with great autonomy within the UAE; (3) the size of Dubai's economy is not significant globally as compared, for example, with Singapore or Hong Kong to attract attention of researchers; and (4) the impact of regional factors such as oil and access to liquidity are often overemphasized. We acknowledge that the role of oil is undeniably an important factor in shaping the economies of Dubai and other GCC countries, but in the case of Dubai, oil plays the role of a catalyst as opposed to being a hindrance, as resource curse theory may suggest. Hence, we start with the discussion on whether the rentier state theory is applicable to Dubai in the first place. This is followed by analysing the key elements of Dubai's economic development model. In section three, we assess the strength of the model by examining its capacity of coping with the debt crisis in the aftermath of the 2008 global financial crisis.

Rentier State Theory and Dubai

Some literature considers Dubai's model within the context of the rentier state theory and neo-patrimonialism. Originally, Mahdavy (1970) attempted to highlight economic challenges faced by the oil-exporting countries and suggested ways to address such problems. Closely related to the rentier state theory is the theory of the resource curse, which similarly looks into poor economic performance of resource-rich economies. Resource curse theory attributes an 'anomaly' economy or an economy with adverse socio-economic consequences to the fact that a substantial portion of national revenue is derived from the oil and energy-related income. Gray (2011) defines the rentier state theory as a state-society relationship, in which the state generates a large portion of income from rents or externally derived payments, typically that of oil and gas. This theory considers the state autonomous from society. It assumes that states do not need to impose any taxation as long as they distribute rent income to society. In turn, the state does not need to have any development strategy.

In fact, Ruthledge (2014) considers these two theories as two elements of the same paradigm. In this particularly critical account of the rentier state and resource curse theories, she points out that rentier state theory has become more deterministic (and pejorative) in nature in the late 1980s onwards. More importantly is that the state is used in a broader meaning to include the institutions of government, commercial entities and the citizens as a whole. Gray (2011) discusses rentier state theory in a context of economic achievements firstly in Dubai, but also in Abu Dhabi and Qatar, and concludes that these states do not fit in the original framework of this theory. Notably, it seems that there is increasing recognition that not only Dubai, but also other GCC states deserve more attention in understanding their developmental model and the specific role of oil revenues. El Katiri (2014) aptly describes the strong economic-welfare function as a distinguishing feature of GCC economies in relation to other resource-rich states. She defines the type of state in the GCC, as a Guardian State—a state in which benevolent state elites aim to maximize social welfare supported by the state autonomy in decision-making. The relatively small population sizes, geographical position and inherited governance mechanisms such as tribal societies are some of the key factors of the apparent divergence from the expected outcomes of the classic rentier state theory.

These are important learning developments. Assuming that such a state as Dubai exhibits all the features of the rentier state theory and primarily autonomous from the society, it would be difficult to envisage how such an economy would be able to make such a progressive economic advancements in essentially an environment without abundant natural resources. As we shall explain below, the Government of Dubai has traditionally played a key role in economic development, not only in policy-making and regulation but also in making direct investments in private enterprises. Pradhan (2009) refers to this sort of state investment as *a best case of the success of state-led capitalism*.

The theory of a 'Guardian State' makes important contributions in explaining development models relevant to GCC economies. It recognizes the resource-led nature of a development model similar to the rentier state theory, but it also highlights its strong socio-economic welfare objective function. This is how the term 'guardian state' developed. However, the success of guardian states to promote economic growth has never been free of some negative externalities, which are often associated with resource wealth and include a high propensity for waste and systemic dilution of market incentives. As a result, sustainability of economic growth is thereby a key challenge in guardian state economies.

Characteristics and Components of Dubai's Development Model

One of the main characteristics of Dubai's economy is being small, open and well integrated into global economic and financial systems. Free movements of factors of production, including capital and labour, as well as of goods and services are a cornerstone of its development strategy. Dubai pursues a regime that is consistent with liberal economic policies and does not impose restrictions on capital inflows and outflows or taxes on capital or labour, except foreign banks and oil companies that are reliable to paying 10 per cent corporate tax. A diverse corporate sector has developed, led by public sector companies such as Emirates Group, DP World, and comprising a myriad of global and international firms operating in virtually every sector of the economy.

Another key development in Dubai's economy is the rapid growth in real GDP in the past 15 years. According to Dubai Statistics Centre, Dubai's real GDP has almost tripled from AED 113 billion in year 2000 to AED 293 billion in 2010 and to AED 335 billion in 2014. Notably, this period includes the negative effects of the 2008/2009 global financial crisis and Dubai's debt crisis, without which the growth could have been much more impressive. The negative effect of these crises is reflected in negative GDP growth rate of −2.5 per cent in 2009.

Historically, Dubai has played the role of a regional entrepôt. Bearing in mind the demographic diversity of Dubai's population throughout time as well as the nature of trade business meant that a broad range of economic, institutional, political and cultural factors have shaped the evolution of Dubai's economy. Hvidt (2009) supports this argument by arguing that Dubai's overall development process has to be seen in the broader context, implying a multi-causal explanation. Hvidt (2009) lists nine parameters that define Dubai's model: (1) government-led development (ruler-led); (2) fast decision-making and 'fast track' development; (3) flexible labour force; (4) bypass of industrialization—creation of a service economy; (5) internationalization of service provision; (6) creation of investment opportunities; (7) supply-generated demand (first mover); (8) market positioning via branding; and (9) development in cooperation with international partners.

Similarly, Nyarko (2010) discusses elements of UAE's development strategy, which may also broadly apply to Dubai. His main elements are defined as (1) a political system, which has resulted in the perception of stability and minimal political risk, encouraging investment; (2) oil; (3) development strategies that have resulted in a very dynamic business environment; (4) openness to foreign skills and management; and (5) labour policies that have enabled the immigration of vast numbers of foreign low-skilled workers. Along similar lines, Davidson (2009) argues Dubai's new post-oil economy benefits from its long history of trade, merchant immigration, re-export activity and its relative openness compared to its Arab peninsular neighbours. Indeed, Dubai's demographic circumstances, together with the geographic position it occupies, have underpinned and determined the nature of its development process.

It is certainly true that all of the above factors have played a significant role in shaping the development path and outcomes in Dubai's economy. Nevertheless, one could argue that some of these factors are more of an exogenous nature from Dubai's standpoint, given the limited control it has over them, while some others are actually direct result of a broader principle or a policy. For example, fast decision-making is the result of a specific role the Government of Dubai plays and its governance approach. Meanwhile, some policies are formulated at the federal level such as the labour policy, where Dubai has limited scope or control. One could also argue that Hvidt's bypass of industrialization and creation of investment opportunities can be more of an effect than a cause or driver of Dubai's model. Bypassing industrialization is a natural outcome for Dubai, having in mind rapid and recent accumulation of wealth, limited natural resources and a small domestic population. It is true, however, that bypassing industrialization has led to the development of a service-based economy and the governance mechanism as practiced today. Similarly, the creation of investment opportunities is a consequence of its development and governance approach. Thus, the challenge in defining Dubai's economic model lies in distinguishing between the sources of its development and the effects of its policies and strategies.

Dubai and the UAE Political and Economic Setting

To understand Dubai's development model, its path and strategy, one needs to distinguish between federal policies and Dubai's own development strategy. Dubai's economic autonomy is confined within a broader UAE economic framework, which includes macroeconomic policy, labour policy, regulatory frameworks for banking and financial industry, and foreign exchange regime, among other policies determined at the federal level. Federal policies are the result of a common and shared economic and political dynamics of the seven emirates. When it comes to policy formulation, Dubai has a strong influence but not decisive over the national or federal policies. In fact, federal policies are reflective of Dubai's economic circumstances, but Dubai often finds itself in the legal loopholes, especially when it has to manoeuvre around the legal pillars to implement its own policies. For instance, Davidson (2007b) highlights the case of the first residential house sales to expatriates and the creation of free zones, as a measure to circumvent the federal restrictions on property ownership by expatriates.

Although Dubai has to manoeuvre between what is federal and what is its own, evidence shows that its macroeconomic and regulatory structures are aligned with the federal system; hence the emirate is largely influenced and shaped by the common federal policies. This is apparent in key areas such as monetary policy, exchange rate policy, fiscal policy, including taxation, ownership policy and company law. For instance, Dubai follows the federal policy of pegging the UAE dirham to the US dollar, which implies that a local monetary policy must align with US monetary policy, as well as tracking the US interest rates regardless of the phase of its own economic cycle. Such policies do not necessarily serve the best interests of Dubai at all times, as the rigidity of monetary policy due to the dollar peg greatly contributed to the exacerbation of the business cycle in Dubai in late 2007/2008. As Dubai's economy was experiencing a broad expansion, the US economy was going through difficulties that led it to run an expansionary monetary policy such as a low interest rate policy, which in Dubai's case was unfavourable and a pro-cyclical measure. Despite such adverse effect, the federal system supported Dubai to overcome its debt crisis in 2008–2009. Dubai also benefits from the federal immigration and labour policy that are highly flexible and, along with other federal policies, are one of the key developmental pillars of Dubai economic model. Thus, UAE macroeconomic policies serve as a broader framework for Dubai's developmental strategy and facilitator for its unique approach to economic development. Figure 5.1 illustrates this and explains the key elements of Dubai development model, as explained below.

Government-Led Economic Development

In contrast to the rentier state theory, which assumes government's passive role in economic planning and development, the role of the Government of Dubai has been significantly large in the Emirate's economic development. This role is in line with the argument developed in the guardian state theory, which asserts that those states markedly differ from most other economies not only by its resource wealth but also by the 'guardian' role the government plays. Al-Sayegh (1998) argues that Dubai has a long tradition in a strong government role in economy, greater inter-

Fig. 5.1 Dubai economic development model. Source: Authors' own analysis

action with the business community and consolidated social contract with its citizens. Importantly, the relationship between the state and its citizens has not come about as a result of oil revenues and rents distribution but rather the vice versa. It is also important to note that the specific role played by the Government of Dubai is primarily inherited through centuries of old relationships between Dubai's rulers and its merchant community. El Katiri (2014), who highlights the pre-existing political and economic structures as a distinctive feature of the Guardian States, underlines this tradition. The pre-existing structures include the tribe as the central social unit in structuring socio-political life. The tribe is divided into families and headed by the tribal sheikh whose role as a guardian is to lead his family members and protect their socio-economic interests.

Developing on its tradition and existing structures, Dubai has developed idiosyncratic governance mechanisms and oriented its government towards a proactive state entrepreneurship and investment policies leading to greater diversification in all economic sectors. Hvidt (2009) attributes much of Dubai's exceptional growth levels in 2000–2007 to the quality of leadership and initiative of the Government, which are felt in the development and modernisation of public services, institutional frameworks, legislation, regulation and infrastructure, as well as the launch of strategic projects such as tourism ventures, the Internet and Media City, Health Care City, Logistic City and Dubai's International Financial Centre—all of them are developed, financed and run by the government. These initiatives have been the driving force behind the impressive development and the catalyst for private sector companies to follow the government lead and participate in the development process.

One can also argue that the institutional structure and centralization of decision-making has enabled the government to easily control and efficiently run its key economic organizations. In addition to the local government represented in the Dubai Municipality and its affiliated authorities that are responsible for the day-to-day running of the city-state, the newly created Executive Office is the place, where the ruler manages all economic activities and new developments such as mega projects, SOEs, FDI, free zones, ports, investment banks and specialized cities. The ruler has also placed his most trusted men in charge of the Dubai Holding, Dubai World, The Department of Economic Development, Dubai Municipality and Emaar. Hvidt (2009) argues that 'although this is not a democratic ideal, this kind of centralisation allows for fast decision-making and significant coordination of development activities and investments'.

Dubai's Governance Model and the Role of Merchants

Given its unique governance approach, Dubai's model is a deviant case of economic development. The peculiarity of this case reflects the nature of the relationship between the ruling family and the merchant community, when Dubai was an entrepôt in the Gulf and derived its prosperity from trade and commerce. Al Sayegh (1998) argues that Dubai's merchants have played an important role in shaping Dubai's economic and political development. Scarce resources and trade meant that merchants and rulers needed to work together to secure their livelihood. Partnerships, genuine creativity and innovation were utilized to create businesses and develop channels to support all kinds of economic activities. Dubai's natural harbour, strategic location and thriving merchant community maintained it as entrepôt for many decades. Contrary to expectations, the merchants' influence did not slow down with the advent of oil; rather it has taken advantage of the new wealth to continue its influence and contribution to the development process until today. Indeed, the government and the merchants share the responsibility for developing and contributing social aspects of their society. Social development has never been confined to strictly government affairs, as merchants have taken on additional roles as service suppliers, urban planners, culture mediators and internationalists who represent the Gulf throughout the world.

Interestingly, on many occasions the ruler's income was not as high as that of the pearl merchants. In fact, there were many times when the ruler resorted to the merchants for financial assistance. Financial dependency of the ruler on the merchant community and vice versa implied the need to focus on business development. In addition, it allowed merchants to have an upper hand or at least equal influence with the ruler in matters affecting their lives. Since the early twentieth century, rulers used to appoint merchants to his Majlis (advisory board); majlis was constituted as a consultative body and has effectively become a de facto government led by the ruler and composed of merchants. The relationship between the ruler and Dubai's merchants remains until today. In fact it became even more complex given the legacy of old relationships. The critical juncture took place in the early twentieth century when the ruler of Dubai persuaded the business community of the Persian city-state Lingah to relocate to Dubai. It instituted the strong private sector and pro-business development path which has characterized Dubai ever since.

As a result, Dubai's achievements are remarkable and noteworthy not only in terms of its economic performance but also in how that performance was achieved. The cosmopolitan nature of Dubai's merchants has added an important dimension in the fabric and nature of the business conduct and its economic structure. Given limited natural resource endowments, the small size of the local labour force, the complex political surrounding and challenging global economic environment, this governance model has proved to be particularly resilient.

One cannot underestimate the achievements of Dubai in this complex environment in terms of social cohesion, safety and a high standard of living. It is clear that Dubai's economic and social aspects are often inseparable as religion and culture shape Dubai's decision-making process through its own management and governance styles. Therefore, combining economic and social achievements of Dubai's model in a complex environment with many exogenous economic and social factors points out that its success is intrinsically driven.

State Entrepreneurship

An important characteristic of Dubai's government engagement in the economy is entrepreneurship. The role of state-guided entrepreneurship cannot be overemphasized as many SOEs are effectively competing in international markets. Shome (2009) argues that state entrepreneurship, as in the case of Singapore, is crucial for small, transitional economies to achieve global competitiveness. Dubai shares a similar orientation, where the state entrepreneurship model seems to be working efficiently. Unfortunately, entrepreneurship in Dubai has not received much attention in academic literature, and hence sharing the general scarcity in research indicates that this aspect of Dubai has largely been overlooked (Nasra and Dacin 2009). In fact, in the period from 1990 to 2006, there was no single article focusing on the examination of entrepreneurship in the Middle East as a whole; only in 2015 that Sherbiny and Hatem produced a historical account of the relationship between state and entrepreneurs in Egypt since 1805. Again, a plausible explanation to this phenomenon could be the perception of the GCC economies as rentier economies and hence not deserving the attention of the research community.

Nevertheless, our examination of the Dubai experience acknowledges the growing role of the state in entrepreneurial activities. This case underscores a contrasting vision to what rentier state theory posits—that the state is deriving rents from the revenues on the account of natural resources and redistributes them within the economy with the objective of keeping the regime in power. The Government of Dubai has undertaken investments and created businesses with private sector management orientation. Such companies, often so-called government related entities (GREs) including Emirates Group, Emaar, Nakheel and Dubal have been used as main investments and development vehicles. It is not uncommon to find the definition of GREs as '100 per cent government owned, private sector company', a definition that reflects both ownership and the intended governance style of Dubai's GREs. While being publicly owned, the GREs' management and governance orientation are that of private sector entities. Hence, the Government of Dubai has a multiplicity of roles to play. Whether it acts as a policy maker, regulator or investor, the default objective is business expansion and economic development.

Another key driver of successful state entrepreneurship is the interplay between the various public and private sector actors in the development process. Hvidt (2007) argues that there is apparent absence or lack of formal institutions and channels to link the public and private sector companies; this absence of formal institutions has been compensated for by the Majlis, the liberal economic policies and the multiple role of leadership through which the distinction between the public and the private sector gets blurred, as many private businesses are often absorbed into the governance structure. As many members of the ruling family are engaged in private investments, one could argue that strong ties between the public and the private sector exist in practical policy formulation and implementation. The close public-private partnership can also be noticed in the division of work and labour, where the government officials focus on the design and formulation of policies and projects while outsourcing to some private companies the task of providing useful intelligence and feasibility studies, and to some others the possibility of decentralising the implementation of policies and projects. Hvidt (2007) adds that this form of engagement shows the extent to which the government has been instrumental in creating many economic actors through the establishment of both public and semi-private companies.

On a final note, one could argue that the development of the entrepreneurial sector in Dubai has largely depended on the role played by the state through public policies, regulation, public spending, public services and corporate leadership. The governance model has contributed to creating well-managed, profitable SOEs in Dubai, thus contradicting the commonly accepted views on inefficiency of SOEs and poor quality of public sector in rentier economies due to large bureaucracies. Hertog (2010) argues that the source of SOEs' success is the profit-driven and market-oriented management 'that is autonomous in its daily operations, hence insulated against political and bureaucratic predation, and that receives clear incentives from a strictly limited, coherent set of high-level principles in the political regime'. This success is enabled firstly by the absence of a populist-mobilization history of economic development, and second, a substantially decisional autonomy of the regime leadership from interest groups within state and society.

Inward Investments and Development Orientation

The attraction and facilitation of foreign direct investment has topped Dubai economic agenda for many years. FDI is instrumental in national capital formation in countries such as Dubai that is suffering from scarcity of natural resources. FDI does not only compensate for the lack of domestic capital resources, but it is also vital for employment generation and transfer of technology and knowledge. Dubai has been an attractive destination to global FDI inflows. This is owed primarily to its high levels of integration in the global economy and the relatively liberal, friendly business environment. Dubai has also invested heavily in its infrastructure, including roads, ports and industrial and free zones such as Jebel Ali Free Zone, while streamlining its administrative procedures and reducing the cost and time of doing business. It has also improved its legal and regulatory frameworks, allowing full foreign ownership of properties and business premises in certain business services and professions such as accountancy and legal services.

While the improvement in infrastructure has been a key factor in attracting inward FDI, the rise in FDI capital flows has simultaneously financed major infrastructure projects essential for the city's economic development, particularly in areas such as ports, roads, bridges, power generations, water desalination, schools, hospitals, construction and real estate. One can only praise the long-term strategic plan that began with the 1950s, with the dredging of the Creek in 1955 and the development of Port Rashid in 1972—to the more recent Al Maktoum International Airport and a vast network of highways as well as a strong global connectivity that places Dubai as a top-class city worldwide. All these investments in infrastructure-related industries have not only created jobs and business opportunities but they have also fuelled Dubai's exponential economic growth and facilitated its economic diversification.

Trade and the manufacturing sector have also played an important role in the development of Dubai. Trade is one of the traditional pillars of the economy and has been a window through which the city-state has achieved its tremendous openness to the regional and global economies, even though it has also amplified its economic exposure to international economic and trade cycles. Unlike other GCC countries with strong oil revenues, Dubai has not shifted from *production-state to allocation-state*, thereby creating a vibrant and dynamic economy. Given the tremendous income from oil exports in the 'allocation state', the population assumes a role of passive recipient of services and benefits and as such, the state and the private sector are far less dependent on each other than in the production-state. This is why Dubai's economic sustainability essentially depends on its ability to maintain a production state orientation and avert conversion into allocation-state.

One can also argue that Dubai's inward investment orientation is reflected in infrastructure investments and development, creation of GREs across industries, and establishment and promotion of a pro-business environment. Dubai actively participates in competitive local and international markets, while creating new state assets in various forms, shapes and industries. This, in turn, creates new business and ample investment opportunities for local and foreign private sectors, thereby sending a positive signal to foreign investors and global markets (Hertog 2010). Dubai's economic development path highlights the positive effects of diversification via commitment to development that resulted out of a series of policies of inward investments, diversification, openness and liberal economic policies that coupled with pragmatic leadership, and all of them have resulted in a rather unique economic model.

Unhindered Access to Capital and Labour Markets

As Dubai is not endowed with abundant natural resources and consequently does not have abundant liquidity, access to international capital and banking markets is one of the critical factors that have contributed to accelerated growth and development of the Emirate. Dubai Government and GREs, while not being rated by international rating agencies, have successfully raised funds in international capital markets using conventional and Islamic instruments. GREs financed their growth using a combination of equity and debt. Nonetheless, a negative aspect in this respect is that access to international capital markets precipitated Dubai's Debt Crisis in late 2008.

Similarly, the ability to attract and maintain a necessary foreign workforce is yet another factor of Dubai's economic model. The economic success of Dubai is underpinned by the growth of its population, which is essentially driven by the influx of expatriate workers and their families. Almost 90 per cent of the population is composed of non-nationals, representing close to 95 per cent of the total workforce. The strong population growth has induced increased demand for real estate, retail, tourism and services. In turn, a flexible immigration policy as per the federal law, a highly efficient government apparatus and the availability of business and job opportunities support population growth.

Dubai's development has been driven by labour-intensive sectors that have seen the largest inflows of low-skilled non-national labour. Data shows sharp increases in labour inflows in labour-intensive sectors such as construction, real estate and services. However, large labour inflows have been accompanied by declining labour productivity. Economic growth in the UAE has been outpaced by labour force growth in recent years, leading to declines in labour productivity per capita. Figure 5.2

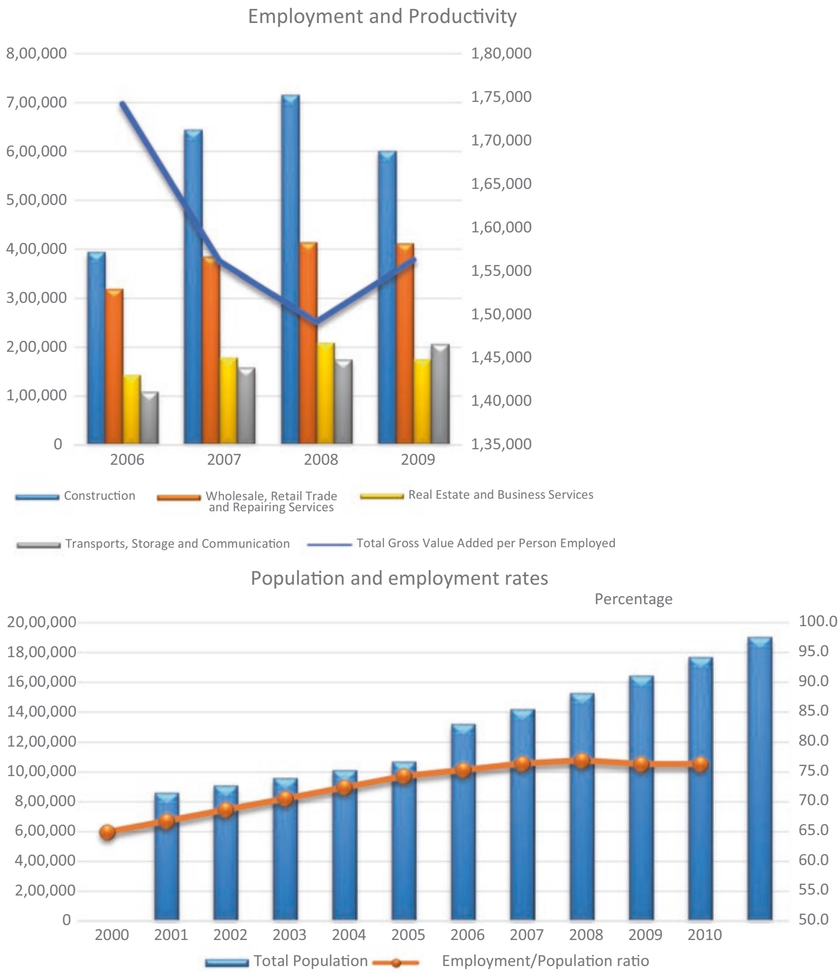

Fig. 5.2 Relationship between employment and productivity (2006–2009) and population (2000–2010). Source: Dubai Statistics Centre

shows that labour force growth was substantial, in particular, prior to the recent crisis—reaching over 10 per cent annually from 2006 to 2008. It also exhibits a declining labour productivity that is a negative spillover effect, as argued by the guardian state theory. Yet, another important reflection of the guardian state is the large proportion of the national workforce employed in the public sector. The public sector is an attractive employer due to various rent streams and contacts, generous retirement packages, job security, favourable working hours and good prospects of promotion with time. Dubai is no exception to this productivity anomaly. This is worsened by the inability of the private sector to match the public sector's high reservation wage (El Katiri 2014). In addition, employment subsidies in the private sector coupled with the nationals' employment quotas, further exacerbate a rent-seeking incentive system as a source of economic benefit. Hence, public sector employment policies contribute negatively to labour productivity resulting essentially in wastage of resources.

To improve future sustainability of the existing economic approach, the Government of Dubai seeks to promote a gradual move towards a knowledge-based economy and an economic policy moving towards encouraging capital investment and promoting growth in higher value-added sectors. The ability to attract and increasingly retain qualified human capital is essential in ensuring that these shifts occur.

Protectionism and Legal Dichotomy

Dubai's demographic structure with a small local population is in stark contrast to the size of its economy and the number of foreign workers and businesses. In addition to labour market incentives, subsidies and quotas, the federal government has developed schemes to protect the economic interest of the local population mainly by mandating Emirati ownership of at least 51 per cent of any business established in Dubai. Exempted from this rule are certain activities such as professional jobs of accountants, lawyers etc. who are allowed to set up 100 per cent foreign-owned businesses. Ownership limitations also extend to property and asset ownership.

Given the limited attractiveness of such restrictive policies to prospective foreign investors, a number of free zones have sprung throughout Dubai. Currently, there are 22 distinct zones targeting different industry clusters and client bases. Hence, Dubai confines liberal economic policies in terms of property and business ownership and business conduct within the special economic free zones. The ever-growing economy has necessitated the creation of a new institutional framework in the form of specialized free zones. This has allowed Dubai to create and manage international and national legitimacy by way of decoupling new economic structures from traditional national institutions. As such, Dubai has effectively been able to become an attractive destination for international investors while keeping its political stability within the Middle East (Nasra and Dacin 2009). A case in point is that of the Dubai International Financial Centre (DIFC), a federal free zone focusing on provision of financial services. Strong and Himber (2009) argue that the legal autonomy of the DIFC is a scalable strategy suitable for global free-market reforms. While the DIFC has its separate Common Law based legislation within the free zone including its own courts, this legal system exists in parallel to Dubai and federal legislation.

Outside the free zones, the Company Law of the UAE requires only locals to own property and businesses and provides some protection mechanisms, perhaps as a reflection of the rentier orientation in which the state is effectively covering social costs and economic welfare benefits.

Economic Diversification Strategy

Dubai's economic development strategy has gone through various phases. The first phase is to shift its dependence away from oil revenues. Oil revenues played an important role in Dubai's quest for development in the early post-discovery years, but this effect has been recently indirect, through the higher liquidity that Abu Dhabi and other GCC oil exporters have injected in Dubai's economy (Nyarko 2010). In fact, Dubai's oil contribution to GDP is now insignificant, accounting for 1.4 per cent in 2013. Contrary to other oil-rich exporting countries that experienced slower economic development due to natural resource endowments, Dubai has not suffered from the Dutch disease phenomenon because of its capacity to take advantage of available regional liquidity to jumpstart economic transformation and achieve diversification.

The second phase of diversification is closely linked to inward investment and development orientation strategy that focuses primarily on developing and investing into enabling sectors such as infrastructure and communications. In fact, the success of this long-term policy of developing and investing into enabling sectors has allowed the development of other dynamic and striving economic sectors such as financial services, tourism and manufacturing. Without this deliberate strategy to develop and diversify the economy away from oil, the resource curse theory would apply.

The third phase of development and diversification is enabling Dubai to develop a competitive edge resulting in a diversified, open and liberal economy. Dubai was the first in the region to open up to foreign capital and labour in a significant way and consequently gained large benefits from the first movers' advantage. The creation of economic clusters and free zones have gained critical mass and allowed for the introduction of economies of scale, which turned the city-state into a regional and global hub for many international companies and multinational corporations.

The fourth phase of diversification is the move towards the creation of a knowledge-based economy. Dubai's model has not only been closely watched and emulated by Abu Dhabi and other small GCC countries such as Qatar, but it has become an exemplary model of capitalising on the already excellent physical infrastructure to develop a first class regional and global connectivity. Attracting and retaining a skilled workforce has also resulted in the accumulation of knowledge and know-how, which pave the ground for less labour-intensive economic development. However, many challenges such as educational development and sufficient investment in research and development have yet to overcome.

Dubai Debt Crisis: How Sustainable Is Dubai's Development Model?

One can hardly make a fair and sound judgement on the sustainability of the Dubai development model without analysing the most stressful test that the city-state has ever experienced: Dubai debt crisis in 2009. This crisis exposed major structural weaknesses in the way the financial and real estate markets operated in the pre-global financial crisis of 2008. In the 2000s, Dubai had experienced an extraordinary growth across most economic sectors. Local credit markets were at the highest levels similar to those of real estate and stock markets, where speculation was the norm rather than the exception. It was also noted that IPO listings were hundreds of times oversubscribed, executives were paid seven-figure bounces and GREs were acquiring high-profile international trophy assets.

Hasan (2010) argues that debt crisis peaked at the government's announcement of US$59 billion debt-payment-standstill on November 26, 2009. Prior to the announcement, the global financial crisis was already in full swing and resulted in virtually shutting financial markets and loss of confidence across markets. Owing to its open economy with strong reliance on global trade flows and access to global financial markets, Dubai's economy experienced major disruptions in activity across sectors, while structural vulnerabilities were exposed. Among key weaknesses were pro-cyclical fiscal and monetary policies that exacerbated by the dirham's peg to the US dollar. Cevik (2011) provides empirical findings indicating how pro-cyclical fiscal policies prior to the crisis reinforced the financial sector cycle, exacerbated the economic upswing, thereby contributing to the build-up of macro financial vulnerabilities. However, for the purpose of this discussion and strictly speaking from Dubai's angle, fiscal and monetary pro-cyclical weaknesses are exogenous factors over which Dubai has limited control.

Nassehi (2013) explains Dubai/UAE open capital account policy as an instrument of a liberal environment for foreign capital, but also as a factor exacerbating Dubai's boom-bust cycle. Dubai's construction boom encouraged the influx of immigrant labour that was instrumental to Dubai's high economic growth. This boom was funded by a rapid increase in foreign borrowing—mainly short term. Foreign liabilities held by the banking sector rocketed from AED 35 billion in 2003 to AED 320 billion in 2007, representing 33 per cent of GDP in 2007. Chailloux and Hakura (2009) also attribute sharp increases in foreign deposits in the banking industry—which rose from AED 47 billion to AED 127 billion in 2007—to the expectations of a dirham revaluation, only to be reversed in mid-2008.

This has posed severe internal liquidity pressures in the economy. Ample liquidity in the banking sector meant cheap money that was lent mainly to GREs. Increased liquidity followed by increased credit and elevated inflation levels were not offset by tightening of monetary policy, given dollar peg restrictions. Contrary to desired monetary policy, the UAE had to follow a low interest rate regime as per US monetary policy which resulted in negative interest rates. Due to the absence of a domestic debt market and the Central Bank's inability to conduct sterilization, Dubai's boom cycle was heightened. Further, due to high domestic liquidity and ensuing increased credit levels in the financial system, Dubai's corporates—mainly GREs—have also raised short-term funds in international markets, banking and capital. According to the IMF, at its peak, external debt of the banks and the GREs amounted to 74 per cent of GDP.

Interestingly, Nassehi (2013) also relates the oil boom of the mid-2000s and the perceived implicit government guarantee for GREs' debt, to the debt overhang. The so-called crony capitalism led international banks to provide finance to GREs despite obvious moral hazard risks, which have contributed largely to pro-cyclical credit growth.

One of the prime lessons of Dubai's debt crisis is the realization of the inability of Dubai's financial markets to serve local development needs and the excessive reliance on short-term debt accumulated by the majority of Dubai's GREs. Clearly, not being able to refinance such debt has led Dubai into a spiral. Dubai's financial markets are primarily cantered on the banking industry, which was highly exposed to the real estate sector. According to the IMF estimates, commercial banks' exposure to the real estate amounted to 29 per cent of their total assets in 2010. This exposure took place not only via lending to developers but also through retail mortgage finance, construction finance, as well as personal loans that were contracted mainly to finance real estate acquisitions.

Following the debt crisis, Dubai took important steps to prevent the repetition of earlier mistakes by bringing about greater discipline in public spending, rationalizations and standardization across the real estate market, and greater efficiency in public services. Nevertheless, the risk of debt overhang still looms over Dubai, albeit at much more manageable levels. Since the beginning of 2011, Dubai's economy has rebounded and recorded growth, and this is expected to continue at a similar pace in the medium term. In spite of persisting global economic challenges and modest global growth, Dubai has shown resilience and a great capacity to bounce back—not withstanding its structural challenges, driven by traditional sectors such as trade, logistics and transportation, and tourism.

Concluding Remarks: Dubai's Unorthodox Approach to Diversification

We have systematically developed an understanding of Dubai's economy by examining its performance and structures to derive its development model. Given the uniqueness of Dubai's economic path and achievements, Dubai's economic story has not been adequately researched. While Dubai's economic performance is analysed in isolation from its historical, cultural and religious background, we have shown that the success of

Dubai is not incidental. In fact, it is the result of policies instituted by the founding fathers of the Emirate in the early 1900s.

In contrast to prevalent views on various inefficiencies associated with resource rich economies as framed in the rentier state theory, Dubai's model of development rests on the (1) government leadership with specific governance and state entrepreneurship models, (2) inward investment orientation, (3) unhindered access to capital and labour markets, (4) protectionism and legal dichotomy and (5) policy of systematic diversification.

This model seems to better differentiate between causes and effects of Dubai's economic development approach than some models previously put forward. Other models found in a limited literature do not offer a coherent and internally consistent model that provides a framework to capture various drivers at play. Therefore, these models fail to provide clear explanations of Dubai's developmental path. Rather, such models seem to point to Dubai's success as a haphazard set of developmental priorities that emerged as an answer to opportunistic circumstances.

Economic development and diversification have been facilitated by leadership commitment to development and access to labour and capital markets, among others. However, a debt crisis in 2008–2009 reveals many structural weaknesses. An important lesson was the realization of Dubai's pro-cyclical macroeconomic policies, structural weaknesses in the real estate market, shallow and underdeveloped financial markets, weaknesses in public spending policy and inadequate support for private sector development.

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