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Abu Dhabi economy tied to Brand Dubai and other United Arab Emirates

ABU DHABI had four powerful reasons for providing Dubai with $10 billion (€6.83 billion) in unconditional aid to bail out its flagship company Dubai World.

First, the aid solidified the seven member United Arab Emirates federation.

The policy initially adopted last month by Abu Dhabi of allowing Dubai to face its creditors on its own threatened to undermine the very existence of the federation. It was founded in 1971 by Sheikh Zayed al-Nahyan, the ruler of Abu Dhabi, and Sheikh Rashid al-Maktoum, leaders widely respected and revered in the Gulf. Their sons, the current rulers, Sheikh Khalifa al-Nahyan president of the UAE, and Sheikh Muhammad al-Maktoum, its prime minister and vice-president, could not be responsible for the union’s destruction. Although there is considerable rivalry between conservative, cautious Abu Dhabi and formerly high-flying Dubai, this had to be overcome.

Second, Abu Dhabi can afford to bail out Dubai. Abu Dhabi holds external assets worth $300 billion, more than three times Dubais estimated total debt of $84 billion. Abu Dhabis external public debt is estimated at a manageable $56 billion.

Abu Dhabi is in the midst of its own building boom and is buying up foreign properties cheaply due to the global economic meltdown. Abu Dhabi’s critics argue it has intervened too late.

Abu Dhabi’s economy is tied to that of Dubai and the other members of the federation. Abu Dhabi’s market has seen sharp fluctuations in stock prices since Dubai World announced its intention of postponing payment of $4.1 billion (€2.8 billion) in Islamic bonds. Although the contraction in Dubai has largely been contained within the country, there are repercussions in the property market elsewhere in the federation, which, as a whole, had a -0.2 per cent growth rate for 2009.

If, however, Dubai were to experience a meltdown because it cannot begin to pay its debts, the UAE could pay a high price. Growth could continue to decline instead of achieving the rates of 2.4 per cent for 2010 and 3.4 per cent for 2011 predicted by the IMF.

Third, Abu Dhabi cannot permit Dubai World to default on its Islamic bonds because this could destabilise the global Islamic banking and finance sector. It has tried to distinguish itself from the risky operations and practices adopted by Western banks and firms which precipitated the crash.

Islamic bonds or sukuk are touted as superior to other types of bonds because they are tied to actual assets and their return is regarded as rent rather than interest, which is prohibited under Sharia, Islamic law.

Islamic bankers argue that they are more conservative in placing investments and can be better trusted than conventional banks.

Therefore, a default by Dubai would deal a hard blow to Islamic banking, particularly because of the media frenzy over Dubai’s economic slide.

Recent sukuk defaults by a US firm, a Kuwaiti company and a major Saudi group have shaken the sukuk market but have made no waves on the international scene. A default by Dubai would have been the largest to date and would have had a huge negative impact. Abu Dhabi, which sees itself as an exemplar of correct Muslim behaviour, would not like to be the agent, by omission, of a catastrophic loss of credibility for the Islamic banking sector.

Fourth, glitzy “brand Dubai” has become the image of the UAE. Therefore, allowing the Dubai bubble to crash land would harm all its members since they have adopted some elements of “brand Dubai”.

In the shadow of the world’s tallest tower and largest mall, Abu Dhabi is building grand hotels, luxurious resorts and the world’s first experimental no-carbon emission city.