

Desert storm ... the fall of an oasis paradise

BY CATRIONA STEWART

AS world markets absorb the shock of Dubai's debt crisis, the emirate is looking to oil-rich neighbour Abu Dhabi for aid. Sheikh Mohammed bin Rashid Al-Maktoum, the emir of Dubai and prime minister of the United Arab Emirates, has met with leaders of Abu Dhabi, who possess the cash to bail out Dubai should its financial crisis deepen.

Abu Dhabi, the United Arab Emirates capital, will now "pick and choose" how

to assist debt-laden neighbour Dubai. An Abu Dhabi government official said: "We will look at Dubai's commitments and approach them on a case-by-case basis. It does not mean that Abu Dhabi will underwrite all of their debts."

Earlier this month, Sheikh Mohammed assured international investors that all was well with Dubai's finances and told media critics to "shut up".

However, on Wednesday Dubai said it is looking for a six-month delay from creditors on repaying nearly \$60 billion (about £36bn) in debt held by its main development arm, Dubai World.

Dubai's empty pockets, drained by over-ambitious development plans and falling retail prices, sparked selling across world markets with America's Dow Jones on Friday seeing its biggest drop in nearly a month, closing down 1.5%.

At stake is the \$59bn in debt held by government-controlled holding company Dubai World and its property arm, Nakheel, builder of palm-shaped islands for the super-wealthy.

Dubai agreed to delay payment on the Nakheel debt by six months.

World leaders including Britain's

Gordon Brown and French prime minister Francois Fillon said the global economy was now strong enough to deal with a shock of this magnitude.

Abu Dhabi – which pumps 90% of the oil that makes the UAE the world's third-largest oil exporter – has already provided \$15bn in indirect support for Dubai through the UAE central bank and two private Abu Dhabi banks.

Dubai World's liabilities make up the majority of Dubai's total debt of \$80bn.

A statement from the Dubai government is expected tomorrow, when the markets reopen after the Eid holiday.



This does not mean that Abu Dhabi will underwrite all of Dubai's debts

Towering Dubai was sure to topple

Crash can be Emirate's big chance to build a new era of sustainability

BY AZEEM IBRAHIM

RUNNING Dubai-based financial companies over the last decade, I have watched its breakneck development from undistinguished port to a global financial hub. The growth rate, and the ability to absorb exceptional quantities of both foreign labour and capital, have been extraordinary. Last week, the whole edifice teetered as the miracle emirate revealed that it was unable to refinance the debts of Dubai World, its largest state-owned conglomerate.

Along with the six others, Dubai is a member of the federation of the United Arab Emirates, formed in 1971 from a loose alliance of British Empire-influenced gulf statelets. A cosmopolitan port for centuries, in the last fifteen years or so Dubai has grown at an incredible rate, much of it based on loans.

By 2008, Dubai's non-oil sectors such as tourism and real estate counted for over 95% of its GDP. It attracted thousands of migrant construction workers, mostly from South Asia, and also many white-collar workers, a large number of whom were from Britain.

The credit crunch made it harder for Dubai to find lenders to refinance the debts on which much of this profit was based. Abu Dhabi helped to some extent, providing limited financial assistance twice this year. But this week, Abu Dhabi announced the support would not be unlimited. Dubai's dream years are over. I have studied the characteristics of asset bubbles, and Dubai's experience belongs in the textbooks.

As sub-prime mortgage lenders have discovered, bubbles arise when speculation forces the price of a commodity up way beyond its value.

In Dubai's case, the commodity was mainly property. Dubai's



mostly state-owned companies just kept on building more and more property, much of which was skyscrapers. I returned to Dubai a number of times over the course of the last few years and each time the landscape was almost unrecognisably changed. At one point, so I was told, there were more cranes in Dubai – with a total area of 4144 square km – than in China – with a total area of 9,640,821 square km.

But it was too much, too fast. For a start, Dubai simply did not build the infrastructure necessary to turn the skyscrapers from symbols to globally competitive workplaces. There were skyscrapers which were empty because no roads had been built to get to them.

The second problem was, like all bubbles, much of it was funded by unsustainable speculation which drove prices up beyond the real value of the properties they were supposed to represent. Friends of mine were making profits at eye-watering rates, and it was difficult not to invest myself. However, one of the most astute investors I know has now lost a staggering \$40 million.

Could Dubai go the way of Iceland? It seems unlikely. The incentive for Abu Dhabi to bail it out is just too great.

Long-term, I believe this crash will be beneficial for Dubai. The simple fact is that the rising prices which fuelled the bubble could not last. And given that, this crash is the adjustment it needs. The situation is comparable to that of the pound during the early nineties.

The collapse in its value, which saw the UK crash out of the Exchange Rate Mechanism, in the long term helped

the British economy to pick up gradually but genuinely over the subsequent eight years or so. Had the pound been kept artificially high by Government intervention (in that case high interest rates), it would have been harder for the economy to recover. In the same way, this sudden sharp correction which shocks markets temporarily will eventually allow Dubai's economy to adjust to new circumstances.

This is preferable to an incremental policy response like that of post-bubble Japan in the early nineties. By cushioning the economy, Tokyo prevented the crisis from bottoming out and providing better conditions for recovery, resulting in Japan's anaemic growth for the best part of that decade.

My experience of the Emirates suggests Abu Dhabi is likely to at least help prevent Dubai from defaulting on its debt again. Over the next ten years or so, it is unlikely that Dubai will regain its record of unsteady unsupported growth. Rather, it is likely to grow at a slower but more sustainable rate. And maybe by the time the investors return in a few years time, the Government will have built some roads to those speculative skyscrapers now stranded in the sands of the Arabian desert.

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The tops of Dubai's towering hotels and office buildings peek through the early-morning fog

Photograph: Steve Crisp



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