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The Limits of Dubai

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Cambridge – Global investors are in a giant huff over Dubai's decision to allow its flagship private company Dubai World to seek a six-month standstill (implying at least partial default) on payments on some \$26 billion in debt. What exactly did investors expect when they purchased bonds in companies with names like "Limitless World," one of Dubai World's bankrupt real-estate subsidiaries? Talk about a bubble mentality.

The idea, I guess, was that the emirate's government would stand behind every loan, no matter how risky. And if the oil-poor Dubai government didn't have the money, then somehow its oil-rich sister state Abu Dhabi would cough up the cash.

An absurd expectation, one might think. But it is hardly more improbable than many of the other massive bailouts we have seen around the world in the wake of the recent financial crisis. What really upset investors, of course, was the realization that, yes, some day untenable debt guarantees will have to be withdrawn. Eventually, an over-leveraged world is going to have to find a way to cut debt burdens down to size, and it won't all be pretty.

There are those that revel in what they see as a come-uppance for brash Dubai's outsized ambitions. I, for one, do not share this view. Yes, Dubai, with its man-made islands, hotels simulating Venice, and roof-top tennis courts, is a real-world castle in the sand. Yet, Dubai has also shown the rest of the Middle East what entrepreneurial spirit can accomplish.

Its airport has become a global hub of such significance that German regulators recently had to force Emirates Airlines to raise its rates to Frankfurt, lest national champion Lufthansa lose too much business. And, with its relatively open goods and capital markets, Dubai has become a trading hub not only for the entire Middle East, but also for parts of Africa and Asia. On the eve of the financial crisis, other Gulf states had started to look to Dubai for insight into how they might diversify their economies and continue to thrive when the oil wells run dry.

Yes, Dubai is certainly an autocratic state where finances are tightly and secretively controlled. Indeed, lack of detailed information on the Emirates' finances was a central reason why the Dubai World default came as such a shock.

But, in many ways, Dubai's rulers have been remarkably tolerant of free expression. A year ago, I sat through an evening of presentations at the University of Dubai by local artists. One artist, an Emirati photographer, presented a visual time line of the construction of one of the stations of Dubai's new metro system. This local artist has lived through the stunning transformation of the city-state over the past 13 years, which has been driven by the kind of building boom that one associates with the fastest growing Chinese cities, not the Middle East.

Rather than simply praising the government's new constructions, the artist emphasized how jarring the change was to long-time citizens. How does one relate to the inanimate objects rising out of the barren yet majestic desert sands? Another artist presented a vision of how outside lighting could be used to transform minarets, and help them to stand out in the blur of modern buildings that characterizes the contemporary Middle Eastern city. His visions were magnificent, and apparently somewhat radical. One had to be impressed that such ideas could be expressed openly.

Anyone familiar with Dubai understands that these are but small examples of a much broader embrace of creativity that has allowed the country to court elite foreign professionals in finance and other industries. Much as in the United States, elite foreigners have played a key role in developing Dubai's various service industries.

Of course, other countries in the Gulf also have some stunning accomplishments to their credit. Saudi Arabia's national oil company has achieved homegrown expertise in oil drilling that is widely admired in the West. Qatar has had success in media with *Al Jazeera*, while Abu Dhabi has helped sponsor remarkable advances in artificial intelligence through its support of computer chess. But Dubai, with very little black gold of its own, has done more with less than any other state in the region.

Unfortunately, Dubai ultimately proved subject to the laws of financial gravity. This time was not different. Massive speculation and borrowing led to excessive debt burdens and ultimately, to default.

Is this the end of the road for Dubai's epic growth? I doubt it. Countries throughout the world and throughout history have defaulted on their debts and lived to talk about it, even prosper. There is no way around the need for Dubai to restructure and prune its excesses before it can resume a more sustainable growth trajectory, though achieving this will take time.

Will there be contagion to vulnerable countries in Europe and elsewhere? Not just yet. While the Dubai case is not different, it *is* special, so the effect on investor confidence should remain contained for now. But investors are learning the hard way that no country's possibilities and resources are limitless.

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