The Thesis Committee for Alexandra Marguerite Frasca
Certifies that this is the approved version of the following thesis:

Dubai, Debt, and Dependency: The Political and Economic Implications of the Bailout of Dubai

APPROVED BY
SUPERVISING COMMITTEE:

Supervisor: _____
Clement Henry

_____
Sanford Leeds

Dubai, Debt, and Dependency: The Political and Economic Implications of the Bailout of Dubai

by

Alexandra Marguerite Frasca, B.A.

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Abstract

Dubai, Debt, and Dependency: The Political and Economic Implications of the Bailout of Dubai

Alexandra Marguerite Frasca, MA; MBA

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Supervisor: Clement Henry

The goal of this thesis is to identify the main political and economic implications of Dubai's debt crisis and subsequent bailout by her wealthier and more powerful sister emirate Abu Dhabi. This paper examines the implications of the bailout of Dubai on two levels: Dubai's relationship with Abu Dhabi and Dubai's relationship with the international investment community. The paper first provides a brief background on Dubai, one of the seven emirates that make up the United Arab Emirates (UAE), and discusses Dubai's key characteristics that helped give Dubai her nickname *Dubai Inc.* – an opportune location, the Al-Maktoum ruling family, and state-led entrepreneurship. It then discusses Dubai's historically competitive relationship with Abu Dhabi and Dubai's push to diversify economically away from oil. The paper outlines two key economic developments – the rise of Dubai's real estate and tourism sectors and the creation of Dubai's government-related enterprises (GREs), which helped finance the real estate bubble. This thesis suggests that Abu Dhabi now holds unquestionable power over Dubai and can control Dubai's GREs and their subsidiaries such as Dubai World. This paper also argues that the international investment community will demand increased transparency and higher standards of corporate governance of Dubai's businesses in light of the entrenched poor practices that the bailout exposed within the tiny-city state's GREs and companies.

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INTRODUCTION

Great heights usually coincide with big trouble.

Andrew Lawrence, Barclays Capital

On January 4, 2010, the CEO of "Dubai Inc." and Prime Minister of the United Arab Emirates (UAE), Sheikh Muhammad bin Rashid Al-Maktoum with great fanfare unveiled the new tallest building in the world, the "Burj Khalifa." Just moments prior to its grand opening, however, the 200-storey, almost kilometer high tower was given a new name. Although it was conceived and constructed as "Burj Dubai," a name representing the spirit of emirate of Dubai and its location, the ruler of the Dubai, Sheikh Muhammad re-christened the tower "Burj Khalifa" in a symbolic gesture to Sheikh Khalifa bin Zayed Al Nahyan, the ruler of the UAE and ruler of the emirate of Abu Dhabi, who just weeks prior had provided Dubai with the necessary funds to avoid national bankruptcy. In many ways Burj Khalifa is the manifest symbol of Dubai Inc.'s fall from grace and subsequent submission to the "mother-ship," Abu Dhabi

Economists, Wall Street analysts, and statisticians have spent years analyzing economic bubbles and bursts in an effort to better understand and predict the next "big crash." Yet if there were any simple, almost "pedestrian" theory of economic crisis identification, it would be the "The Skyscraper Index." A concept put forth in 1999 by Andrew Lawrence, the then research director at Dresdner Kleinwort Wasserstein. The theory argues that the world's tallest buildings are constructed on the eve of economic crashes. In other words, business cycles and the construction of skyscrapers are correlated – by the time investment in skyscrapers reaches a new high, the economy is already heading into a recession. If the construction of exceptionally tall buildings is a reliable

indicator of economic crises in the making, then the construction of the Burj Khalifa from 2004-2010 was the manifestation of the impending crash of Dubai's economy. In the case of Dubai, the skyscraper theory holds water and provides a basic entry into a discussion of the tiny-city state's rise, her crash, her rescue, and the resulting long-term political and economic implications.

Though the predictability of Dubai's real estate market crash is beyond the scope of this paper, the bailout of the ambitious emirate by her "big sister," Abu Dhabi, stunned the world. The goal of this paper is to answer the question of what are the political and economic implications of Dubai's crash and subsequent bailout on her relationship with Abu Dhabi and on her relationship with the greater global investment community. This paper argues that Abu Dhabi's bailout of Dubai Inc. carries with it immediate political and economic consequences for the emirate of Dubai in terms of the balance of power between the two emirates and her position within the federation of the UAE. The financial lifeline that Abu Dhabi provided Dubai will mean that Dubai must now "toe the line" – no longer the "prodigal son," Dubai's penitence to Abu Dhabi will entail several political and economic changes. Politically, the ruling family of Dubai, the Al-Maktoums, will promote the federation and not Dubai both in the emirate itself and internationally. Economically, Dubai Inc. will hand over either ownership or control of her treasured and choice assets, such as DP World and Emirates Airlines, to Abu Dhabi and make modest reforms to mirror with those of the federation and Abu Dhabi.

Furthermore Dubai's crash brought to light not only how far the entrepreneurial city-state had strayed from her sister emirate and the federation as a whole, but also how far Dubai Inc.'s business practices had strayed from international best practices. To compound the negative impact the crisis had on international investors' perception of Dubai, the wayward emirate and Abu Dhabi have continued to handle the bailout poorly,

sending mixed messages to the global investment community. This paper further argues that if Dubai and in turn Abu Dhabi wish for the UAE to continue to be considered an "oasis" for international investment and trade, then they must institute and follow best practices in corporate governance as investors have already shown a they are willing to leave.

The paper begins with a brief review of Dubai's rise from a minor pearling outpost to a cosmopolitan center for trade and business, pointing out the key characteristics that led to her rise – determined leadership, a serendipitous location, and an entrepreneurial mindset. The following sections then lay the ground work for the paper's main arguments by discussing: the role of the Dubai government as an "entrepreneur," Abu Dhabi's reaction to Dubai's rise and goals, and the real estate bubble and burst. The final two sections argue that Abu Dhabi's bailout of Dubai will have a significant impact on Dubai's political and economic relations with Abu Dhabi and with the international investment community as the crash highlighted both Dubai's disregard for her relationship to Abu Dhabi and some of Dubai's poor business practices.

FROM PEARLS TO PETROL

Becoming an *entrepôt*

Entrepôt: a commercial centre; a place to which goods are brought for distribution to various parts of the world.

Globalization: an ongoing trend to greater integration (economic or otherwise) among nations. There is an increase in the flow of ideas, goods, services, capital, and people among countries and within countries.[1]

The history of Dubai is unique and crucial to the debacle she presently faces. From her beginnings as a little-known port town of palm-frond huts in the eighteenth century to today's dazzling spectacle of soaring skyscrapers and man-made islands, she has strove to distinguish herself economically, politically, and socially from both her regional peers and the greater international community. In essence, she has become an *entrepôt* of what is now an overanalyzed and almost trite concept, *globalization*. Yet, when globalization's primary definition – the exchange of goods, capital, people and ideas – is applied to contemporary Dubai, one can all too easily to identify strong elements of the concept in the goals of the little city-state's leadership and her history. The evolution of Dubai, from pearls to peaks, and now perils, stems from three prominent, historic attributes: undying ambition, a serendipitous location, and an entrepreneurial mindset.

The tiny city-state began as a pearling post in a minor inlet of the Persian Gulf, loosely under the control of the Bani Yas, a regional tribal conglomeration, based out of what is present day Abu Dhabi and led by the Al Nahyan family, the current ruling family of the UAE. Until the arrival of the British in the mid 1700's, the local residents

[1] Oxford English Dictionary. Definition 2.

played the local Bani Yas constituent tribes off against the rivaling, but much larger Qawasim tribe from Oman. Looking for a more lucrative trading route to India, the British East India Company set up operations in the general area of present day UAE. Yet the British were soon bested in their trade, as Arab traders began to undercut and outperform the East India's Fleet, by using their intimate knowledge of the waters.[2]

Though it was the region's rise as the "Pirate Coast" that attracted the attention of the British Navy, the minor port town also acquired a position on the emerging map of international commerce. The piracy reached a peak in the early 1800's, spurring the East India Company to request the assistance of the British Royal Navy to suppress the pirates. Britain sent a task force of 7,000 troops to the region who swept down the coast from Ra's al-Khaimah all the way to Sharjah, stopping just short of Dubai, sparring the city from any of the damages the other settlements suffered. When the British troops eventually arrived in the area of modern-day Dubai, they met peacefully with the local Bani Yas governor.

A Good Dose of Ambition

Although, officially Dubai has always been under the dominion of wealthier or more powerful, but distant rulers, (e.g. Abu Dhabi and Britain), she has operated largely autonomously and in recent history with open disregard to superior powers. On his first visit to Dubai in the early 1820's, the British Political Resident observed that despite the city-state's tributary status to Abu Dhabi, her residents independently operated and controlled the port, the watchtowers, and armory.[3] In 1822 Sheikh Maktoum bin Buti erected the family from obscurity among the many families within the Bani Yas

[2] Davison. Dubai the Vulnerability of Success. p 11.
[3] Davison. Dubai the Vulnerability of Success. p.12.

confederation of tribes, by participating in a coup against the Al Nahyans, the ruling family of Abu Dhabi. The Al-Maktoum family subsequently seized the helm to steer Dubai onto her historic streak of independence. After the coup had failed Sheikh Maktoum moved his clan from the coastal islands of the Gulf to Dubai, a move that doubled Dubai's population and established him as facto ruler, marking the birth of the Al-Maktoum dynasty. Thus, much like the majority of Dubai's population today, the Al-Maktoum family also began as immigrants.

CHART 1: RULERS OF DUBAI

Rulers of Dubai[4]	
1833-1852	Sheikh Maktoum bin Buti
1852-1859	Sheikh Saeed bin Buti
1859-1886	Sheikh Hasher bin Maktoum
1886-1894	Sheikh Rashid bin Maktoum
1894-1906	Sheikh Maktoum bun Hasher
1906-1912	Sheikh Buti bin Suhail
1912-1958	Sheikh Saeed bin Maktoum
1958-1990	Sheikh Rashid bin Saeed
1990-2006	Sheikh Maktoum bin Rashid
2006-Present	Sheikh Muhammad bin Rashid

The Al-Maktoums coyly played the political field by shifting their alliance between powerful regional tribes, enabling them to remain quasi-autonomous until the arrival of the British. The Al-Maktoums then adopted a dual-strategy of regional political neutrality and increased relations with Britain, which brought increased stability to Dubai's residents. In return for putting a halt to piracy of British ships and for not

[4] Sheikh Mohammed's official website: http://www.sheikhmohammed.co.ae/vgn-ext-templating/v/index.jsp?vgnextoid=b2284c8631cb4110VgnVCM100000b0140a0aRCRD

entering into agreements with or entertaining any other powers (i.e. Russia and France), Dubai and the other "Trucial States" received the bulk transit of Britain's Far East trade and more foreign interest in the local pearling trade. Yet as the trade became more lucrative, it attracted the attention of other European powers, whom the British soon indirectly blocked through a series of bans to protect the Trucial States' "traditional economies." For instance, the British declared a ban on "technology imports," more specifically a ban on pearling technology.[5] Bans such as this only fed the growth of the black market and the re-export market[6] – a simple activity that required no technology injections or problematic foreign assistance, and therefore escaped British scrutiny."[7]

A tipping point in the region's relations with Britain came with the discovery of oil, which greatly increased all the city-states' value in the eyes of the British. Though the reality of Dubai's shallow reserves was unknown at the time, Dubai cleverly used her new oil card to trump greater concessions from Britain. Despite having signed various "most favored" nation concessions treaties with Britain, by the 1930-1940's the Al-Maktoums were leveraging the unsolicited bids for exploration rights that they received from the Americans to renegotiate their treaties with the British-backed Iraqi Petroleum Company (IPC).

The Al-Maktoums' tenacity and pure ambition can be seen early in their rule. In 1938 a large group of dissatisfied and essentially marginalized merchant families organized their own consultative *majils*. Their goal was not to overthrown the current ruling Sheikh Said bin Maktoum Al-Maktoum, but rather to redirect the majority of oil concessions that were flowing directly into the coffers of the Al-Maktoums. They

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[5] Davison. Dubai the Vulnerability of Success. p.23.
[6] Re-export is defined as the export of anything, which has been temporarily imported.
[7] Davison. Dubai the Vulnerability of Success. P.67.

proposed that the money be spent in the name of the people to create a municipal court, a social security system for the elderly, a more independent customs house, and an education department.

The Al-Maktoums did not appreciate the merchants' suggestion of restructuring the steady income they received from the British. After several failed negotiations for trade concessions between the Al-Maktoums and the dissatisfied merchant families, Sheikh Said decided to resolve the problem once and for all. He swiftly and quietly disposed of the leaders of the rebellious families by slaughtering them at a wedding party to which he had invited them as an "olive branch" in the stalled negotiations.

The Al-Maktoums ambitions for control and power were not confined to walls of the tiny city-state as evidenced by the family's role in the federalization of the United Arab Emirates. In 1971 in a last ditch effort to leave a lasting legacy before their military and political forces withdrew from the Trucial states, the British pushed for the creation of a federation of the Trucial States looking to Dubai to lead the union. Sheikh Rashid bin Said Al-Maktoum hosted the majority of the initial meetings of the Trucial States to discuss a potential federation. However, as Abu Dhabi's oil reserves began flowing in increasingly larger volumes, Sheikh Said could read the writing on the wall - Abu Dhabi would have superior wealth. He thus set up a meeting with Abu Dhabi's new leader, Sheikh Zayad bin Sultan Al Nahyan to discuss a two state union.

Britain's initial plan for the Gulf states was to create a unified republic of the nine regional powers - the larger states being Bahrain, Qatar, Abu Dhabi, and Dubai and the five smaller (but just as proud) states being Sharjah, Ra's al-Khaimah, Ajaman, Umm al-Qawain, and Fujairah. Negotiations failed to gain traction after the first year and the rulers of Bahrain and Qatar, who in many respects had never truly wanted to be part of

the federation, walked away from the negotiation table in the fall of 1971.[8] Yet with Britain's deadline to withdraw from the region drawing closer, in December of 1971 the remaining seven states hastened to sign the federal papers, creating the United Arab Emirates (UAE).[9]

Location, Location, and Free Trade

In addition to having ambitious if not at times tenacious, sovereigns, Dubai was uniquely located at the crossroads of Britain's routes to India and Iran. In 1961 her status as an international port was officially recognized when Britain moved the Trucial States Commerce agency's headquarters to Dubai from Sharjah. Yet even under British rule, Dubai made herself an attractive haven for merchants from around the world whose native markets faced political or economic uncertainty, (e.g. Iran under the Qajaris and later the Shah, India under Nehru's protectionalist rule, and Iraq after the nationalism revolution in 1958). These merchants were attracted not only by Dubai's proximity to Iran and India for trading, but also by the Al-Maktoums' laissez-faire trade policies. Though merchants from around the world were already docking in Dubai by the early 1800's, in 1890 Sheikh Maktoum bin Hasher Al-Maktoum officially declared Dubai a "free port," abolishing the 5% tax on trade and removing all customs fees and vessel licensing requirements. From then on the number of boats berthing in Dubai grew increasingly year over year, thus beginning the global flows of people and goods to Dubai that continues to the present.

Many foreign merchants set up permanent offices in Dubai when tensions in their homelands forced them to look for safer and more stable headquarters. Some of the first

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[8] Davison. Dubai the Vulnerability of Success. p 62.

[9] To be exact Ra's Al-Khaimah did not sign at the initial treaty at the last minute but applied to join within a year, to make the UAE a seven-member state nation.

merchant families to immigrate to Dubai are extremely powerful today, not only in terms of wealth, but also in terms of politics. Those who came over the earliest benefited from the Al-Maktoums' policy of offering prime land grants to new merchant families who moved their operations and offices to the tiny city-state. These merchant families have since been able to sell or lease their land at very high prices to expatriates, real developers, etc when demand for space in the city state began to climb in the 1990's.

Dubai's Historic Relationship with Abu Dhabi

Although Abu Dhabi's first oil well, (and the first in the federation) Ra's Sadr, dug in 1950, proved to be dry, the emirate has always been "the bread winner" in two emirates' historic relationship. Prior to the creation of the UAE, Dubai and Abu Dhabi competed with one another, especially as part of Britain's Trucial State system from the late 1890's-1971. Under the British the two squabbled for favor and rents from the United Kingdom's Political Resident. Yet even before Britain's arrival, the two competed for pearls with two of the largest diving fleets in the region.[10] However early on in their relationship, Dubai strove to differentiate herself as a sort of entrepreneur – in the early 1800's Dubai was busying herself with piracy and courting international traders.

Long before the discovery of oil in the region, Dubai strove to court British and international traders to her port and by the 1900's she had firmly established herself as the main port of the Trucial States.[11] Dubai tended to look outward more than Abu Dhabi in terms of both economics and culture – thus Dubai was the first of the pair to bring the mainstays of the "modern state" to her people. This was most pronounced in the 1950's

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[10] Walker, Julian. "Social and Economic Developments in Trucial Oman in the First Half of the Twentieth Century." Liwa – Journal of the International Center for Documentation & Research. Vol. 2, no 3. June 2010. p 36.

[11] Al-Sayegh, Fatma. "Merchants' Role in a Changing Society: The Case of Dubai, 1900-90." Middle Eastern Studies. Vol 34, No. 1. January 1998. p. 87.

when Abu Dhabi was suffering from the "introverted and overly cautious leadership" of Sheikh Shakhbut bin Sultan Al Nahyan. Shakhbut's failure to recognize the need to improve socioeconomic conditions and invest in infrastructure led to the migration of a significant portion of his population to Dubai.[12]

Meanwhile Dubai moved full speed ahead, courting and accepting external assistance from Britain in order to modernize. In 1952 Dubai opened the doors of Al-Maktoum Hospital, the first modern hospital in a 1000-mile radius. Over ten years later Abu Dhabi opened her first hospital in 1968.[13] Dubai opened the first public library in the region in 1963. As the twentieth century progressed and the pressure to modernize across the Gulf region increased, Abu Dhabi began to catch up with Dubai's efforts. Dubai established the first city-state supported police department in 1956, while Abu Dhabi formed her first force in 1957. As will be discussed in the section "Laissez-Air," the two emirates even competed for control of the skies both building airports and investing in national airlines. However, it was the discovery of oil in the Gulf region just before the start of World War II that most significantly shaped the course of two emirates' relationship.

In 1958 Abu Dhabi discovered oil in commercial quantities at Umm Shaif close to Das Island and officially began producing oil in 1962. In just her first year of oil production, Abu Dhabi produced 14,200 barrels per day (b/d) of oil. The following year, production rose by a staggering 239% to 48,200 b/d and by an even bigger jump to 186,800 b/d in 1964.[14] Abu Dhabi continued to discover new fields and increase

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[12] Davidson. P 77.
[13] El Shammaa, Dina. "Abu Dhabi's oldest hospital on its last legs." January 28, 2008. http://gulfnews.com/news/gulf/uae/health/abu-dhabi-s-oldest-hospital-on-its-last-legs-1.79840
[14] Butt, Gerald. "Oil and gas in the UAE." United Arab Emirates: A New Perspective, 2001.Trident Press. p 232.

production throughout the 1960's and 70's, while Dubai did not discover any significant fields until the early 1970's.

CHART 2: OIL PRODUCTION IN DUBAI AND ABU DHABI

Early Oil Production in Abu Dhabi and Dubai

'000 barrels daily

	1971	1972	1973	1974	1975	1976	1977	1978
Abu Dhabi	935	1,050	1,305	1,410	1,400	1,595	1,665	1,450
Dubai	-	-	230	240	250	315	320	360

Sources: International Energy Statistical Review: 1981, 1982, 1984, 1986, 1988, 1990, 1992; British Petroleum Company Statistical Review of the World Oil Industry: 1968, 1969, 1972, 1975, 1977, 1979.

Though some officials in Dubai continued to remain hopeful of field discoveries, the leaders of Dubai (as will be discussed in the following section) were quick to diversify away from oil when it became clear in the 1980's that the tiny city-state was not as endowed as her sister state Abu Dhabi. Today Abu Dhabi has a total of 979 producing oil fields, and controls more than 85% of the UAE's oil output capacity and more than 90% its reserves.[15] In the context of global energy, Abu Dhabi possesses nearly 8% of the world's oil reserves. Dubai, on the other hand, has only 151 producing oil fields and in 2008 oil production made up 2.1% of its GDP.[16]

[15] Butt, Gerald. "Oil and gas in the UAE." United Arab Emirates: A New Perspective, 2001.Trident Press. p 231.

[16] DiPaolo, Anthony. "Dubai Gets 2% GDP From Oil After Diversifying Revenue, Prospectus Shows." Bloomberg. September 28, 2010. http://www.bloomberg.com/news/2010-09-28/dubai-gets-2-gdp-from-oil-after-diversifying-revenue-prospectus-shows.html

THE STATE AS AN ENTREPRENEUR

"Build it and they will come"

The rise of Dubai's entrepreneurial spirit has been shaped in large part by her lack of significant oil reserves. By mid 1970-1980's it was very clear to Dubai's leaders and people that her reserves would never rival those of Abu Dhabi. Though the "initial" hype and potential of large oil reserves brought an early flow of global capital to Dubai, the flow soon petered out or rather was diverted to petro-rich Abu Dhabi. Encouraging economic diversification of any kind thus became the prime focus of the Al-Maktoums in the latter half of the twentieth century.

Dubai's leadership's understood their oil rents were finite and therefore Dubai would need to build or attract new industries in order to survive. In 1960, the government of Dubai reclaimed and rebranded national petroleum production as the Dubai Petroleum Company (DPC) after the concessions treaty with Britain expired that year. The Al-Maktoums further leveraged the reserves to expand economic relations internationally. With the DPC's increased autonomy, it added six new partners to its roster, a roster which had previously been dominated by Britain and Britain alone. The DPC now had agreements with two French companies, two Spanish companies, a Germany company, and an American company. At the same time, the Al-Maktoums began to invest heavily in the development of hydrocarbon-related industries, which was a natural, but unfortunately, limited extension of her weak petro-economy.[17] Oil production in Dubai peaked in 1991 at 410,000 b/d and then averaged around 230,000 b/d for the later half of

[17] In 1979 they opened Dubai Aluminum (DUBAL), which is still very profitably today. Then in 1980 they started a liquid natural gas plant (DUGAS), a year later a cabling company, Dubai Cabling Company. More were to follow, Arabian Liquid Chemicals, Gulf Metal Foundry, Gulf Engineering Industry, and Foseco Minsep.

the 1990's. According to Dubai officials, by the end of 1999 production had dropped to 170,000 b/d and it was estimated that Dubai's reserves would be exhausted by 2020.[18]

To continue to play a role in the rapidly globalizing economy, Dubai's leaders and citizens knew they would need to attract and or build industries beyond oil. Thus the Al-Maktoums pursued a development strategy of "if you build it they will come," to attract foreign businesses to their shores. If Dubai could provide the right conditions – good infrastructure and free markets – and the right tools – labor and minimal regulation – for foreign businesses, she reasoned industry, production, and wealth would follow. Beginning in the 1950's, the state launched a series of infrastructure development projects: dredging the creek, multiple expansions of the berthing docks, building an airport, and constructing roads and bridges. These large-scale construction projects attracted both foreign money and foreign labor, in particular floods of unskilled workers from South Asia and the greater Middle East.

All of Dubai's infrastructure and economy building endeavors carried hefty price tags that were at first partially financed with Dubai's oil rents and partially with risky fixed-income vehicles. The first debt issue was Sheikh Rashid Al-Maktoum's "creek bond" in the mid 1950's, which he floated himself for a year and half until he could secure a buy-out by the Kuwaiti government. The bond was used to finance the dredging of the Dubai creek which had been rapidly silting up over the last ten years and posed a significant threat to Dubai's port businesses. As he considered both the creek's dredging and the debt issue successes, Sheikh Rashid opted to use similar financing for later projects, rationalizing them with the belief that the issues' accrued interest would easily be covered by the dividends such projects would generate for the state's commercial

[18] Butt, Gerald. "Oil and gas in the UAE." United Arab Emirates: A New Perspective, 2001.Trident Press. p 237.

sector. Follow-on projects were financed with money from other Gulf States – in 1962 Qatari money helped finance the first proper bridge across the creek; and Saudi money financed the laying of a tarmac road between Dubai and her sister emirate Ra's al-Khaimah.

Laissez-Air

In order to provide the proper conditions for a flourishing transportation and logistics industry, the Al-Maktoums moved quickly from water and land projects to air projects. One of the more controversial and classically "Dubai" projects was the development of her air infrastructure – an airport and an airline. Until end of the 1950's Dubai had no airport. Travel to Dubai from abroad required either a flight into Sharjah and an overland trip; or a flight into Bahrain and a boat ride. Neither of the two options was fast or comfortable. Sheikh Rashid worried that the lack of direct transportation to Dubai would be a major impediment to Dubai's growth and a large deterrence to foreign businesses considering establishing offices in Dubai. The Sheikh envisioned extending Dubai's characteristic laissez-faire business tradition to the air with an "open skies" policy.[19]

Regional landing rights had been a source of much contention between the emirates under British rule and continued to be in the latter half of the 1950's when the Al Nahyans, the royal family of Abu Dhabi, attempted to garner British backing for their own airport. At that time Sharjah had a monopoly on landing rights and flights because she was the first emirate to negotiate with Britain to service the Royal Air Force in the early 1930's. Sharjah later persuaded Britain to agree to a seating quota system to limit the number of non-oil related and non-Sharjah visitors on flights into the Trucial States,

[19] Davison. Dubai the Vulnerability of Success. p.94.

essentially icing out Dubai and Abu Dhabi of developing their own air systems. Although Abu Dhabi's proposal for an airport was met with a flat refusal of support from Britain, a year later Dubai persuaded the British to her airport project, claiming that the emirate was prepared to bear the entire financial burden of building the airport herself. Another factor that helped Dubai win over the British was her enlistment of the famous British pilot Freddie Bosworth, who had been involved in Dubai's gold-trade, to lobby Britain's Political Resident to her cause.

The approval and then construction of an airport was both a slap in the face to Abu Dhabi and the beginning of a contentious competition for the air between the two emirates. In 1960 planes began to land and take off from Dubai's new airport. It was not until eight years later that Abu Dhabi's first airport was opened. Dubai's new airport featured the first "duty- free" shop in the region, which was so popular with residents that the parking garage for the shop had to be expanded just months after opening in order to serve the growing demand. However, the Al-Maktoums' "build it and they will come" strategy did not sell itself to the extent they had hoped it would, as the airport failed to attract the British Overseas Airways Corporation (BOAC), one of the largest international and regional carriers.[20] Sheikh Rashid quickly resolved this problem by agreeing to buy out the extra capacity on BOAC flights if they landed in Dubai, which satisfied the BOAC's 60% capacity minimum to operate new routes.

Sheikh Rashid's successor, Sheikh Muhammad bin Rashid Al-Maktoum, pursued a more entrepreneurial tact to increase air traffic to Dubai. In the late 1970's Gulf Air, a major regional carrier, jointly owned by Saudi Arabia, Bahrain, Qatar, Oman, and Abu Dhabi, began to cut its flights to Dubai after becoming frustrated by Dubai's refusal to

[20] In 1971 British Overseas Airways Corporation merged with another British airplane to become what we know today as British Airways.

offer Gulf Air subsidies and preferential treatment, two items that Abu Dhabi's airport had been all too eager to offer the carrier. Instead of sacrificing Dubai's laissez-faire "open skies" policy, the new ruler of Dubai, Sheikh Muhammad bin Rashid Al-Maktoum, opted instead to build Dubai her own national carrier. Despite strong criticism and steep regional competition, Dubai's new airline, Emirates, was launched in 1985 with a $10M investment from Sheikh Muhammad. When advisors suggested that he grant the new airline preferential landing rights and subsidies, Sheikh Muhammad refused, arguing he could never compromise Dubai's open skies policies and the fledging airline would need to learn to be profitable on its own.

Lucky for Sheikh Muhammad, he found like-minded individuals to build and run the new airline, namely his uncle and Maurice Flanagan, the former BOAC manager at Dubai International Airport. Flanagan eagerly accepted the Sheikh's challenge to build a new airline that would not only compete with the regional power Gulf Air, but also hold its own against such global elites as British Air, Air France, and United. According to Emirates' website, the company has posted a profit every year in her operating history except her first year of operations 1986 when the costs of building infrastructure and expanding the fleet forced the company to post a net loss.[21] In a 2007 interview, the 77 year-old co-founder and CEO of Emirates, Flanagan, succinctly summarized the Al-Maktoums' aspirations for Dubai and her airline: "Dubai is like the medieval city-states

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[21] http://www.theemiratesgroup.com/english/our-company/our-history.aspx#y1985.

It should be noted that Emirates' "profitability" is a hotly debated topic in the airline industry. Several of the world's incumbent carriers complain that Emirates has 'unfair advantages,' despite the fact that many of the airlines criticizing Emirates were built on subsidies themselves. It should also be noted that Emirates denies receiving any form of subsidy. Rutledge. "The World's Emerging Aviation Hub." February 2006.

such as Venice — its economic dynamism is far greater than its size or population. Dubai is fast becoming a world centre, so Emirates will grow too."[22]

With air, land, and sea access to Dubai built out to international standards, the Al-Maktoums continued to woo the global flows of goods, labor, and capital to Dubai's shores through regulatory and tax incentives. Labor seemed to arrive in Dubai with little beckoning – both unskilled and skilled workers were attracted to this "economic oasis" by the sheer amounts of capital being invested in infrastructure projects which required labor to engineer, execute, finance, and manage the massive projects.

The Free Zones

In the 1980's Abu Dhabi began codifying previously informal practices relating to commerce and foreign ownership as formal federal directives. The 1984 Commercial Companies Law mandated that all emirates comply with a local sponsorship or *kafil* system. Under this new "official" system, all companies registered in the seven emirates must be owned at least 51% by an UAE national. Though most of the emirates viewed these directives and others coming from Abu Dhabi as "a necessary price to pay for the collective security benefits of federal integration," many in Dubai felt they prevented foreign direct investment (FDI), economic diversification, and were a contradiction to the city-state's *laissez-faire,* free port reputation.[23] Not wanting to confront Abu Dhabi on the issue and in turn increase the tension between the two emirates, Sheikh Rashid set up special authorities to manage specific areas within the emirate that he decreed legally fell outside the purview of federal UAE law.

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[22] Armistead. "Interview: Emirates boss heads for bigger goals." The Times. July 2006. http://business.timesonline.co.uk/tol/business/industry_sectors/transport/article691222.ece

[23] Davison. Dubai the Vulnerability of Success. p 114.

The Jebel Ali Free Zone Authority (JAFZ), the first of the "free zone" projects, was established adjacent to Dubai's new port at Jebel Ali in 1985, thus creating a special enclave for the new authority and easy access to the loading docks.[24] Sheikh Rashid appointed Sultan Ahmad bin Sulayman to administer and manage the new free zone. Two of Sulayman's most important policies for the economic zone were not requiring indigenous ownership and allowing companies to operate tax-free for their first 50 years. He strove to provide companies with the necessary tools to set-up shop quickly: ready-made office buildings, streamlined visa processing for employees, and cheap energy and transportation. Additionally, the timing of the JAFZ could not have been more opportune – the middle of both the Iran-Iraq War and the Lebanese Civil War - as the new free zone operated as a stable, safe haven of business for regional merchants and international investors who had previously been leery of the UAE's FDI ownership requirements. By 1990, 220 companies had established offices in the JAFZ. Ten years later in 2000 there were over 1,750 companies.[25]

The success of the JAFZ spurred Dubai to establish numerous other free zones that focused on specific industries. In 2000 crown prince Mohammed bin Rashid unveiled two new free zones, or "cities": the Dubai Technology & E-Commerce Free Zone and the Media Free Zone, popularly know as Dubai Internet City and Dubai Media City, respectively. In fact the free zone model has become so popular that today nearly a third of Dubai's land mass is occupied by free zone authorities.[26] Dubai's fellow emirates have been quick to follow suit, establishing their own "free zones" in an effort both to diversify their economies and to compete with Dubai, by providing foreign corporations

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[24] Davison. Dubai the Vulnerability of Success. p 115.
[25] "Jebel Ali Free Zone International." IFC Special Economic Zones Workshop. IFC. Slide 9.
[26] Davison. Dubai the Vulnerability of Success. p 118.

slightly lower cost alternatives to those of the ambitious city-state. Dubai's other fully operating free zones include: Dubai Airport Free Zone (1996), Dubai Silicon Oasis (2004), Dubai Knowledge Village (2003), Dubai Healthcare City (2009), Dubai International Academic City (2006), Dubai Gold and Diamond Park (2000), Dubai Multi Commodities Centre (2002) and Dubai Techno Park (2002).

Although she has more free zones in the works, the most notable, recently established free zone is the Dubai International Financial Centre (DIFC) whose controversial governance will be discussed at greater length in the final section of this paper. The DIFC, which houses both the Dubai International Financial Exchange (DIFX) and the Dubai Financial Services Authority (DFSA), was established in 2004 to "provide a secure and efficient platform for business and financial institutions to reach into and out of the emerging markets of the region."[27] Sheikh Muhammad elected Anis al-Jallaf, a former Dubai banker and the Chairman of Emirates Bank International, to set up and administer the new zone. The zone's regulatory framework was created based on English common law and included the establishment of the DIFC Judicial Authority (DIFC Courts), an independent judicial system within the financial district capable of settling all civil and commercial disputes within the DIFC.

In addition to the many international financial institutions that set up offices in the DIFC, KPMG, Swiss Private, Volaw, Credit Suisse, and Merrill Lynch to name a few, numerous banks with large Islamic banking groups, who previously used London as their hub for Islamic banking operations, have moved to Dubai. The banks cite the DIFC's auspicious location at the crossroads of the Muslim-emerging markets (the surrounding

[27] DIFC website. http://www.difc.ae/discover-difc

GCC and Levant nations, Pakistan to the east, and North Africa and East Africa to the southwest) as their main attraction.

With a leadership known for its entrepreneurialism, free trade policies, and global ambitions and state coffers full of oil rents and tax and customs revenues, Dubai embarked on a path to differentiate herself regionally from her sister emirates, namely Abu Dhabi, and to differentiate herself internationally as the prime destination for international trade and finance. Although her desire to distinguish herself as such played a significant role in her eventually "fall from grace," by the early 2000's it had earned the tiny city-state the nickname of "Dubai Inc."

CREATING A BUBBLE

This section will address the foundations of Dubai's real estate bubble and conclude with a brief overview of how the rise of Dubai Inc. was financed. The real estate bubble primarily began in mid 1990's with significant direct and indirect government action in two important industries: luxury tourism and real estate.

"Build it and they will come" 2.0

The leadership of Dubai did not think of marketing the little city-state's long sandy beaches, winter sun, and soft swells as a resort destination until the late 1980's when the pressure to diversify from oil was heavier than ever. In fact, Dubai remained "hotel-less" until 1960 when the Airlines Hotel opened next to the brand new Dubai International Airport. Shortly thereafter, the Carlton Towers, servicing the airport, and The Ambassador Hotel, servicing visiting dignitaries, were opened to help supply beds for Dubai's growing number of business travelers. By 1990 Dubai had over 70 hotels and 600,000 visitors per year, the majority of whom were staying in Dubai's four to five star-rated hotels.[28] In 1992 the government established the Dubai Tourism and Promotion Board with the purpose of launching Dubai onto the international tourism scene and attracting visitors to Dubai for pleasure rather than business. The new office, under the leadership of Khalid Ahmad bin Sulayman and with satellite offices in Britain, France, the USA, India, and South Africa immediately began its "Destination Dubai" campaign. With over 1.3M visitors per year by 1995, the majority of whom were coming for the sandy shores and not the port docks, the new tourism office was deemed a success.

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[28] Davison. Dubai the Vulnerability of Success. p 120.

The number of visitors to Dubai continued to grow at increasing rates from the late 1990's until the mid 2000's. Total revenue for Dubai's hotels jumped from 2,228M Dhs in 1999 to 3,409M Dhs in 2002. Hotel revenue doubled from 2002 to 2005 to 7,912M Dhs. On average annual hotel revenue grew by over 20% per year until the global recession hit in 2008.[29] The growth from the late 1990's up until today is largely due to Sheikh Muhammad's push to establish Dubai as one of the most prestigious, high-end tourism destinations in the world.

In 1997 Sheikh Muhammad, crown prince at the time, created the Jumeirah Group from his own personal wealth. The group's first investment was the Jumeirah Beach Hotel, which with 600 rooms and suites held the position of being the emirate's premier resort for just two years until Jumeirah opened the world's first seven-star hotel, the Burj Al Arab. The iconic sail shaped hotel, built on a man-made island directly offshore from the Jumeirah Beach Hotel, "required massive investment and almost certainly continues to make considerable losses."[30] Despite the property's dismal returns, the international media coverage that the new hotel generated for Dubai seemed to justify the price paid by Sheikh Muhammad. In 2004, the Jumeirah Group became part of the newly established Dubai Holding, the umbrella company under which Sheikh Muhammad consolidated his empire of nearly 20 large-scale infrastructure and investment companies and projects spanning 11 industries.[31]

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[29] "1999-2008 Hotel Statistics Summary." Department of Tourism and Commerce Marketing. Government of Dubai. http://www.dubaitourism.ae/Portals/0/Statistics%5CHotelStatistics/A003%201999-2008%20Hotel%20Statistics%20Summary.pdf

[30] Davison. Dubai the Vulnerability of Success. p 121.

[31] "Jumeirah Group." International Directory of Company Histories. 2007. Encyclopedia.com. 15 Mar. 2011 <http://www.encyclopedia.com>.

Allow foreigners to buy property

Prior to the late 1990's Dubai's real estate sector remained largely undeveloped. From the 1930-1990's the Al-Maktoums had donated real estate either to wealthy national families to garner their support or to merchants who moved their businesses to Dubai. Many of these families built new homes for themselves and a few developed residential and commercial properties to lease to foreigners and businesses. However, before 2002 there were no property rights for foreigners. The state had unsuccessfully launched "99-year leases" for foreigners in 2001 as a way to allow foreign ownership, a move which failed to gain traction with foreigners.[32] The real estate market dramatically changed in May 2002 when crown prince Sheikh Muhammad issued a decree allowing foreigners to buy and own freehold property in select areas of Dubai.

Though still vague on the exact extent of foreigners' property rights, the decree set off the city-state's real estate and construction markets. In a 2010 interview with Grant Thornton International's *Elevate* magazine, Dean Foley, an international sales manager at property company Hamptons International in Dubai, described the start of the real estate mania:

> When the new laws were passed you could pick up property in Dubai for no money at all. £20-30,000 would have got you a one-bedroom project, for example, around the marina...(but, once word got out) Property prices were astronomically high. A lot of people were flipping properties…exchanging contracts and selling them on the next day for 15-20% profits. A lot of the corporations we see now in Dubai are a direct result of a builder putting up his house, selling it within hours…and then having the cash flow to do more and more.

[32] Cooper, Peter J. "A Short History of Dubai Property: Part 3." AMEInfo.com, August 12, 2004. http://www.ameinfo.com/40570.html

As an example of the burgeoning bubble, in 2004 while Dubai's overall economy was growing at a record rate of 16.7%, the city-state's construction and real estate sectors were out pacing all other sectors, at growth rates of 29% and 22% respectively.[33]

If the 2002 change to Dubai's property laws spurred the boom, the March 2006 amending property law cleared up any lingering worry of foreigners' property rights, further increasing real estate speculation. The March 2006 Land Registration Law of the Emirate of Dubai (No. 7/2006), known as the "Dubai Property Law," was enacted to clarify and confirm the freehold ownership of land by UAE and GCC nationals, as well as by non-GCC citizens in certain areas designated by the ruler.[34]

The role of the state in the creation of the bubble extended far beyond the new property laws as the state directly and indirectly invested in real estate developments via its "government related enterprises" (GREs). Both the Al-Maktoums' personal business entities and the government's entities led the charge in real estate development, via the directly or indirectly state-owned real estate firms, namely: Dubai World's Nakheel; the Investment Corporation of Dubai's Emaar Properties; and the three property entities under Sheikh Muhammad's umbrella company Dubai Holding, Dubai Properties, Tatweer, and Sama Dubai. According to Robin Bloch's research paper, "Dubai's Long Goodbye," the firms were strongly encouraged to outperform one another in developing very large-scale, expensive, and 'iconic' projects, which were often seen from the outside as garish and overblown, such as Nakheel's Palm and The World developments, and Tatweer's US$110B ultra-theme park Dubailand.[35] Please note that the aforementioned

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[33] Hanware, Khalil. "Will Dubai's Real Estate Bubble Burst?" Arab News. Jeddah, March 29, 2005. http://archive.arabnews.com/?page=6&section=0&article=61271&d=29&m=3&y=2005

[34] Termini, Raymond and John Vogel. "Property Law in the UAE." The American Lawyer." October 2007

[35] Bloch, Robin. "Dubai's Long Goodbye." International Journal of Urban and Regional Research. Vol 34, Issue 4, pages 943–951, December 2010

real estate development companies (Emaar, Nakheel, Dubai Properties, Tatweer, and Sama Dubai) and their respective umbrella companies (Dubai Holding, Dubai World (DW) and the Investment Corporation of Dubai (ICD)) will be described in-depth in later sections which analyze the crash of the real estate market.

Financing Dubai Inc.

All the discussion of Dubai's development – from infrastructure projects to free trade zones and from real estate to tourism – begs the question of how the tiny city-state financed it without the oil wealth that its sister emirate Abu Dhabi was endowed with. On top of the lack of petroleum reserves, Dubai faced two additional constraints: no income tax and minor access to the global sovereign debt market. With its tiny population, Dubai lacked a sufficient tax base that she could tax. Before 2008 the government of Dubai had successfully attempted to raise a negligible $410M in debt internationally.[36] Additionally as of 2009 Dubai still had not received a sovereign debt rating for issuing debt to finance her growth plans.

While Dubai's development strategy focused on turning herself into a truly global entrepôt (i.e. becoming the international center for import/export business, finance, education, healthcare, luxury travel and real estate), her strategy to finance these goals relied primarily on a "state-directed, venture capital-like model." The government created individual corporate entities, which were given ambitious goals to develop specific sectors. These government-related entities (GREs) were initially financed from Dubai's meager and dwindling oil revenues, trade duties, and local consumption taxes saved by the government. However, the GREs primary source of funding quickly became debt

[36] Musacchio, Aldo, Andrew Goodman, and Claire Quershi. "Dubai: Debt, Development and Crisis (A)." Harvard Business School. Case: 9-710-071. June 30, 2010. p 5.

financing from regional and international banks and investment companies an example of which we saw back in the 1950's with Sheikh Rashid Al-Maktoum's "creek bond." However, as the GREs' projects became bolder and bigger, namely by the time the Al-Maktoums began to target the real estate and luxury tourism sectors, so did the capital needed to finance them.

In order to successfully tap into international debt markets and issue dollar denominated bonds, Dubai's GREs would need credit ratings from international credit rating agencies such as Moody's and Standard and Poor's. Even though the GREs' bond issuances were explicitly "not guaranteed" by the government of Dubai, the rating agencies decided to give the various issues strong credit ratings.

CHART 3: MOODY'S AND STANDARD & POOR'S RATINGS OF GREs' ISSUANCES

Moody's Ratings			
	Pre-Nov 2009	**November 5, 2009**	**November 26, 2009**
DP World	A1	A3	Baa2
DEWA	A1	A3	Baa2
DIFCI	A1	A3	Ba1
JAFZ	A3	Baa1	Ba1
DHCOG	A3	Baa1	Ba2
Emaar	Baa1	Baa1	Ba2

Standard & Poor's Ratings				
	Initial	**July 1, 2009**	**November 1, 2009**	**December 1, 2009**
National Bank of Dubai	A	A	A-	BBB
Dubai Islamic Bank	A	A-	BBB+	BB-

Sources: Mergent BondViewer, www.arabianbusiness.com

Moody's and Standard and Poor's supported their high initial ratings (A1, A3...) of issues by citing the specific GREs' strong relationships with the government of Dubai. For instance in Standard and Poor's September 2009 rating of DP World, a subsidiary of GRE Dubai Would, the agency claimed:

> The relationship between DP World and Dubai leads us to believe that in the event of financial distress the emirate would support the company in a sufficient and timely way. The emirate gives no formal guarantees on DP World's debt though. DP World is an 80%-owned subsidiary of Dubai World--a holding company 100% owned by the government of Dubai. Dubai World's status in the hierarchy of state-owned entities in Dubai is one of the highest, as it was created by decree from the Ruler of Dubai (Law No. 3 of 2006), and it is also the government's single biggest investment. According to the decree, the chairman of Dubai World, Sultan Ahmed Bin Sulayem, has to be appointed by a decree issued by His Highness the Ruler of Dubai (Art. 8).[37]

Credit agencies and investors perceived the strong ties among the GREs, the government of Dubai, and the Al-Maktoum family as implicit guarantees that the government stood behind them. An explicit guarantee from the government aside, there was circumstantial evidence that in the case of a financial crisis the government of Dubai and the Al-Maktoums would in fact back the GREs and their subsidiaries. Most of the GREs were created by decrees from the government of Dubai, received some financial investment from the government, and were typically run or governed by members of the Al-Maktoum family or the family's inner circle. Thus it would appear that it was in the best long-term interests of Dubai's leadership and government to support entities they helped create if a crisis struck.

An examination of the GREs' and their subsidiaries' annual reports also indicated that it was hard for foreign investors to determine these entities' levels of debt and leverage before the crash due to their opaque reporting. For instance, by taking a closer look at the annual reports of Emaar Properties, a subsidiary of the government-owned ICD, one can see how unclear Emaar's debt situation was. Heading into 2008, according to Emaar Properties' consolidated balance sheet, the real estate developer had a debt to asset ratio of 32% and a debt to equity of 47.4%. These numbers to some extent were

[37] "DP World Ltd. Credit Rating." Standard and Poor's. September 16, 2009. http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245193605416

deceiving for two reasons: (i) the financial statements consolidated both the performance of Emaar's "Subsidiaries" and "Associate" companies; and (ii) the Notes did not provide clear or exact details of Emaar's loans from banks and its loans to its Associates.

CHART 4: EMAAR LEVERAGE PRIOR TO CRASH

Emaar Debt Levels Pre-2009 Crash			
	(US$ millions)		
	2007	**2008**	**2009**
Maturing within 12 months (1)	425.7	1,242.6	1,225.1
Maturing after 12 months (1)	1,671.7	1,255.2	1,123.2
Secured Loans and Borrowings (1)	-	614.7	493.2
Unsecured Loans and Borrowings (1)	-	1,883.0	1,876.8
Investment Properties (2)	1,534.3	3,606.9	2,326.7
Secure/Unsecured Debt	-	*32.6%*	*26.3%*
Property/Unsecured Debt	-	*191.6%*	*124.0%*

(1) "Interest-Bearing Loans and Borrowings." Note 22. Notes to the Consolidated Financial Statements. (2) Consolidated Balance Sheet, 2008 & 2009.
Source: Consolidated Financial Statements and Notes. "Emaar Annual Report 2008" and "Emaar Annual Report 2009." Emaar Properties PJSC and its Subsidiaries.

Additionally confusing was the fact that Emaar's annual reports failed to distinguish between Emaar's "encumbered" and "unencumbered" properties, thus investors could not accurately analyze Emaar's true debt burden and Emaar's ability to cover maturing debt. Its annual reports also do not report how much money Emaar had drawn down on its financing facilities. Thus the level of "unsecure debt" cited in the table above is an inaccurate and overly aggressive number as it assumes all facilities have been drawn down. (The number is shown simply to give a general sense of Emaar's potential for overleveraging). Despite of the lack of explicit government guarantees and unclear financial statements, all parties caught up in the real estate frenzy - investors, credit agencies, and Dubai Inc.'s real estate developers - gave little heed to the number of maturing loans in the GREs' debt portfolios.

DUBAI WORLD CRISIS & THE GLOBAL RECESSION

This section gives a description of how Dubai's real estate bubble burst and then discusses the unknown depths of Dubai Inc.'s debt in 2009 and the parties involved – the borrowers and the regional and international lenders.

Real Estate Bubble Bursts

Less than a month after Lehman Brothers filed for bankruptcy[38] and Merrill Lynch agreed to sell itself to Bank of America, the 7th annual "Dubai Cityscape" real estate investment and development conference ended in Dubai with record level attendance. On the opening day of the conference, October 5, 2008, Nakheel, the government-owned developer, unveiled plans to build a new contender for the world's tallest tower title. While Dubai mortgage-lender Tamweel announced it would launch up to 2B Dhs of Islamic loans and the Jumeirah Group showcased its plans for the Jumeirah Gardens, a US$95.3B development of luxury apartments, shopping districts, and offices.[39] No one in Dubai seemed to be noticing international markets' reaction to the unfolding financial crisis in the U.S. The day after the conference closed all of the major global stock market indexes – FTSE in London, Dax in Germany, CAC-40 in France, Dow Jones in the U.S., Ibovespa in Brazil, Nikkei in Japan, Hang Seng in Hong Kong, and Straits Times in Singapore – fell more than 7%.[40] And yet regional real estate developers' optimism showed no sign of slowing, as Gulf investors and analysts alike clung to the belief that Dubai and the greater UAE market were immune to the U.S. recession that was quickly spreading to foreign markets.

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[38] September 15, 2008

[39] Smith, Justin. " Report from Cityscape Dubai 2008." Business Intelligence – Middle East. October 7, 2008. http://www.bi-me.com/main.php?id=25280&t=1&c=9&cg=2

[40] Kollewe, Julia. "Markets crash: How panic spread around the globe." Guardian.co.uk. October 10, 2008. http://www.guardian.co.uk/business/2008/oct/10/marketturmoil-creditcrunch1

Just over a year later, on the eve of Thanksgiving, November 25, 2009, Dubai's flagship GRE, Dubai World (DW), shocked international markets with an announcement of its own insolvency. DW, the owner of Nakheel and DP World, one of the largest port operators in the world, asked creditors for a 6 month "standstill" until May of the following year on at least US$4B of its US$26B in debt obligations. DW's subsidiary Nakheel was scheduled to repay a US$4B *sukuk* (an Islamic bond) on December 14th, the first in a series of debt repayments spanning from 2009 to 2014. The company also quietly announced that it had enlisted Aidan Birkett, Deloitte Consulting's managing partner for corporate finance to restructure DW. Though the announcement came shortly after the close of Gulf markets and on the eve of a national UAE holiday, the impact was still felt - the Nakheel sukuk promptly dropped to 80 cents on the dollar, while Dubai's sovereign credit default swaps jumped 111 basis points to 429 – higher than Iceland's.[41]

The day after the DW announcement, global markets took a hit. The FTSE 100 index, a good proxy for the many international banks and companies with investments and offices in the Gulf (HSBC, Royal Dutch Shell, Barclays, and Lloyds) saw nearly £44 billion in value wiped off London's biggest companies. The British exchange took its largest one-day fall since March 2009, plunging by more than 170 points (170.68, or 3.2%).[42] The announcements from DW and the government of Dubai following the initial "standstill" request did little to ease investors' fears. Due to the general lack of information and opacity of the information available to the public, it was difficult for investors and analysts to determine the exact depths of unsecured debt in the emirate.

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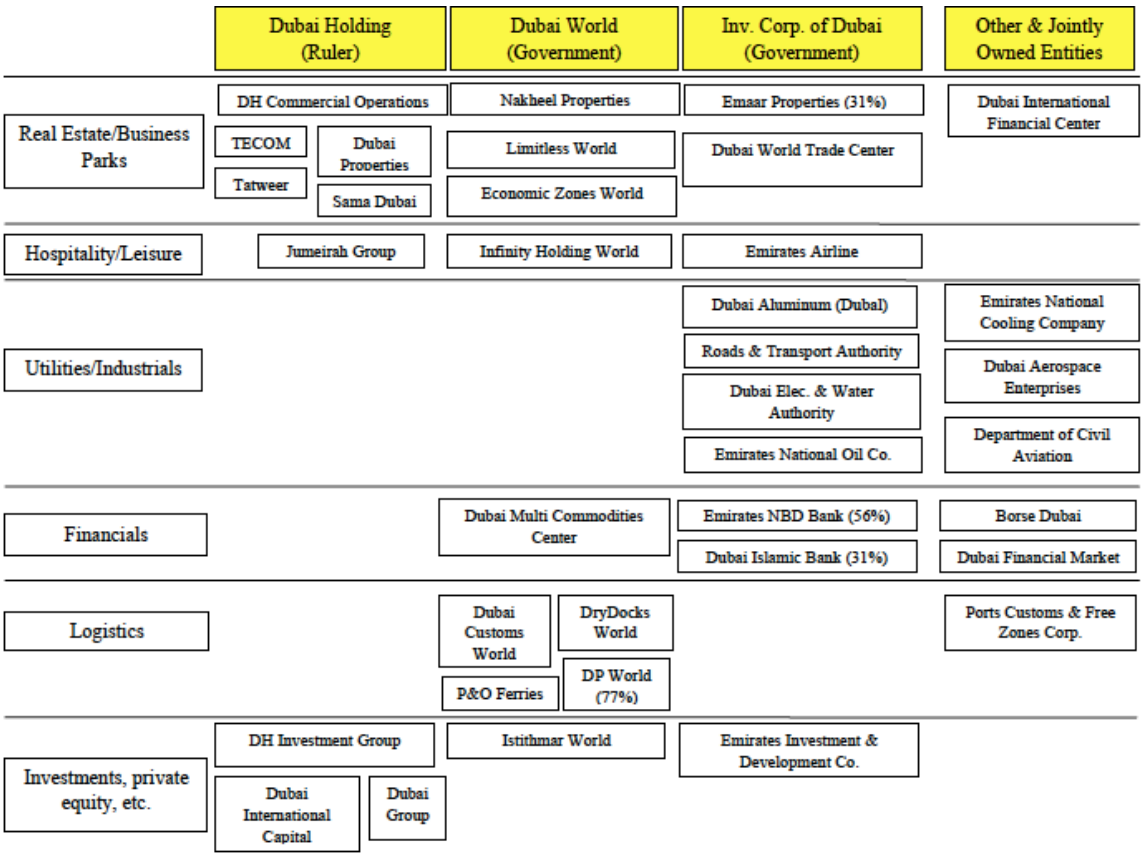
[41] Spencer, Richard. "Dubai recovery hopes hit by debt 'standstill' call." The Telegraph. November 25, 2009. http://www.telegraph.co.uk/finance/globalbusiness/6655687/Dubai-recovery-hopes-hit-by-debt-standstill-call.html

[42] Moya, Elena. "FTSE plunges with Dubai debt crisis." guardian.co.uk. November 26, 2009. http://www.guardian.co.uk/business/2009/nov/26/dubai-debt-protection?INTCMP=ILCNETTXT3487

DW's US$ 26B in debt was only a portion of the estimated US$ 80B of total debt owed by the little city-state's three largest GREs – Dubai Holding, Dubai World, and the ICD – and several smaller GREs.

CHART 5: THE GREs OF DUBAI INC.



Source: IMF Staff Report. February, 2010.[43]

Increasing investor anxiety more was the blurred line between the government's finances and the royal family's. According to Dubai Holding's 2009 Annual Report, the entity was defined as a "holding company" whose "ultimate majority shareholder… is His Highness Sheikh Mohammad Bin Rashid Al-Maktoum." This implies that Dubai Holding is not a

[43] "United Arab Emirates: 2009 Article IV Consultation." Staff Report. IMF, February 2010

government-backed company, but rather backed by the ruler himself. However, in the Notes to Dubai Holding's financial statements it is stated that the holding company has access to funds from the Dubai Financial Support Fund (FSF), thus implying that the government of Dubai considers Dubai Holding a "government-related" entity. This begs the question: does the state consider and thus support Dubai Holding as a government-backed entity as it does its other two explicitly government-backed entities DW and ICD? Unclear statements from government officials or the rather lack of statements all together in the initial aftermath of the DW crisis created unnecessary confusion and rumors about whether GREs were guaranteed, who was guaranteeing them, and how in debt were they.

On the Monday of the following week, the Director General of the Dubai Finance Department, Abdulrahman al-Saleh, told Dubai Television: "[Creditors] think Dubai World is part of the government, which is not correct…Creditors need to take part of the responsibility for their decision to lend to the companies."[44] At the same time, the UAE 's Central Bank announced the creation of a facility to provide both UAE banks and foreign banks operating in the UAE extra liquidity, implying that perhaps Abu Dhabi would support Dubai in the event of a default. The government of Abu Dhabi said it would consider "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."[45] Thus investors began to ask the question what banks and investment companies had exposure to DW, to what degree was their exposure, and how much could they expect to recover.

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[44] Thompson, Ben. "Dubai World debt 'not guaranteed' by government." BBC News. November 30, 2009. http://news.bbc.co.uk/2/hi/8385164.stm

[45] Thompson, Ben. "Dubai World debt 'not guaranteed' by government." BBC News. November 30, 2009. http://news.bbc.co.uk/2/hi/8385164.stm

Debt Exposure

The following three sub-sections describe: the depths of Dubai's GREs' debt, the exposure of Abu Dhabi-related entities to Dubai's debt, and the exposure of foreign parties to Dubai's debt. The numbers given are complied from various research reports and official reports from government bodies. However, it should be noted that due to the opacity of GREs and lack of regular or clear reporting by GREs, these numbers are in general estimates or "best guesses" given by analysts covering the region.

CHART 6: DEBT OF THE GOVERNMENT OF DUBAI & HER GREs

Outstanding Dubai "Public Sector" Debt as of December 2009

US$ million	Disclosed Debt (1)	Other Est. Liabilities (2)	Total Est. Liabilities (3)
Dubai World	26,219	7,866	34,085
Dubai Holding	15,090	4,527	19,617
ICD	28,275	5,655	33,930
Dubai Government	18,700	0	18,700
Other Entities	1,885	0	1,885
Total	**90,169**	**18,048**	**108,217**
Total (ex-Gov)	71,469	18,048	89,517

Source: Batori, Paolo and Mohammed W. Jaber. "UAE: A Closer Look at Dubai's Debt." Strategy and Economics. Morgan Stanley Research. December 7, 2009.

A December 2009 Morgan Stanley report on Dubai's debt burdens noted that the direct non-bank liabilities of the government of Dubai (i.e. not including the GREs' debt) increased from US$.5B at the end of 2007 to over US$16B in 2008. The report further noted that in the course of 2008-2009 the government's direct debt exposure increased from less 3% of GDP to over 22% of GDP and was expected to increase to 45% by 2011.[46] The emirate's direct debt as a % of GDP is lower than regional averages and

[46] Batori, Paolo and Mohammed W. Jaber. "UAE: A Closer Look at Dubai's Debt." Strategy and Economics. Morgan Stanley Research. December 7, 2009. p 2.

significantly lower than that of the nations hit hardest by the global recession – Greece, Latvia, Spain, Ireland and so forth. Yet, when the estimated debt of Dubai's GREs in 2009 (US $89B, or 116% of GDP), is added to the government's direct debt, Dubai's public sector debt increases to 140% of GDP or US$108. [47]

Analysts Batori and Jaber were keen to point out that:

> There are no official estimates of the debt owed by Dubai's GREs. Calculating the overall size of their debt liabilities is further complicated by a number of factors, including: (i) the complex organizational structure of Dubai's quasi-sovereign holdings; (ii) the lack of transparency regarding operations of its mostly unlisted companies; and (iii) the lack of data on bilateral, non-disclosed loans extended to these entities.[48]

Of the $16B debt raised by the emirate itself $15B has been earmarked for the state's FSF, whose primary role is to provide financial support and liquidity to strategic and developmental government bodies and GREs. The creation of Dubai's FSF in July 2009 and the entities that the government had designated for funding, such as Sheikh Muhammad's Dubai Holding increased confusion over the government's explicit versus implicit support for GREs.

Abu Dhabi Entities' Exposure to Dubai Debt

Prior her bailout of her sister emirate, Abu Dhabi had strongly subscribed to several of Dubai's GREs' debt issues. Gathering and compiling the exposure of Abu Dhabi-based and owned banks to Dubai's debt was difficult due to the lack of public and transparent reporting of both lenders and debtors. However, from banks' press releases and reports, news articles, and analysts' reports, at least three banks with significant

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[47] Batori, Paolo and Mohammed W. Jaber. "UAE: A Closer Look at Dubai's Debt." Strategy and Economics. Morgan Stanley Research. December 7, 2009. p 3

[48] Batori, Paolo and Mohammed W. Jaber. "UAE: A Closer Look at Dubai's Debt." Strategy and Economics. Morgan Stanley Research. December 7, 2009. p 3

exposure to the DW crisis have been identified: Abu Dhabi Commercial Bank (ADCB), National Bank of Abu Dhabi (NBAD), and First Gulf Bank.

The ADCB, which is the second largest bank in Abu Dhabi by asset size (AED 166.6B)[49] and 64.8% owned by the government of Abu Dhabi, did not openly disclose its exposure to the DW crisis until eight months after the standstill announcement. Its January 2010, " 2009 Full Year and Fourth Quarter" press release did not once mention the word "Dubai," but it did show a 151% increase in "impairments" over 2008.[50] In the ADCB's July 2010 press release "First Half of 2010 Financial Results," the bank finally reported a net loss due to "the enforcement of provisions and impairments, especially those associated with ADCB's exposure to Dubai World."[51]

On the other hand, the NBAD at first claimed no exposure to DW despite owning the debt of several DW subsidiaries. The bank told reporters in April 2010 that it had no exposure to Dubai World, failing to mention its exposure to Dubai World's subsidiaries.[52] According to Reuters in December 2009, NBAD's exposure to the "Dubai World Group" was US$345 million total. General corporate loans amounted to US$100 million to real estate developer Nakheel and $125 million to Limitless, DW's other real estate firm. NBAD also has $114M invested in Nakheel's $3.52B sukuk due December 14, 2009 and $6M in the same sukuk, held in its trading portfolio and marked to market.[53]

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[49] As of June 30th, 2010

[50] "ADCB Reports Full year and Fourth Quarter Results." Press Release. Abu Dhabi Commercial Bank. Abu Dhabi, UAE. January 26, 2010. http://www.adcb.com/common/pr/2010/jan/fourth_quater.asp

[51] "Abu Dhabi Commercial Bank Reports First Half 2010 Financial Results." Press Release. Abu Dhabi Commercial Bank. . Abu Dhabi, UAE. July 31, 2010. http://www.adcb.com/common/pr/2010/july/First_Half_2010_Financial_Results.asp

[52] "Abu Dhabi, Dubai debt sales to put strain on Bonds-BofA." Bloomberg. November 25, 2010. http://www.arabianbusiness.com/abu-dhabi-dubai-debt-sales-put-strain-on-bonds-bofa-364185.html

[53] Uppal, Racha. "Factbox: UAE banks' exposure to Dubai World and affiliates." Reuters. http://www.reuters.com/article/2009/11/30/us-dubai-banks-factbox-idUSTRE5AT3JF20091130

Other Abu-Dhabi banks with exposure to the DW crisis have been identified: First Gulf Bank, owned by the ruling family of Abu Dhabi, the Al Nahyans; Abu Dhabi Islamic Bank PJSC; Union National Bank PJSC; and Al Hilal Bank.

CHART 7: EXPOSURE TO UAE DEBT BY COUNTRY

Foreign Claims (US$) on UAE by Nationality of Reporting Bank[54]	
USA	$10.62
Japan	$9.00
United Kingdom	$50.30
France	$11.30
Germany	$10.60
Netherlands	$4.70
Switzerland	$4.60

Source: Bank of International Settlements (BIS)

Due to the fact that the Bank of International Settlements does not break down the above claims by individual emirate, the above numbers do not accurately reflect foreign banks' exposure to just Dubai's debt. Additionally, most international banks do not disclose exposure on a country by country basis for the Middle East region, let alone disclose debt by the individual GREs they have invested in such as Nakheel or Dubai World; instead they report exposure by global region. However, a 2008 document from the Emirates Banks Association, named the top foreign banks lending in the UAE (see below). Though seemingly large in their absolute value, foreign banks UAE loans, when looked at as a percent of the banks' total loan portfolios are in fact considered manageable.

[54] Ishmael, Stacy-Marie. "European banks most exposed to UAE debt [UPDATED]." FTAlphaville.ft.com. November 27, 2009. http://ftalphaville.ft.com/blog/2009/11/27/85801/european-banks-most-exposed-to-uae-debt/

CHART 8: EXPOSURE TO UAE DEBT BY FOREIGN BANK

Foreign Banks UAE Loan Exposure (US$B)[55]	
HSBC Middle East Limited	17.0
Standard Chartered Bank	7.8
Barclays Bank	3.6
ABN-Amro Bank (RBS)	2.2
Arab Bank	2.1
Citibank	1.9
Bank of Baroda	1.8
Bank Saderat Iran	1.7
BNP Paribas	1.7
Lloyds TSB Bank	1.6

Source: Emirates Bank Association

Standard Chartered Bank appears to the only bank with significant risk exposure. According to Credit Suisse's November 2009 "Research Flash" published after the DW crisis, 14% of Standard Chartered's loan portfolio is in the Middle East, but only a little of it is actually in Dubai. The report also claimed that information from banks so far points to a limited impact in general and that many banks had hedged their exposure. The other banks' absolute exposure to UAE debt is either very small absolute value (e.g. BNP Paribas and Lloyds) or a fraction of the their regional loan portfolio (e.g. HSBC). HSBC's UAE exposure amounts to only 1.7% of the bank's regional group loans and only 11% of its UAE debt is in property.

[55] Schmid, Christine. "Research Flash: Potential Dubai Impact." Credit Suisse Equity Research. November 27, 2009.

BAILOUT - ABU DHABI COMES TO THE RESCUE

This section provides a description of the series of events that led to Abu Dhabi's rescue of Dubai, the surrounding media coverage and investor response to the bailout, and the questions the bailout raises.

Local and International Reactions to the Standstill

As noted earlier the official press releases and statements made by DW and the governments of Dubai and Abu Dhabi during the DW crisis did little to ease investors' worries or clarify the level of leverage and the parties involved. DW's first announcement of the "standstill" was made with little thought to timing - the Eid holiday in the Muslim world and Thanksgiving in the U.S. To make matters more confusing, just two hours before the standstill announcement, two Abu Dhabi government-related banks released US$5B to the Dubai FSF, a move that in many ways made investors feel slightly more secure after the shock of the DW standstill hit two hours later. Eckart Woertz of the Gulf Research Center, argued:

> The handling of the standstill request has revealed lack of professionalism and has done little to inspire the confidence of markets…Investors were left with the rumor will and statements by non-DW executives who revealed no further details…From a city that has aspired to become a regional if not international financial center by aspiring to best practices, markets had expected otherwise.[56]

The statements made by Abu Dhabi officials continued to fail investors, such as one Abu Dhabi official stating that the oil-rich emirate "will pick and chose" which Dubai enterprises to bailout.[57]

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[56] Woertz, Eckart. "Implications of Dubai's Debt troubles." Gulf Research Center. December 2009.
[57] Daya, Ayesha. "Abu Dhabi to 'Pick and Choose' Dubai Debt Support, Reuters Says." Bloomberg. November 28, 2009. http://www.bloomberg.com/apps/news?pid=newsarchive&sid=akVgK67kb0OA

According to Woertz many investors misplaced the blame for the information gap on financial analysts covering the Gulf instead of on the GREs themselves, the individual Emirati governments, and the federal government of the UAE. Though there are some instances in which analysts failed to do significant due diligence and financial crises or scandals ensued, their role and duty in Dubai debt crisis is very complex and opaque. As regional financial reporting is not as standardized or regulated as it is in say New York or London, analysts who cover the Middle East clearly cite this in their reports and in theory are factoring this lack of information into their risk rating and valuation of regional companies.

It could be argued that both analysts and the market failed to notice a series of minor, yet telltale events leading up to DW's standstill announcement. (See "Timeline of the Standstill" below). But high market exuberance and the belief that the Dubai market was somehow immune to the contagion to the global recession clouded investors' judgment and ultimately led to the "surprise" standstill announcement in November 2009.

CHART 9: Chronology of the DW Standstill Announcement

Timeline of the Standstill
2002: Dubai allows foreigners to buy property via 99-yr leases in designated areas. DIFC conceived and announced by Sheikh Muhammad
2003: Sheikh Muhammad appoints Ian Hay Davison as the chairman of the DFSA within the DIFC
2004: Beginning of bubble conditions in credit (foreign and domestic) and real estate. Federal laws are passed to allow for the actual establishment and function of the DIFC
June - Ian Hay Davison and Phillip Thorpe, CEO of the DFSA are fired for unexplained reasons
2005: Dubai International Financial Exchange opens within the authority of the DIFC
2008: May - Government of Dubai(GD) launches $4 billion foreign and local currency MTN program
June - ICD syndicated "Islamic" loan ($6 billion), guaranteed by GD
July - Dubai property prices peak. DW subsidiary Emaar completes construction of world's tallest tower
2009: February - Partial refinancing of loan ($2B) to ICD subsidiary Borse Dubai; ICD provides balance.
February - GD announces $20B FSF; first $10B to be subscribed by central bank
March - GD sells $10 billion bond to central bank of U.A.E.
April - Dubai Electric and Water Authority (DEWA) and Dubai Civil Aviation refinance $3B through sukuk and 18-bank syndicate
June 8 - DIFC and Thunderbird School of Management release a study of UAE family-run and owned businesses highlighting the need for better corporate governance
June 30 - Moody's downgrades Dubai Inc. issuers rating DP World, JAFZ, DIFC, DEWA, Dubai Holding
September 9 - Sheikh Muhammad says he is "not worried" about GD's ability to repay debt
September 10 - DW announces talks with core banks to reschedule $12 billion of debt, including Nakheel
September 17 - Nakheel's overseas property portfolio transferred to Istithmar World, subsidiary of DW
October 15 - DW cuts 15% of 70,000 staff to save $800 million over three years
November 4 - Moody's again downgrades Dubai GRE issuers
November 19 - Sheikh Muhammad removes three directors from the board of ICD - Mohammed al-Gergawi, Sultan Ahmed bin Sulayem, and Mohammad Ali Alabbar.
November 20 - Sheikh Muhammad replaces the governor of the DIFC, Omar Bin Sulaiman, with Ahmed Humaid Al Tayer
November 25 - GD issues $5B bond to two Abu Dhabi banks. Two hours later, DW asks for 6 mo standstill
December 8 - Moody's downgrades all Dubai issuers to non-investment grade
December 14 - Abu Dhabi extends $5B more to GD to pay Nakheel 09 fully and in time
December 21 - DW holds first meeting with steering committee of bank creditors
Sources: "Cutting through the haze." Morgan Stanley Research Report, "United Arab Emirates: 2009 Article IV Consultation—Staff Report." IMF, February 2010.

Another often underestimated factor that added to the surprise of the DW announcement were the popular reputations of Dubai and the Al-Maktoum family as entrepreneurs and advocates of free markets that the two had cultivated since the 1990's. Dubai was considered an entrepreneurial oasis for ambitious Middle East professionals and international young professionals looking for a fast-tracked career to wealth and power. The Al-Maktoums had created an charismatic authority around themselves for pioneering opportunity and free-trade in the region, while their regional neighbors wrestled with civil wars, harsh dictators, and general unrest and instability. Residents of Dubai both idolize and admire the royal family for their perusal of the advancement of the emirate and their "normalness." Sheikh Muhammad is considered "one of the people" as he is often seen driving himself around the city without security. Thus the debt standstill announcement was received with both surprise and disbelief by the many who viewed the Al-Maktoums and their kingdom with both respect and fondness.

Mechanics of the Bailout

On December 14, the day Nakheel's $4B sukuk was due; Dubai paid the bond back in full after Abu Dhabi offered its fellow emirate two last-minute $5B bailout bonds. The situation remained largely ambiguous until March of 2010 with rumors heating up in February of DW offering a 40% haircut and repayment after seven years to creditors. Following the market chatter, Dubai stocks plummeted and the government denied any such proposals.[58] Then on March 25, 2010 the Dubai government finally announced it would provide a US$9.5B lifeline to DW to aid its debt restructuring and DW presented an outline of a repayment plan to creditors. The March proposal would

[58] "Timeline: Dubai debt saga." Maktoob News. Yahoo Business. March 28, 2010. http://en.news.maktoob.com/20090000452546/TIMELINE_Dubai_debt_saga/Article.htm

restructure US$23.5B of debt, including converting US$8.9B of the government's debt investment in DW into equity. The restructuring plan also involved a cash injection of US$1.5B from the Dubai FSF and the issuance of two tranches of new debt to be repaid over five- and eight-year periods.

The seven core creditors to DW, who had lent close to 60% of the debt quickly formed a coordinating committee to hash out the broad terms of the repayment deal presented in March. Three months of extensive discussion with creditors followed the March announcement. In May they agreed in principle to DW's restructuring plan. But the final plan was not to be formally presented to all 73 of DW's creditors until July.

Investor anxiety remained high after the March announcement, as there was no explicit government guarantee on the debt structure nor had the interest rate of the new debt issues been made public. BBC's Middle East Business reporter, Malcolm Borthwick, said investors were further confused by the fact that "the trade creditors of Nakheel had been offered 40% of what they were owed in cash, with 60% in 'publicly traded securities,'" yet no exact details on these securities had been provided.[59] Dubai World also said it owed US$14.2B to creditors outside the support of the Dubai FSF, and these creditors would "receive 100% principal repayment" through the new debt issues, again no details on how they planned to make these payments was provided.

In July the final restructuring plan was presented to all 73 of DW creditors with the final date to sign the lock-up agreement set for September 9. All but one of DW's creditors signed the agreement, Aurelius Capital Management which had bought US$ 5M of debt in the secondary market. By missing the September deadline Aurelius would not receive the incentive fees paid to creditors that signed the deal in time. IN October

[59] Borthwick, Matthew. "Dubai World gets $9.5bn government backing." BBC News. March 25, 2010. http://news.bbc.co.uk/2/hi/business/8586473.stm

however, the New York Times' DealBook reported that Deutsche Bank had bought Aurelius' debt and that the restructuring deal was finally approved.[60]

Implications for the Prodigal Son

Since the standstill and ensuing vague announcements from the government of Dubai and DW, creditors to Dubai GREs have openly become concerned with three primary issues:

(i) Can DW and other GREs meet their future debt obligations?

(ii) Which GREs and to what extent will the government of Dubai (and in turn Abu Dhabi) cover unmet obligations going forward?

(iii) Considering Dubai's evolving bankruptcy laws, what sort of recovery rates can creditors expect if their debtors become insolvent?

Debt recovery in the region was in fact an issue even before the standstill announcement. The summer after Bear Stearns crashed, Standard and Poor's GCC group issued a report titled "Debt Recovery for Creditors and the Law of Insolvency in the UAE" because of "recent developments in the debt markets, including the deteriorating credit of some major corporate borrowers, the recent credit crunch and the implementation of Basel II guidelines."[61] Standard & Poor's classified the insolvency regime of the UAE as "Group B" in its global classification framework, the middle rank that nations can receive. Although a Group B designation generally implies recovery of 70%-90% of principal and accrued but unpaid interest at the time of default, Standard and Poor's was quick to point out "as of the time of writing there had never been a major

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[60] "Creditors Back Dubai World Debt Restructuring." DealBook, New York Times Online. October 27, 2010. http://dealbook.nytimes.com/2010/10/27/dubai-world-gets-full-support-for-restructuring/

[61] "Debt Recovery and Insolvency Laws Remain Untested in the UAE." Press Release, Standard and Poor's. August 18, 2008.

corporate insolvency in the UAE, the local laws and regulations relating to creditors' rights in the event of a debtor insolvency remained substantially untested."

Doubts of debt repayment, government guarantees, legal recourse, and in general long-term market recovery only increased after DW's November 2009 announcement in part due to the lack of direct action by the government of Dubai. Some of the steps that the government of Dubai and the federal government have taken indirectly addressed investors' fears. However, since the standstill announcement, there has not been an explicit or open dialogue with foreign investors on the aforementioned issues. Rather DW, other GREs, and the governments of Dubai and Abu Dhabi have taken an almost "closed door" approach to answering the questions that the international investment community has been asking.

In addition to investor's questions, the bailout of Dubai Inc. by Abu Dhabi raised several key economic and political issues for the sister emirates and their respective GREs to revolve. The issues revolve around two politically and economically based relationships: Dubai and her savior, Abu Dhabi; and Dubai's GREs, her government, and the international investment community. The two following sections will present and analyze the two aforementioned relationships concluding with this paper's main arguments.

EMIRATI RELATIONS: DUBAI RETURNS HOME TO ABU DHABI

The DW crisis brought to light several key economic and political issues between the sister emirates that had historically been pushed aside so as to present a more perfect federation to the international community. This section will briefly cover the recent evolution of the two emirates' relationship with Dubai as the "prodigal" sister emirate and Abu Dhabi, as the "big brother" or "mother-ship" emirate and conclude with the paper's first argument of the implications of the bailout in terms of Dubai's relationship with Abu Dhabi.

Dubai's Disregard

Though Islam is the official religion of both emirates, the culture of the two city-states has differed significantly in the last 20 years due in large part to Dubai's economic role as an entrepôt and international reputation as the regional entrepreneurial oasis. Because Dubai has historically tried to be a key node in the global network of trade, it has become home to many foreigners who bring with them their own cultures – a state characteristic of diversity that Abu Dhabi to some extent lacks. Those merchants and families, specifically the Iranian merchant families, who came in the early day of the emirates' history are now full UAE citizens and play important roles in the economy and government. However many of them retain strong ties to Iran – an important fact that will be discussed later on.

Though both emirates have invested heavily in real estate and tourism since the late 1990's, Dubai more so than Abu Dhabi, has wanted and needed to attract foreign companies, labor and tourists. Thus in order to keep foreigners in the city, Dubai was quick to create loopholes by which foreigners could enjoy some of their cultural norms

that run against traditional Muslim culture. For instance, drinking alcohol is strictly forbidden to nationals, however in hotels and other designated areas, foreigners are allowed to consume it. Although Abu Dhabi also lets foreigners drink and smoke in designated areas, its foreign population pales in comparison to Dubai's. According to an article in MEED, in 2006, the ratio of expatriates to nationals in Abu Dhabi was 3:1 while in Dubai it was 9:1, and the UAE average was 4:1.[62]

Some of the concessions Dubai has made to attract and keep its foreign population have gone against federal rule and since Abu Dhabi is the seat of the federal government these concessions are often viewed as transgressions against Abu Dhabi's rule. As the larger wealthier emirate, Abu Dhabi expected Dubai to be a more humble member of the federation. Instead the prodigal emirate continued to make entrepreneurial moves to diversify its economy - from building airports to declaring free zones – to the chagrin of Abu Dhabi. The mother ship to some degree considered these moves as challenges to the cohesion of the federation. She felt Dubai was promoting herself over the UAE as a whole, by building the largest tower in the world, the biggest indoor ski resort, a man-made island in the shape of a palm, and so on. Abu Dhabi's suspicions of Dubai are rooted in the two emirates' competitive history. Yet now that Abu Dhabi's superior position has been made evident to the world by: (i) its seat at the head of the government when the federation was formed, (ii) its role as the federation's bread winner when its deep oil reserves were confirmed, and (iii) most recently its rescue of Dubai Inc, she expects her wayward sister will toe the line.

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[62] Mirza, Adal. "Downturn requires employment rethink in Dubai." March 12, 2009. http://www.meed.com/special_report/2009/03/downturn_requires_employment_rethink.html

The Price of the Bailout: Dubai reined by Abu Dhabi

Though poorly managed from a PR and investor relations standpoint, Abu Dhabi's bailout of Dubai Inc. carries with it immediate political and economic consequences for the emirate of Dubai in terms of her relationship with sister emirate Abu Dhabi and her position within the federation of the UAE. Dubai must now "fall in line" – no longer the "prodigal son" allowed to start glitzy projects on another's dime, Dubai's penitence to Abu Dhabi will entail political and economic changes. On the political level both externally and internally Dubai must appear less "Dubai" and more "Emirati." The ruling family of Dubai, the Al-Maktoums, is going to have to promote the federation's and in turn Abu Dhabi's ambitions and not those of Dubai Inc.

Economically Abu Dhabi will at least indirectly control the direction of Dubai Inc. if not directly take control of some of the ambitious emirates profitable subsidiaries. Dubai's GREs may be forced to hand over her treasured and choice assets to Abu Dhabi, such as DP World, and make modest reforms of her emirate level laws to mirror with those of the federation and Abu Dhabi. If Abu Dhabi really wanted to put Dubai "in her place," the wealthier emirate could demand Dubai cut the growth of her state airline, Emirates. It has also been rumored in recent months that Abu Dhabi could also take a large equity position in Emirates and potentially merge the airline into its own. Etihad, Abu Dhabi's state airline, and the second biggest carrier in the UAE, has never posted a profit since its inception in 2004. Despite the airline's continued losses which in 2009 amounted to $9.4B,[63] it is seeking to rapidly expand its fleet and routes, thus it stands to directly benefit if Emirates were forced to cede some routes or curtail expansion plans.

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[63] Salama, Vivian. "Etihad unlikely to break even, CEO admits."Arabianbusiness.com. May 3, 2010. http://www.arabianbusiness.com/etihad-unlikely-break-even-ceo-admits-182515.html

If the name change of the Burj Khalifa is superficial evidence of a submission of Dubai to Abu Dhabi, then Dubai's recent enforcement of the UN sanctions against the Islamic Republic of Iran serves as further proof of the ambitious emirate's compliance. Dubai's history of rebuking Abu Dhabi's directive is most obviously depicted in the history of the UAE's relationship with Iran. Dubai has historical had warm relations with Iran due to its large Iranian population and significant trade ties. Over the last decade, Iran has consistently ranked number one or two as Dubai's top re-export market. Additionally some estimate that roughly 80,000 Iranians live in Dubai[64] and Iranians own 15% of the Dubai real estate market.[65] Dubai has ignored Abu Dhabi's guidance on international relations from early on in the history of the UAE. During the Iran–Iraq war (1980-1988), against the wishes of Abu Dhabi, Dubai supported Iran, while the six other emirates supported their fellow Arabs in Iraq. Dubai's ties with Iran have in turn drawn scrutiny from the U.S. and Western nations seeking to isolate Tehran over its nuclear activity. Abu Dhabi, who lacks the trade ties to Iran, on the other hand, has taken the side of the U.S. on the issue of sanctions in large part because of other GCC nations' support for the sanctions against the predominantly Shia Iran.

Dubai and Abu Dhabi's disagreement over how to deal with Iran came to a head in June of 2010 as the UN Security Council geared up for a fourth round of sanctions against the Islamic Republic of Iran. Two months prior to the final UN vote, Gulf Research Center analyst, Nicole Stracke predicted that the new sanctions would have an economic impact not only on Iran, but also on Dubai: "A new round of sanctions would

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[64] Dahl, Fredrik. "Sanctions squeeze Iranians in trade hub Dubai." Reuters. April 27, 2010. http://www.reuters.com/article/2010/04/27/us-iran-sanctions-dubai-idUSTRE63Q0U320100427?pageNumber=2

[65] Smith, Sam. "Dubai on track to grow trade by 15%." http://www.emirates247.com/business/economy-finance/dubai-on-track-to-grow-trade-by-15-2010-11-30-1.323100

deepen the problems in Dubai and make it more difficult for the economy (of Dubai) to recover."[66] Just over six months after the DW debt crisis, in June of 2010, the UAE signed the UN's a fourth round of sanctions against Iran.

Shortly after, the UAE's Central Bank ordered financial institutions to freeze accounts linked to dozens of firms named in the UN sanctions. UAE officials also significantly increased scrutiny of money transfers to Iranian banks such as Bank Sepah, which has ties to Iran's Revolutionary Guard.[67] Following the sanctions implementation, numerous Gulf correspondents and analysts reported significant distress in Dubai-Iran trade.[68] According to Morteza Masoumzadeh, the vice president of the Iranian Business Council in Iran, as many as 400 Iranian businesses in Dubai might have to close shop in the next 12 months.[69] According to Emirati news source "Emirates 24/7," in 2010 Dubai closed down the offices of 40 firms suspected of breaching the sanctions.[70]

Yet what defines this round of UN sanctions in the context of the Dubai-Abu Dhabi relationship is not that the sanctions may actually hurt Iran-Dubai trade, but rather that Dubai "toed" the federal line. Despite vocally opposing the sanctions, Dubai fell in-line with its sister Emiratis and upheld the sanctions. Six months after the sanctions passed, Sami al-Qamzi, director general of Dubai's Department of Economic

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[66] Dahl, Fredrik. "Sanctions squeeze Iranians in trade hub." Reuters. April 27, 2010. http://www.reuters.com/article/2010/04/27/us-iran-sanctions-dubai-idUSTRE63Q0U320100427?pageNumber=1

[67] Murphy, Brian. "Sanctions on Iran hit Dubai transporters, too." AP. March 1, 2010. http://www.washingtontimes.com/news/2011/mar/1/sanctions-on-iran-hit-dubai-transporters-too/

[68] Kenyon, Peter. "As Sanctions Squeeze Trade, Iran Looks For Options." Morning Edition, NPR. December 23, 2010. http://www.npr.org/2010/12/23/132264754/as-sanctions-squeeze-trade-iran-looks-for-options

[69] Dahl, Fredrik. "Sanctions squeeze Iranians in trade hub." Reuters. April 27, 2010. http://www.reuters.com/article/2010/04/27/us-iran-sanctions-dubai-idUSTRE63Q0U320100427?pageNumber=1

[70] "Most UAE banks stop money transfers to Iran." September 5, 2010. http://www.emirates247.com/most-uae-banks-stop-money-transfers-to-iran-2010-09-05-1.287821

Development, told Reuters "it's never an option to end trade with Iran." In near contradiction of his previous comment, when asked about the enforcement of the UN resolutions al-Qamzi said: "this is a federal issue, the UAE will comply with all the resolutions" and conceded that there is likely to be a negative "impact" on Dubai's economy as a result of the sanctions. [71] His contradicting statements highlight the dilemma that Dubai faced. Once the regional beacon for free trade with all nations, Dubai was ordered by her much wealthier sister emirate to sever ties with one of her biggest trading partners, Iran, and she has had trouble obeying orders, resisting them at least superficially.

Several regional analysts have also attributed Dubai's acquiescence on the Iran issue to a change in the relationship between Dubai and Abu Dhabi due entirely to Abu Dhabi's bailout of Dubai.[72] They argue that Dubai is being forced to follow Abu Dhabi "on a political level" because of her indebtedness to the wealthier emirate. Abu Dhabi has attached "political conditions to its financial rescue, including possibly seeking strategic equity stakes in Dubai assets and reining in Dubai's independence in foreign policy."[73] This argument, though well supported by several events post-crash (the Burj Khalifa and Dubai's acquiescence on Iran), is not fully proven. It should be of note that as part of the DW restructuring plan the government of Dubai will receive equity in lieu of repayment of principal in DW. Thus in essence if one is to assume that Abu Dhabi owns much of Dubai's debt, and the government of Dubai owns much of DW's debt, then at least indirectly Abu Dhabi already owns DW and its assets.

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[71] Fuchs, Martina. "UPDATE 1-Dubai will never sever trade ties with Iran – official." Reuters. December 1, 2010. http://www.reuters.com/article/2010/12/01/dubai-gdp-idUSLDE6B00TF20101201

[72] Eckart Woertz, Gulf Research Institute. John Sfakianakis, BSF-Crédit Agricole Group. Adal Mirza, MEED.

[73] Engalnd, Andrew and Simeon Kerr. "Abu Dhabi left with little choice." Financial Times. December 14, 2009. http://www.ft.com/cms/s/0/4d89b972-e8d9-11de-a756-00144feab49a.html#axzz1HYpiyVw7

To date, Dubai Inc. has yet to sell Abu Dhabi any of its most precious investments such as the MGM Mirage, DP World, or Emirates Airways. Rumors of sales continue to circle yet nothing has exchanged hands. This is due in large part to the fact that Abu Dhabi is facing a mini-economic crisis of its own and thus any seizure of Dubai's assets could be construed as the "pot calling the kettle black." Immediately after the DW standstill announcement in 2009, several of Abu Dhabi's own GREs were brought under public scrutiny for excess risk. Rating agencies quickly called for a re-examination of the debt and issuer ratings of the Abu Dhabi National Energy Company, Mubadala Development, the Tourism Development and Investment Company, the International Petroleum Investment Company, Aldar Properties, and the Emirates Telecommunications Company.[74]

Citing uncertainty over whether it could assume blanket government support for these entities in March 2010, Moody's did in fact downgrade the aforementioned GREs. More importantly Abu Dhabi's internationally recognized sovereign wealth fund, Mubadala Development, which holds positions in General Electric and the Carlyle Group, was forced to provide a $5.2B lifeline to Abu Dhabi's own real estate developer Aldar in January 2011. Thus Abu Dhabi is no longer above the fray in terms of fiscal responsibility and in turn her leverage over Dubai to extract concessions such as Dubai's choice assets is slightly lessened.

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[74] Harnischfeger, Uta. "Seven Abu Dhabi firms face debt review." The National. December 9, 2009. http://www.thenational.ae/business/banking/seven-abu-dhabi-firms-face-debt-review

DUBAI INC. & THE INTERNATIONAL INVESTMENT COMMUNITY

Before Dubai World's standstill announcement and the subsequent market crash, many international investors were either willing to accept or ignore the sub-par business practices of some Dubai GREs and regional companies. Investors' justification for investment in Dubai despite known poor business practices varied from investor to investor. Some rationalized that the poor corporate governance models and "closed door" business practices common in Dubai were simply part of the risk that came with an emerging market such as the UAE. Other investors who were cognizant of these poor practices and had witnessed one or two of resulting scandals, such as the DIFC leadership fallout in 2004, justified investing in Dubai with the "higher the risk, the higher the return" argument. While others who were also aware simply wrote off the poor corporate governance models either as growing pains of a transitioning economy or as traditional and cultural business practices that "worked" in the region. Additionally, as often observed in bubbles, market exuberance can overpower even the most conservative investors and encourage taking greater risks.

Investors have recently shown a willingness to leave Dubai until the city-state's business models and corporate governance structures are clarified, reformed, and regulated. If Dubai and in turn Abu Dhabi wish for the UAE to continue to be considered an "oasis" for international investment and trade, then they must institute and follow the best practices of international corporate governance. As one analyst put it, "forms of governance prevalent in the Gulf since the 1970s, which have developed fitfully and unevenly since, no longer seem well matched for the economic development activities,

plans and ambitions of regional states."[75] Dubai is troubled by business practices that are anachronistic, un-scalable, and sometimes unfair.

Dubai's crash highlighted business practices that are typical of small, closely-knit, family-oriented communities such as those of the Gulf nations and that have been in practice long before real estate developers even started dreaming of sail-shaped towers. The lines between government and private enterprise, and family and business, are blurred in Dubai. The city-state's nickname alone "Dubai Inc." is evidence of this confusion over ownership, regulation, and fair practices. Furthermore investors and creditors are "growing wise" to this characteristic of doing business in Dubai. Some investors are acting with their feet and Dubai is feeling the effect. According to Arabianmoney.net, a regional financial industry website, the economy and investment sentiment in Dubai may have finally reached their lowest points in 2010,

> …11 brokers closed this year; a top broker just resigned; volume is down 90 per cent; everybody is talking about how much they lost on Dubai property; capital spending is lower; interest rates are falling; hotel room rates are down; foreign fund managers have given up; there was a capital flight after a property crash; and Swiss bankers are very negative.[76]

As noted earlier, rating agencies have already downgraded over six Dubai GREs and are now examining Abu Dhabi's GREs. The agencies have pointed out the characteristic blurred ownership and support between government and private enterprise in Dubai as being the reason they can no longer imply from the government's actions implicit guarantees of GRE debt.

The following subsection will discuss the three key areas where best practices need to be implemented or improved - the division of Corporation and State; Corporation

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[75] Nicoll, Alexander. "Dubai's debt woes expose flaws in governance model." Strategic Comments, The International Institute for Strategic Studies. Vol 16, March 2010.
[76] "UAE stocks as the Trade of the Decade?" GCC Stock Markets. Arabianmoney.net. July 19, 2010. http://www.arabianmoney.net/gcc-stock-markets/2010/07/19/uae-stocks-as-the-trade-of-the-decade/

and Family (i.e. Corporate Governance); and Corporate Transparency - and conclude with this paper's final argument about the implications of the bailout for Dubai's relationship with the international investment community.

Blurred Lines: DIFC Scandal

The DIFC corporate governance scandal of the mid 2000's is good example of the poor delineation between state and private enterprise and between family and business. In 2002 Sheikh Muhammad's announcement of the creation of the Dubai International Finance Centre (DIFC) was well received by the international investment community as the Sheikh had emphasized the DIFC would be founded on best practices and would be designed and run by some of the most esteemed financial regulators and consultants in the world. In 2002 Naser Nabulsi, the former Investment Officer and Head of the Asset Management Group for The Executive Office of Sheikh Muhammad, was hired as CEO for the DIFC. Anis al-Jallaf, the CEO of Emirates Bank and chairman of both Dubai Investments PJSC and Union Properties, was made chairman of the board of directors of the DIFC. The same year Sheikh Muhammad asked Ian Hay Davison, to chair the Dubai Financial Services Authority (DFSA) - the highest body of the DIFC, which was responsible for drafting legislation for the DIFC, regulating the DIFC, and ensuring the integrity of the banking centre and financial exchange housed within the DIFC.

One of the most respected figures in international financial regulation, Davison is credited with restoring Lloyd's of London's reputation after a series of underwriting scandals in the late 1980's. Before accepting the position in Dubai, Davison, the "veteran of tough financial regulation," set up the new regulatory system for Hong Kong's Securities Committee. Sheikh Muhammad also hired Phillip Thorpe, the former CEO of the UK's Investment Management Regulatory Organization, as the new CEO of the

DFSA. Over the next two years, many other well-respected experts of financial regulation and governance were recruited to the DFSA to help build the DIFC.

On June 17, 2004, just two years into the DIFC's launch, the international press reported that Ian Hay Davison and Phillip Thorpe were immediately dismissed for undisclosed reasons. The announcement shocked both employees of the DIFC project and supporters of Dubai's ambitions as the two leaders had embodied the "world-class" regulation and governance that the new hub for financial services was supposed to be built upon. Shortly after his dismissal, Davison vocally drew reporters' attention to problems facing the DIFC. In an interview with Dow Jones Newswires, Davison said "I'm extremely disappointed that the efforts of my colleagues and myself to establish standards of corporate behavior in the DIFC have not been dealt with by al-Jallaf. He's dismissed my CEO and me rather than dealing with conflicts of interest at the DIFC."[77] A week before the two were fired, the DFSA had complained about conflicts of interest and dubious land deals at the DIFC. The DIFC's chairman, al-Jallaf, and another DIFC board member Majid Radpay apparently had arranged several insider deals.

Three companies linked to al-Jallaf received contracts: to develop the DIFC's properties, to provide all the glass for the new buildings, and to insure the centre's headquarters. Union Properties, whose board al-Jallaf is chairman of, received the rights to develop two of the 10 joint-venture-designated plots of land in the DIFC without a public tender. Radpay, on the other hand, had negotiated a $260M development deal between DIFC and Nexus Capital, a Swiss firm in which he was a large shareholder. People familiar with the situation said that the DFSA council had been objecting to the DIFC's corporate governance practices since August of 2003 and that after the firings,

[77] Kerr, Simeon. "Dubai Financial Center's Business Actions Draw Criticism." Dow Jones Newswires. June 21, 2004.

the members of the seven-person council claimed they would resign if they did not get the reassurances of their independence from the DIFC that they had been seeking.[78] The firings not only raised eye brows about the business practices of the DIFC's leadership, but also brought into question the very platform of the DIFC: to attract the largest international banks and the most prestigious financial institutions by being "the best-regulated financial centre in the world."[79]

When DIFC CEO Nabulsi was asked about the three inside deals, he said both the board and the government had been aware of them and therefore there had been no "conflict of interest." Nabulsi claimed "a conflict of interest means you hide something, but the minute you show it, it doesn't become a conflict."[80] According to the OECD's *Guidelines for Managing Conflict of Interest in the Public Service*, a conflict of interest is defined as: "a conflict between the public duties and private interests of a public official, in which the public official has private-capacity interests which could improperly influence the performance of their official duties and responsibilities."[81] Thus it is clear that regardless of al-Jallaf's or Radpay's action or inaction in the deals there was a conflict of interest between the board of the DIFC and the companies doing business with the DIFC.

Beyond both the poor corporate governance of the DIFC – the conflicts of interest and a compromised regulatory commission – the DIFC episode also highlighted the "closed-doors" business culture that is prevalent in Dubai. The decisions to fire the two

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[78] Kerr, Simeon. "Dubai Financial Regulators Seek Independence After Firings.." Dow Jones Newswires. June 24, 2004.
[79] O'Sullivan, Edmund. "Testing Times at the DIFC." Middle East Economic Digest. June 25, 2004.
[80] Kerr, Simeon. "Dubai Financial Center's Business Actions Draw Criticism." Dow Jones Newswires. June 21, 2004.
[81] "Policy Brief: OECD Guidelines for Managing Conflict of Interest in the Public Service." OEDC. www.oecd.org/dataoecd/31/15/36587312.pdf

very people hired to give the DIFC its "stamp" of financial integrity were made with little outside counsel or counsel of the parties involved. The other members of the DFSA were not consulted about the firings. Davison was reportedly fired by mobile phone while he was on vacation in France. Furthermore after the decisions were made DIFC's leadership gave little to no heed to the resulting media storm that the decisions created once the public found out. With press and investor scrutiny and criticism of the DIFC still high a month after the firings, Sheikh Muhammad personally intervened in the DIFC situation to start the damage control and salvage what was left to the DIFC's initial reputation.

The DIFC in 2004 and the DW debt announcement in 2009 highlighted another gap in Dubai's business model – investor relations and shareholder communications. Although "investor relations" is a recent addition to a "best practices" business model for public companies and more specifically for investment companies, it is a crucial element to building an efficient and transparent business that attracts investors. With the rise of the Internet as investors' primary source for financial research and news, investors now demand more information and instant information regarding business events such as changes of leadership, notices of new tenders, or announcements of reorganizations. If they wish to continue to attract foreign investors, Dubai companies ought to adopt a more robust investors' relations program, to enhance disclosure of events, and to increase transparency of decisions.

Messy Corporate Governance

As seen in the DIFC scandal, prominent businessmen in Dubai tend to wear many hats – CEO of one company, Chairman of a few companies, and large shareholder of many companies. Best corporate governance practices hold that the positions of the CEO and the Chairman should be held by different individuals. According to Professor

William Cunningham, a professor of Corporate Governance at the McCombs School of Business at the University of Texas, it is a general rule of thumb in corporate governance best practices that an individual does not sit on more than five boards from both the perspective of the individual and the company.[82] An indivdual is typically not capable of performing to the best of his ability the duties of a board member at so many difference companies as duties take both time and focus. A simple review of the manamgent teams and board of directors of Dubai banks, investment groups, and companies on Bloomberg.com revealed that many members of Dubai's prominent families hold more than five directorships, chairmanships and/or executive roles at different companies.

For instance, Ahmed Humaid Al Tayer, the latest governor of the DIFC is the Chairman and Director of two banks - the Commercial Bank of Dubai and Emirates Bank International. He is also the Vice Chairman and Director of Dubai Aluminum Company, Ltd, a Director of ICD and a Director of Emirates National Oil Company Limited.[83] Ahmed Humaid Al Tayer's family additionally owns and manages the Al Tayer Group, a privately-held, holding company with more than 19 companies under management, operating in 12 different countries in the region. Another example is the current CEO and Executive Director of the ICD, Mohammed Ibrahim Al Shaibani. He is also the Chairman and Director of Dubai Bank, the Chairman of the Board of Dubai Islamic Bank PJSC, the Director-General of His Highness' Ruler's Court, the Director of Emaar Properties PJSC, and SHUAA Capital, and a Member of the Board of Directors for Al Khaleej Investments

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[82] Author conversation with Professor William Cunningham. March 3, 2011.

[83] "Ahmed Al Tayer: Profile & Biography." Bloomberg Businessweek. http://investing.businessweek.com/businessweek/research/stocks/private/person.asp?personId=28509109&privcapId=11750651&previousCapId=11750651&previousTitle=Dubai%20International%20Financial%20Centre

(Singapore) and Amlak Finance PJSC.[84] In total he is wearing hats at more than seven companies and in some cases both an executive hat and a governance hat.

FAMILY MANAGEMENT AND FAMILY TIES

Some could argue that the intertwined and tightly knit, "closed doors" business culture of Dubai is due largely to the very small size of Dubai's business community. The mere size of the UAE's population is 8.7 million total and only 947,997 of those are full Emirati citizens as of 2010.[85] It could also be argued that the practices of private negotiations and wearing multiple governance and executive hats are a result of the UAE's culture and history of "family businesses."

Family businesses have been described as the "fabric of the UAE economy." The most obvious examples are at the top - the Al-Maktoums regularly appoint or offer members of the royal family and their inner circle positions in their personal investment vehicles, GREs, and government agencies. The UAE's family business culture stems in part from the region's historic tribal societies, which have been noted for their emphasis on "insiders" (i.e. family members or relations) who can be trusted, versus "outsiders" (i.e. non-family members) who are held with suspicion until they have been thoroughly vetted. This emphasis on individuals only being viewed as an insider or outsider can be seen in the UAE in how hard it is for a non-relation to hold an executive position in a family business and how little information family businesses in the region are willing to share with the public. Professor Ludo Van der Heyden of INSEAD explained this

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[84] "Mohammed Al Shaibani: Executive Profile & Biography." Bloomberg Businessweek. http://investing.businessweek.com/businessweek/research/stocks/private/person.asp?personId=25165943&privcapId=39090328&previousCapId=33776635&previousTitle=Dubai%20World%20Corporation

[85] "UAE population up by 65% in four years." Khaleej Times Online. April 2, 2011. http://www.khaleejtimes.com/DisplayArticle08.asp?xfile=data/theuae/2011/April/theuae_April59.xml&section=theuae

phenomenon: "it is difficult for people outside the system to get in. Firstly outsiders don't understand the system and secondly they're not invited in."[86]

TRANSPARENCY

In general, there is nothing wrong with a company that is owned and run soley by one family. However, in the case of the UAE, family businesses tend to be more resistant to adapting to the international changes in business best practices, more specifically in the areas of corporate governance and transparency. According to one regional business reporter writing about family businesses in the UAE:

> Their balance sheets are some of the most closely-guarded secrets in the country, so we cannot know exactly how each of them is performing, but looking at their public assets, it is easy to see that they dominate some of the key sectors, including automotive, real estate, fashion, and retailing.[87]

The media has long complained about Gulf businesses' lack of transparency and disclosure. But in light of the recent debt crisis in Dubai, international investors are making similar complaints. Without disclosure or even just a robust investor relations group in businesses and GREs, the press and investors are left with the "rumor mill" as noted earlier by regional expert Woertz.

Since the mid 2000's the UAE and the emirate of Dubai in particular have made notable efforts to increase the awareness of corporate governance best practices. For example, in 2004, the Hawkamah Institute for Corporate Governance, the first institute and think-tank for Corporate Governance in the region was launched in Dubai "to promote the core values of transparency, accountability, fairness, disclosure and

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[86] el-Baltaji, Dana. "Dubai: Business Culture in Question." Arab Media & Society. American University in Cairo's Center for Electronic Journalism. March 11, 2009. http://www.isn.ethz.ch/isn/Communities-and-Partners/Partners/Detail/?lng=en&id=97551

[87] "UAE: Family business - Generation game." www.7days.ae, August 17, 2005. http://www.zawya.com/story.cfm/sidZAWYA20050817092502

responsibility."[88] Hawkamah has strategic partnerships with many local and international institutions, including the DIFC, OECD, UAE Ministry of Finance and Industry, Centre for International Private Enterprise, IFC, the Union of Arab Banks, Dubai School of Government, and Young Arab Leaders.

The Institute has been proactive in its outreach and research – every year it holds a well attended conference on the topics of state of corporate governance in the MENA and in what ways can corporate governance be improved. Hawkamah has partnered with the IFC to conduct a survey of regional CEOs as "a reality check" on the state of executives' awareness of corporate governance best practices and the corporate governance reforms being introduced in the region. Research, education, and outreach are important first steps to building a business culture of corporate governance and transparency, as effective corporate governance systems cannot be implemented overnight in a region whose culture runs opposite to some of the tenets of fair and open governance. As Dr. Nasser Saidi, the executive director of the Hawkamah Institute, said "effective corporate governance systems require at least 5-7 years to take hold" and have to be "a joint effort between the private sector and the public sector."[89]

CRISIS AS AN IMPETUS FOR REFORM

The recent crash of the Dubai real estate market brought the tiny emirate's business practices under the increased scrutiny of the international press and investment community who have highlighted the entrenched poor business practices of both family-

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[88] Hawkamah Institute for Corporate Governance website: http://www.hawkamah.org/about_hawkamah/vision_mission_values/index.html

[89] Khouri, Rami G. "Governance Newsmaker Interview with Dr. Nasser Saidi." Governance Newsmaker, World Bank . Vol 3, Issue 2. June 2009. http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/EXTMNAREGTOPGOVERNANCE/0,,contentMDK:22191112~menuPK:4406842~pagePK:34004173~piPK:34003707~theSitePK:497024~isCURL:Y,00.html

owned and government-owned entities. The lack of strong corporate governance systems and transparency is not new to the UAE as evidenced by the DIFC scandal in 2004 and the region's history of "family business" business culture. Yet if Dubai truly wants to be the premier, world-class regulated center for finance and business that her leaders profess, reforms of her current business model and culture are necessary.

Abu Dhabi would be served well by a review of her own business culture as her state-owned entities are beginning to attract the same press and investor scrutiny that Dubai's entities attracted. In the long term Abu Dhabi would also be served well by supporting Dubai's efforts to re-establish itself as the foremost regulated and transparent center for finance and business as this will bring international investment and companies to not only Dubai but also the greater UAE.

CONCLUSION

The bailout of Dubai carries with it significant implications about the future of Dubai's Emirati and international relations on both a political and economic level. Abu Dhabi has leveraged her bailout of Dubai to rein in the ambitious and entrepreneurial Dubai both politically and economically. Already Dubai has conceded grounds on the issue of its relations with Iran and is rumored to be willing to cede its choice properties to her wealthier sister. At the same time, the bailout has increased international investors' scrutiny of Dubai's business practices and culture, bringing to the forefront the issues of Dubai's poor corporate governance and emphasis on the "family" model and culture of business. In the longer term, if Dubai and Abu Dhabi wish to continue to be an "oasis" for international investment and trade, they must institute and follow better corporate governance practices and communications.

If Dubai and Abu Dhabi do not reform their business communities, one would expect the initial flight of capital from Dubai to "safer" emerging markets to continue. However the popular uprisings in Egypt, Tunisia, Bahrain, Syria, and Yemen have proved this assumption wrong. Despite Dubai being considered an even "higher risk" emerging market as the depths of her debt and broken corporate governance were uncovered in her bailout, recent unrest and revolutions across the Middle East have led to a minor flight of capital and "holidaymakers" to Dubai. Companies in Egypt, Libya, and Bahrain have moved most of their non-local staff and executive teams to temporary offices Dubai. The international oil-field equipment-supplier Weatherford International Ltd transferred almost 200 employees and family from the Libyan capital of Tripoli to Dubai in mid-February of 2011.

International moving companies, private charter airlines, and international schools in Dubai are all seeing an uptick in business inquiries. For example, GEMS Education, the biggest private-education provider in the UAE with schools in Dubai, the rest of the UAE, and around the world, received over 60 emails and calls a day in April from families in Middle Eastern countries experiencing popular unrest.[90] Whether corporations' moves will become permanent has yet to be determined. With a leadership that never pauses "to look in the rear-view mirror," Dubai has been and continues to be a locus of rapid change – a place where skyscrapers can be built overnight and their financiers broke by morning. Or as one Dubai executive put it, "in a funny sort of way, Dubai's problems, the fact that they happened in 2009, is not a bad thing…today, that looks like history and today Dubai looks more like a safe haven."[91]

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[90] Sharif, Arif and Camilla Hall. "Dubai Advances as Middle East Turmoil Disrupts Lives, Commerce." Bloomberg. April 7, 2011. http://www.bloomberg.com/news/2011-04-06/safe-haven-dubai-gains-as-middle-east-turmoil-disrupts-lives.html

[91] Sharif, Arif and Camilla Hall. "Dubai Advances as Middle East Turmoil Disrupts Lives, Commerce." Bloomberg. April 7, 2011. http://www.bloomberg.com/news/2011-04-06/safe-haven-dubai-gains-as-middle-east-turmoil-disrupts-lives.html

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