UNITED ARAB EMIRATES
Economic, Social, and Institutional Analysis
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EXECUTIVE SUMMARY

Grasping the economic environment of a country is important to businesses and organizations for several reasons, such as the timing and nature of decisions regarding investment and market expansion, or, conversely, divestment and downsizing. Here are three examples: delayed investment decisions during periods of overall economic expansion could mean a loss of market share that is difficult to redeem. Choosing the right kind of financing of strategic investments anticipating deflationary or inflationary tendencies may considerably reduce the real cost of funds. Recognizing structural economic changes early on can guide investment and provide an early mover advantage in expanding industries and segments.

With this economic and country analysis we aim to deepen the understanding of current conditions, underlying factors and choices that have created them, and future perspectives for the United Arab Emirates (UAE) Government, and, most importantly, for companies and organizations operating in or with - or planning to operate in or with - the UAE.

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The UAE has developed from a juxtaposition of Bedouin tribes to one of the world’s most modern and wealthy States in only about 50 years. This is not only thanks to the country’s oil reserves, which are the world’s seventh largest, but also thanks to a capable leadership making continued circumspect investments and a wide-ranging economic liberalization strategy combined with strong Government control. The UAE works as a modern State, grounded in tribal loyalties and Islamic values. UAE rulers are supreme in their decision-making power, so that policies can be implemented swiftly and with little bureaucratic delay. The Government operates guided by strategic plans that aim at balanced and durable development and prosperity for the country’s citizens; it has been able to achieve evident progress towards most of its strategic goals.

Economic growth has been impressive and steady throughout the history of this young confederation of emirates with brief periods of recessions only, e.g. in the global financial and economic crisis years 2008-09, and a couple of more mixed years starting in 2015 and persisting until 2019. Between 2000 and 2018, average real Gross Domestic Product (GDP) growth was at close to 4%. The UAE leadership has driven forward economic diversification efforts already before the oil price crash in the 1980s, and the UAE is nowadays the most diversified economy in the Middle East and North Africa (MENA) region. Although the oil and gas sector does still play an important role in the UAE economy, these efforts have paid off in terms of great resilience during periods of oil price fluctuations and economic turbulence. Unless global economic disruptions and regional tensions escalate, we expect growth to pick up again in the UAE in 2020-21, supported by expansionary fiscal policy interventions and new investor friendly laws.

As impressive as economic growth has been population growth in the UAE: the total population has increased from just about 550,000 in 1975 to close to 10 million in 2018. This growth is mainly due to the influx of foreign workers into the country, making the national population a minority. We expect population growth to gradually slowdown in the coming years. This is, on the one hand, due to a shift towards a knowledge-based economy and lower demand for labor in lower productivity sectors such as construction (also due to an asset bubble that has built up over the last years). On the other hand, this is also due to the effect of the country’s Emiratization policy, which will bring more nationals, Emiratis, into the labor force and private sector employment in higher productivity sectors, reducing demand for highly skilled foreign labor.

The UAE features a unique labor market system, in which residence in the UAE is conditional on stringent visa rules. This system is a major advantage in terms of macroeconomic stability, as labor supply adjusts quickly to demand throughout economic business cycles. This allows the Government to keep unemployment in the
country on a very low level of less than 3%, and it also gives the Government more leeway in terms of macroeconomic policies - where other governments often need to make trade-offs between fighting unemployment and fighting inflation.

Inflation has been picking up in 2017 and 18. Contributing factors were the introduction of a value added tax (VAT) of 5% in 2018 as well as higher commodity prices. Despite the Government’s expansionary fiscal policy and a growing economy in 2018 and at the beginning of 2019, prices have been dropping in late 2018 and 2019 owing to oversupply in some sectors of importance to consumer prices. We expect inflation in 2019 to remain below 1%, but to pick up again in 2020, as the Government will stay on its current course and growth will pick up.

The introduction of the VAT has provided the Government with an additional source of income - approximately 6% of the total revenue in 2018, or 27 billion United Arab Emirates Dirham (AED) - affording its fiscal policy more independence from oil and gas-related revenue, which constitutes about 36% of the total Government revenue. While the Government may still adjust the exact arrangement of the VAT, we do not expect any new taxes in the foreseeable future. Additional taxes would destroy one of the UAE’s main enticements for businesses to operate in the country and put a heavy burden on the economy.

The UAE’s monetary policy is in the service of stability and predictability, as the Central Bank of the UAE (CBUAE) keeps a peg to the US Dollar (USD) and moves interest rates close to the Federal Funds Rate. This policy makes sense in the current situation of global and regional economic and geopolitical uncertainty. Also considering the fact that exports have become the main driver of the UAE’s economic growth (the contribution of international trade to GDP grew from 31% in 2017 to 33.5% in 2018, outpacing overall GDP growth for the period), and the fact that the AED is currently undervalued, a departure from this policy - and particularly the peg - would negatively affect this important part of the UAE economy in the short term.

In the mid- to long term, however, we expect the UAE leadership to give up the peg. The peg will become less important, as the UAE transitions to a knowledge-based economy - and becomes yet more independent from the oil and gas sector (oil is currently still being traded not in AED, but in USD). On the contrary, it will become more and more important for the Government to have monetary policy at its free disposal to target inflation, shun too heavy reliance on taxes, and avoid situations where decisions on exchange rates and interest rates contradict fiscal policy measures - as has been the case in recent years, where monetary policy has limited fiscal policy effects on economic expansion. We expect that the UAE will take such a step-in coordination with other Gulf Cooperation Council (GCC) countries, in order to prevent a negative impact on exports.

Slower economic growth between 2015 and 2019 can be attributed to several factors affecting both demand and supply. The share of trade with Qatar is not big enough for the blockade to have had a significant impact in that context. Nevertheless, removing the blockade would lead to an expected output growth of 0.7% of GDP.

Within the UAE, prosperity is highly unequally distributed along geographic, national and gender factors, as well as skills levels. Nevertheless, inequalities do not show in the form of any remarkable social tensions, which is thanks to - among other factors - the leadership’s strong legitimacy, and cultural norms that tend to accept inequality. On the contrary, the UAE population ranks among the happiest globally. We do not expect this environment to change in any significant way, also because population growth should slow down a bit, reducing social pressure. It is important for businesses to consider such social and cultural factors, in order to successfully hire and manage people.

Proactive and farsighted leadership makes a difference in terms of laying the foundations for a country’s long-term development. The UAE offers businesses a strong enabling environment: stable political and macroeconomic conditions, a future-oriented Government, good general infrastructure and ICT infrastructure.
Moreover, the country has made continuous and convincing improvements to its regulatory environment and is generally a top country for doing business.

The weaker points remain the level of education across the UAE population, limitations in the financial and labor markets, barriers to trade and some regulations that hinder business dynamism. The major challenge for the country, though, remains translating investments and strong enabling conditions into knowledge, innovation and creative outputs. To do so, the UAE Government should continue removing obstacles to collaboration and trade, continue its strong and proactive course on educational and innovation policy and pursue further reforms in the labor market so that all available talent, including women, flows where it can add most value. As for businesses, they need to reckon with some constraints to getting highly qualified employees for the time being, which can make “importing” such employees necessary.

Considering their position in a natural-resources dependent region, characterized by perennial political and societal divides, the UAE finds itself in an intricate global, regional and local risk landscape. Major risks include the deteriorating international economic environment, with potential impacts on trade, and climate-inaction as well as climate-action. Additional challenges include a younger population, the expanding role of women, and the large expatriate population. The UAE has been taking credible steps internationally, regionally and nationally to enhance resilience, economy and governance and has shown a capacity to evolve in order to meet present and future demands. We give the country good chances that it will be able to continue its current path of success.

Where the Government’s effectiveness has been more mixed is in the area of environmental and climate-related policies. Nevertheless, sustainability is a priority for the UAE Government, backed by substantive funding and a number of initiatives, giving business a particular opening here to come in with environmental technologies and solutions.
INTRODUCTION:
GREAT LEADERSHIP THAT TRANSFORMED SOCIETY IN A CONFLICT-PRONE REGION
The UAE has developed into one of the world’s most modern and wealthy States in only about 50 years. This is not only thanks to the country’s oil reserves, but also thanks to a capable leadership making continued circumspect investments and a wide-ranging economic liberalization strategy combined with strong Government control.

How well the UAE will be able to continue its path of success, will depend on the steps the UAE is taking internationally, regionally and nationally to enhance resilience to global, regional and local risks - against the backdrop of the UAE’s position in a natural-resources dependent region, with longstanding political and societal divides. It will particularly depend on how consolidated economic diversification efforts will prove, and if a real shift from simple growth supported by government spending to a sustainable private sector-driven growth has happened. It will also depend on finding a balance between the efficiency of the current Government structure and the capacity to further develop Government in order to respond to an evolving society: keeping pace with a younger population, the expanding role of women, and the large expatriate population.

The UAE Government has constantly been evolving and learning, and has proven to be dedicated to making progress and delivering on results. It has initiated a series of measures to ensure a dialogue with changing parts of the population, instituting, for example, a Minister for Youth Affairs. A competitive knowledge economy, a first-rate education system, and a sustainable environment and infrastructure are anchored in the UAE Vision 2021 and backed by credible action. Furthermore, the UAE is an active member in numerous international organizations and processes. We believe that this forward-looking and multi-stakeholder approach is the best suitable to master technological, geo-economic and environmental challenges, maintain stability within the UAE and drive forward prosperity.
Gulf country with major expat population

The UAE is a federation of seven emirates, located in the East of the Arabic peninsula, opening to the Gulf in the North, and bordering to Saudi Arabia in the West and South, and to Oman in the East. Of the 83,600 square meters that the UAE comprises (including islands), 97% are desert.

*Figure 1 - Abu Dhabi is the biggest emirate in the UAE*

![United Arab Emirates map](source: Wikimedia Commons)

The population is thus mostly concentrated in the coastal areas. The two biggest cities are the capital city Abu Dhabi city and Dubai. Abu Dhabi and Dubai are also the emirates that are home to the biggest shares of Emiratis among the seven emirates.

The UAE’s total population is estimated at 9.6 million (2018 estimate). However, the number of Emiratis is relatively small compared to the number of foreigners residing in the UAE. Emiratis are descendants of a few tribal groups who have lived along the Gulf for centuries and share linguistic, religious and cultural commonalities with other Arab tribes on the Arab Peninsula. More than 89% of the population are estimated to be non-citizens, which documents a strong presence of expatriate labor in the country. Most foreigners come to the UAE for temporary work rather than for permanent settlement. Besides, the UAE Government seldomly grants citizenship or permanent residence to expatriates.

Foreigners come to the UAE not only from neighboring Gulf or MENA States. The largest share of expatriates - up to 70% of the UAE population - originate from South Asian countries. Among Arab expatriates those from non-GCC countries like Egypt, Jordan, Syria and Palestine constitute the biggest group. The British represent
the biggest share of OECD expats in the UAE. Overall, the major countries of origin are India, Bangladesh, Pakistan, Egypt, and the Philippines.

From Bedouin tent to global business hub

The UAE’s recent history gives insights into the character of society, economy and politics. Only about 50 years ago, the UAE looked nothing like it looks today - present day Abu Dhabi was quite literally a beach housing a little village of pearl divers. When the United Kingdom concluded a series of truces and protectorate agreements with the emirates of the Gulf to secure the trade route to India during the 19th century, these emirates were home mostly to Bedouins and fishers. There were no bigger cities and life was simple and traditional.

The first discoveries of oil off the coast of Abu Dhabi in 1958 did not change much of this reality at first, as Abu Dhabi’s leader at that point - Sheikh Shakhbut bin Sultan Al Nahyan - was suspicious of the riches and the push for modernization that they entailed. His brother, Sheikh Zayed bin Sultan Al Nahyan - known as Sheikh Zayed - took a different course when he took charge of Abu Dhabi in 1966. All while staying firmly rooted in the traditions of his emirate, he used the financial opportunities the oil reserves provided to bring foreign expertise and technologies and to invest heavily in infrastructure, education, health, and economy of Abu Dhabi, setting the course towards the nowadays UAE.

Backed by the world’s seventh-largest oil deposits, and thanks to such continued considerate investments combined with decided economic liberalism and firm Government control, the UAE has seen their real GDP more than triple in the last four decades. Nowadays the UAE is one of the world’s richest countries, with GDP per capita almost 80% higher than OECD average. Furthermore, the UAE is in the top ranks of several global indices, such as the World Bank’s (WB) Doing Business, the World Economic Forum’s (WEF) Global Competitiveness Index (GCI), the World Happiness Report (WHR) and the Global Innovation Index (GII). The Economist Intelligence Unit (EIU), for example, assigns the UAE rank two regionally in terms of business environment and 22 worldwide. From the 2018 Arab Youth Survey the UAE emerges as top Arab country in areas such as living, safety and security, economic opportunities, and starting a business, and as an example for other States to emulate.

Under the protectorate agreements, the United Kingdom led the foreign and security policy of the emirates along the Gulf. When the United Kingdom decided to withdraw from the region in 1968 it was thus not clear whether the emirates could secure their own territories – given a relative lack of experience in foreign and security policy, an absence of clear borders, and new claims to land laid in view of the oil discoveries. Sheikh Zayed entered into talks with neighboring emirates to join forces in a federation, to which Dubai, Sharjah, Ajman, Ras al-Khaimah, Umm al-Quwain and Fujairah agreed. In 1971 the UAE became an independent state. That the federation would survive was not a given, considering the often-adversarial relationships between the tribes of that region of the Arab peninsula. Owing to talented leadership especially from Sheikh Zayed, who ruled from 1971 until his death in 2005 as the UAE’s first president, the idea of a viable State solidified gradually.

Also, the way in which the UAE Government was structured from the outset played a role in this success: the UAE Constitution assigned sovereignty over fields such as economic and social policy and mineral and oil wealth to the individual emirates, and only key areas such as foreign and security policy to the federal level. In this way, the individual emirates could see a clear net benefit from this federal layer in terms of their own prosperity and viability. By and by, the constituent emirates were more willing to transfer responsibilities that proved to be necessary and useful to the federal entities.
Visionary and effective political and legal systems

The UAE’s modern political system has traits of the tribal societies that have characterized the Arab Peninsula for centuries - in which the ruler enjoys the respect and loyalty of his followers, but is in turn also responsible for their safety and welfare. It is a more patriarchal style of leadership that rests on political loyalties linked to tribal structures. A hereditary family is in charge of each of the emirates. These families chose an emir, the leader of an emirate, from among the family members. The seven emirs form, on the federal level, the Supreme Council. The Supreme Council elects, in turn, a President from among its members - usually the ruler of Abu Dhabi. The Supreme Council also appoints the federal Government, which is led by the Prime Minister. In this so-called Council of Ministers each emirate is represented by at least one Minister; the Prime Minister post normally goes to the emir of Dubai. The Council of Ministers initiates legislation for ratification by the Supreme Council.

Political parties are not allowed in the UAE. However, there is a unicameral Federal National Council, consisting of 20 appointed and 20 elected members, which is comparable to a legislative body, but has a consultative role only. Again, all emirates are represented in the Federal National Council. Although there have been a few calls for more political plurality in the country during the Arab uprisings in 2011, by and large, the population supports and has trust in the leadership and its vision and programs. The leadership’s legitimacy is grounded, among other things, in sound economic conditions and resourceful social development measures, including steps to bring about a world-class education system, a knowledge-based economy, and a robust sense of national pride and identity. There is also a system of consultation in place that allows all Emiratis to take part in regular audiences with the leading sheikhs. This seems to be a suitable mechanism of political engagement for the modest number of UAE nationals.

The UAE leadership is determined to evolve the country’s political and governance system in its own way and is approaching any democratic political mechanisms with considerable caution. This way of dealing with political progress can be understood by considering the lack of an electoral legacy and the historical tensions in the region. The combination of these factors has made elections divisive and risky affairs. There is little scope for trial and error. The UAE Government is concerned by the influence of Islamist organizations of various forms in the region, and there have been numerous arrests and convictions of individuals linked to such groups since 2011.

The UAE has not experienced any significant incidents based on social, ethnic or religious conflicts recently. The likelihood and potential for such violence remains low, although the UAE’s participation in the coalition fighting the IS in Iraq and Syria, its firm stance against extremist Islamic groups, and its involvement in the civil war in Yemen does make it a potential object of terrorist activities. The UAE Government carries out extensive surveillance and monitoring activities to forestall any such incidents. It also reacts swiftly and harshly against any violent and criminal activity in the country, for example by imprisoning and deporting non-national offenders, or by withdrawing citizenship of Emirati delinquents.

The leadership of Sheikh Zayed has set the tone for the UAE’s development: it is a country that embraces the opportunities that improve and sustain the living standard and quality of life for the citizens - for example liberalized trade - while honoring and protecting traditional religious and societal norms in a balancing act. The UAE legal system comprises both civil and Islamic laws. The ruling families’ legitimacy flows from tribal and religious norms, which thus reach into the political and legal system. The State, however, is built around modern, secular institutions. Shariah courts are implicated in personal status and criminal cases, as well as labor and commercial disputes.
The UAE leadership endeavors to maintain its heritage among a majority expat population, while cultivating a culturally tolerant and open mindset within the society. In the course of a 2016 restructuring of the cabinet the post of Minister of Tolerance was introduced, with the mandate of promoting tolerance as a value within the UAE and beyond. UAE officials consistently stand up for a moderate version of Islam and take an uncompromising stance against various forms of extremism.

UAE rulers are supreme in their decision-making and, thus, also wield great governing power. Policies can be implemented with little red tape, budgetary allocations are decided upon promptly, and Governmental bodies are put in a position that allows them to deliver on their objectives. This relatively nimble structure seems to have been well suited to catapult the UAE from a traditional society to one of the world’s richest and most progressive economies in absolute record time.

Among its many ambitious goals, the UAE has set itself the goal of becoming a global benchmark regarding the provision of Government services. The UAE Government’s work is guided by strategic plans with the overarching objective of achieving balanced and durable development and promoting its citizens’ prosperity. The central strategic planning document is the National Vision 2021, which is steadily kept up to date. It defines twelve key performance indicators for the country based on six clusters:

1. cohesive society and preserved identity
2. safe public and fair judiciary
3. competitive knowledge economy
4. first-rate education system
5. world-class healthcare
6. sustainable environment and infrastructure

The UAE leadership steadily reviews the Government’s performance, supported by the UAE State Audit Institution, which ensures that Government is managed efficiently. In 2015 a Government task force was put together to monitor and facilitate progress towards the goals stated in the Vision 21, followed by a Government restructuring in 2016. This reshuffling brought new structures and functions for key Ministries, the launch of several new Ministries of State responding to evolving economic and social demands, and the appointment of eight new Ministers, of which five women. Newly created Minister posts included those for Tolerance, the Future, Youth, Happiness and Climate Change.

On most of the clusters of the Vision 2021 the Government could achieve substantial progress, including on diversifying the economy, improving educational and health standards, promoting national identity, integrating innovation into national plans and becoming an involved and responsible member of the international community. However, there are some clusters under which progress has been slower. These include, for example, providing a sustainable environment and ensuring a fair judiciary. Underlining the coherence and future-orientation of the UAE leadership, the Vision 2021 is carried forward in the so-called UAE Centennial 2071. This document outlines vision and goals in four areas: future-focused government, excellent education, a diversified knowledge economy and a happy and cohesive society.

Given that the UAE has been a small and nascent state in a historically conflict-prone region, the country has generally been a moderate force in the region, trying to foster peace through shared economic progress and dialogue. The UAE is strongly supportive of positive regional and international relationships and makes consistent efforts to develop its foreign relations. Considering the rising tensions in the region, however, the UAE has recently started strengthening its military and security capability, and with its engagement in Yemen in 2015 it assumed a security and military role.
A complex risk-landscape

The UAE is nested in a multi-dimensional risk-landscape with local, regional and global elements. The MENA region is, according to a report by the WEF with the title *The Middle East and North Africa Risks Landscape*, particularly susceptible to disruptions from technological progress, environmental shocks, fractures between global and regional stakeholders and geo-economic tensions. This report uses data from the WEF Global Risks Perception Survey – a poll of stakeholders around the world – and responses to the WEF Executive Opinion Survey from business leaders in the MENA region to elaborate the following biggest risks facing the region.

A key risk factor in the short term is the deteriorating international economic environment, including economic conflicts between major economies and a disintegration of international trade rules and agreements. The International Monetary Fund (IMF) estimates potential trade disputes to be a major factor for lower economic growth worldwide. Trade plays a more important role in the MENA region than in the rest of the world: the trade-to-GDP ratio regionally is close to 80%, increasing the risk that the deteriorating economic environment holds. The UAE have an even higher ratio of trade-to-GDP of 170%.

*Figure 2 - Trade plays a crucial role in the Emirati economy*

Climate-related issues account for three of the top five risks by likelihood and four by impact over the next 10 years. These include the risks of extreme weather events, water crises, and failure of climate-change mitigation and adaptation. According to the WB and other international organizations, the MENA region is particularly vulnerable to climate change: it is one of the world’s most water-scarce regions, highly dependent on climate-sensitive agriculture, and concentrating a majority of its population and economic activity in coastal areas. More than 20 port cities in the region face a particular risk of rising waters.
Not only climate-inaction holds a risk for the region, but also climate action. If countries do indeed take measures that successfully limit global temperature increase to well below 2 degrees Celsius - as stipulated in the Paris Climate Agreement - global demand for hydrocarbons could drop from 100 million barrels per day to below 80 million barrels per day by 2040, according to models from the International Energy Agency (IEA). This will have serious repercussions for the MENA region, unless the regional economies effectively diversify away from hydrocarbons.

In late 2014 oil prices fell by more than 60% in only a few months, slashing the budgets of oil-producing States globally. Nevertheless, the UAE managed to accumulate only a minor budget deficit (1.3% of GDP in 2016 compared to 13% in Saudi Arabia) and to limit the decline in GDP to 0.3% (in 2016). Forward-looking investments in the years of high oil prices and economic liberalization and diversification efforts had paid off in terms of great resilience.

The UAE’s economy is the most diversified Middle Eastern economy.

Figure 3 - WMD’s and environmental risks could be devastating

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st</td>
<td>Weapons of mass destruction</td>
<td>Weapons of mass destruction</td>
<td>Weapons of mass destruction</td>
</tr>
<tr>
<td>2nd</td>
<td>Extreme weather events</td>
<td>Extreme weather events</td>
<td>Failure of climate-change mitigation and adaption</td>
</tr>
<tr>
<td>3rd</td>
<td>Water crises</td>
<td>Natural disasters</td>
<td>Extreme weather events</td>
</tr>
<tr>
<td>4th</td>
<td>Major natural disasters</td>
<td>Failure of climate-change mitigation and adaption</td>
<td>Water crises</td>
</tr>
<tr>
<td>5th</td>
<td>Failure of climate-change mitigation and adaption</td>
<td>Water crises</td>
<td>Natural disasters</td>
</tr>
</tbody>
</table>

Legend: Red = Societal, Orange = Geopolitical, Green = Environmental, Blue = Technological
**Figure 4 - Extreme weather events and other environmental shocks are likely to happen**

<table>
<thead>
<tr>
<th>Top 5 global risks in terms of likelihood (next 10 years)</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st</td>
<td>Extreme weather events</td>
<td>Extreme weather events</td>
<td>Extreme weather events</td>
</tr>
<tr>
<td>2nd</td>
<td>Large-scale involuntary migration</td>
<td>Natural disasters</td>
<td>Failure of climate-change mitigation and adaption</td>
</tr>
<tr>
<td>3rd</td>
<td>Major natural disasters</td>
<td>Cyber-attacks</td>
<td>Natural disasters</td>
</tr>
<tr>
<td>4th</td>
<td>Large-scale terrorist attacks</td>
<td>Data fraud or theft</td>
<td>Data fraud or theft</td>
</tr>
<tr>
<td>5th</td>
<td>Massive incident of data fraud/theft</td>
<td>Failure of climate-change mitigation and adaption</td>
<td>Cyber-attacks</td>
</tr>
</tbody>
</table>


Apart from these global factors there are also regional risks. The top two risks across the region for doing business are energy price shocks and unemployment or underemployment. Vulnerabilities to oil price fluctuations persist - particularly in those regional economies that have seen government spending rise. High youth unemployment has plagued the region over the past 25 year, standing at 30%, on average, in 2017. In the UAE, youth unemployment was around 8%. Nevertheless, if the other regional economies do not manage to integrate 27 million young people into the labor market in the next few years, this may lead to instability.
Figure 5 - Energy price changes hold the biggest risk for the MENA region

<table>
<thead>
<tr>
<th></th>
<th>Top 10 risks in MENA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Energy price shock</td>
</tr>
<tr>
<td>2</td>
<td>Unemployment or underemployment</td>
</tr>
<tr>
<td>3</td>
<td>Terrorist attacks</td>
</tr>
<tr>
<td>4</td>
<td>Failure of regional and global governance</td>
</tr>
<tr>
<td>5</td>
<td>Fiscal crises</td>
</tr>
<tr>
<td>6</td>
<td>Cyber-attacks</td>
</tr>
<tr>
<td>7</td>
<td>Unmanageable inflation</td>
</tr>
<tr>
<td>8</td>
<td>Water-crisis</td>
</tr>
<tr>
<td>9</td>
<td>Illicit trade</td>
</tr>
<tr>
<td>10</td>
<td>Failure of financial mechanism or institution</td>
</tr>
</tbody>
</table>


Figure 6 - Youth unemployment is comparatively low in the UAE

Source: World Bank, World Development Indicators

Some specific measures the UAE has taken in response to this challenging environment globally, regionally, and locally include the Abu Dhabi Sustainability Week, the World Government Summit, the Arab Start-up Initiative, the CLICKS Initiative, the Initiative for Global Prosperity, the UAE Business Council - a platform for exchange about policies, targets, and best practices in the area of environmental technologies for national
- rollout - and the UAE climate change platform - an initiative linking financing and private sector. The Shams solar power park, ambitious renewable energy targets, and annual sustainability and environmental prizes are further examples of measures to respond to environmental challenges.

The UAE has signed several international agreements, such as the Paris Climate Accord, and hosts the International Renewable Energy Agency (IRENA). At the United Nations (UN), the UAE is an active member, having put forward numerous initiatives on issues such as women’s empowerment, sustainable development, and internet governance. Regionally, it is an active member of the GCC, and has played a central role in bringing the States of the Gulf region on board with the Paris Climate Agreement. It supports the reform of the League of Arab States, and the work of the Organization of Petroleum Exporting Countries (OPEC) as well as the Organization of Islamic Cooperation.
MAIN MACROECONOMIC INDICATORS: DIMINISHING RELIANCE ON OIL AND LABOR SYSTEM AS COMPETITIVE ADVANTAGE
In this chapter we will take a look at the overall macroeconomic opportunities and challenges the UAE is presented with. We will compare the UAE’s economy to its peers and other relevant economies. Moreover, we will track the development of the economy, focusing predominantly on the past two decades, and establish where it is headed. The UAE is a fairly young country and does not have a long governance record yet. However, the leadership understood the importance of data for decision making from the beginning, and there is plenty of historic information starting from the early 1970s. The Federal Competitiveness and Statistics Authority (FCSA) is tasked with gathering and storing the data relevant to the country.

Main insights

As a young federation of emirates in a conflict-prone region, the UAE faces many challenges, historical reliance on revenues from oil being one of them. The UAE has been aiming at diversifying its economy from the outset, thanks to a forward-looking leadership. This approach made weathering storms possible that were crippling to other economies with similar starting positions.

The economy has been growing steadily since the UAE’s foundation, with only a few brief periods of recession and more mixed years starting in 2014/15 and persisting until 2019. The efforts to diversify the economy have been successful and this is a main reason for the UAE’s capacity to weather global economic crises as well as heavily fluctuating oil prices. Nevertheless, oil and gas continues to play an important role in the UAE economy. Between 2014 and 18, the accommodation and food, education, information and communication, arts and recreation, and real estate sectors overperformed in terms of growth, whereas the construction, logistics, professional services, public, and oil and gas sectors underperformed.

The UAE features a labor market policy that allows for rapid adjustments of the country’s labor force to changes in economic conditions. This, in turn, allows the UAE Government to keep unemployment on a low and stable level, which constitutes an advantage in terms of macroeconomic stability and flexibility. Overall, inflation has been low following the global financial and economic crisis years 2008-09, and, in late 2018 and 2019 deflationary tendencies manifested, mostly due to the impact of declining rental prices.

Outlook

Unemployment will remain low, as labor market policy will not change significantly, at least for the blue-collar workers in the country. Overall economic growth will pick up again: a growth rate of around 3% in 2020 appears realistic, but no growth similar to the tremendous expansion of the early 2000s. The oversupply in the real estate sector is an issue; growth in this sector in the longer term is in question, the construction sector is already experiencing slower growth. Following the trend throughout the 2010s, we expect inflation to remain fairly low, even when growth picks up again in 2020.

Population growth will likely slow down. More Emiratis, and more Emirati women, will flow into the labor force and into higher productivity sectors, reducing the demand for highly skilled expat labor. A shift in the economy away from lower productivity sectors, and a decline in the construction sector, will also reduce the demand for lower skilled foreign labor.

For businesses

In general, doing business in the UAE makes business sense, considering the stable macroeconomic conditions backed by unwavering Government support, and the positive economic outlook. Uncontrolled inflation has often been an issue for businesses in the UAE and the region. However, for the near future, we do not expect issues for businesses related to high levels of inflation.
Sectors to focus on are education, arts and recreation, which are relatively small, but growing fast. The food and accommodation sector has also been in rapid expansion. However, it is noteworthy that supply growth in accommodation currently outpaces tourism growth 2.5 to 1 (9.3% vs 3.9% for January 2019). Hotel prices are dropping because of that, despite the healthy growth in tourist arrivals. The real estate sector may look promising now, but the prospects are unclear.

**For the Government**

Stronger measures facilitating that the population can attain higher levels of education and that this higher skilled population successfully manages the transition from higher education into the job market can promote the necessary shift from lower to higher productivity sectors.

**A story of extraordinary economic development**

GDP – the most famous macroeconomic indicator – is used to express the size of an economy. The most intuitive way of calculating GDP sums up the value of all final goods and services produced in an economy. The value of intermediate goods and services is excluded from the calculation to avoid double-counting. The graph below shows how, in 2018, different sectors contributed to the UAE’s GDP.

*Figure 7 - Oil & Gas is still the dominant sector in the UAE economy*

The value of goods and services in an economy changes over time due to two factors: real changes in an economy’s output, or changes in the overall price level in the economy - that means inflation, or deflation. Consequently, there are two ways to express GDP: as real and as nominal GDP. The UAE’s nominal GDP in 2018 was 414.2 billion USD, and the real GDP 392.8 billion constant 2010 USD.
Historically, the UAE’s real GDP has been growing steadily, with few periods of contraction - notably in 2008 and 2009, the years of the global financial and economic crisis. The average growth rate was higher than that of many other countries - above a comparison to countries with roughly similar size, as well as other major economies in the region. The gap between the UAE and Austria has shrunk substantially over time, and the UAE’s edge compared to both Israel and Singapore is growing. Based on WB data, the UAE is currently the 29th largest economy worldwide. It is likely that the country will rise higher in the ranks in the near future, outdoing such regional players like Iran, and such prominent European countries like Norway.

Although GDP allows us to see the size of an economy, it is less useful for comparing the economies of different countries in terms of economic prosperity and living standards. Other things equal, a country with a bigger population will always have a higher GDP. GDP (nominal or real) is divided by the population to arrive at nominal or real GDP per capita (pc), indicating the average GDP per person, and making comparisons possible.
Figure 9 - Real GDPpc shows a downward trend

Source: World Bank, World Development Indicators

“Population” refers to residents as defined by the WB - based on de facto status and excluding refugees who are not permanently settled - rather than to citizens. For many countries this distinction may not be that important. But for the UAE, where expats outnumber Emiratis almost 9 to 1, this distinction is important. For all the pc calculations, we use population numbers provided by the WB (according to the WB, the UAE reached a population of 9.6 million in 2018).

Nominal GDPpc for the UAE, expressed in current USD on the graph above, shows an expected (albeit slow and interrupted) upward trend. Nominal GDPpc increased from just above 30,000 USD per person in 2001 to just above 40,000 USD per person in 2018. It is quite volatile, reflecting financial and economic turbulences – the significant dip in 2009 can be attributed to the effects of the global financial and economic crisis starting in 2007, and the decline in the years 2015-2016 coincides with the crash of oil prices in that period.

Real GDPpc behaves in a peculiar manner, however. Average output per person is shrinking, not growing, as could be expected for a successful economy with a compound annual growth rate of close to 4% in the discussed period (more about growth rates below). Only from 2010 until 2016 is there an upward trend in real GDPpc, until it levels off again in 2017. There is an especially marked drop (15.2%) in 2009, reflecting the aftermath of the global financial and economic crisis. In 2010 the trend reversed, partly due to a slowdown of population growth between 2007 and 2014, but mostly due to a rapid economic recovery and significant economic output improvement. This continued until 2016, when real GDP growth slowed down again.
One explanation for this development is the UAE’s rapid population growth, due to the influx of foreign labor. The country relies on expat labor since its early years. Looking at the next graph, we can clearly see the inverse relationship between the rapid population growth that has happened in the UAE in the last 18 years, and real GDPpc.

Source: World Bank, World Development Indicators

Figure 10 - GDPpc was growing from 2010 - 2016

Source: World Bank, World Development Indicators

Figure 11 - GDPpc shows an inverse relationship with the population size

Source: World Bank, World Development Indicators
This relationship is even more apparent, when we compare GDPpc with the growth rates of GDP and population. We can see that real GDPpc grows when the growth rate of GDP outpaces the growth rate of the population (and vice versa). Whenever the real GDP growth rate is high enough to offset population growth, we see an increase or at least a levelling off of real GDPpc. Whenever real GDP growth is weak or negative, however, real GDPpc takes a deep dive.

*Figure 12 - GDPpc grows when GDP increases faster than the population*

To add an additional element, we can take a look at employment data. The sectors, into which most of the growing population flows, are predominantly low productivity sectors, like construction. As the amount of people employed in such sectors grows, GDPpc naturally drops. We can conclude that the population is growing mostly through the influx of low-paid labor.
Figure 13 - Low productivity sectors, like construction, contribute to the GDPpc decline

The above table shows 3.9% growth of real GDP year-over-year in the UAE over the last 18 years. In total, the UAE’s output has doubled in that period - real GDP has increased by more than 98%. For comparison, the USA’s output grew by 41%, and the Euro area’s output by 25% in the same period. Nevertheless, real GDPpc has fallen steadily in the UAE for the past 18 years: 2.2% on average per year, and 36% in total over the period.
Figure 14 - Real GDPpc is decreasing, while real GDP is growing

The decrease of real GDPpc in the UAE is not a recent phenomenon, but a longer-term trend. To give an order of magnitude: in 1975 the UAE’s population was 548,301; five years later it had almost doubled, reaching 1 million. Population growth has thus been continuously driving GDPpc down in times of insufficiently strong economic growth. In the graph above we can see a first peak around the year 1980, before both real GDP and real GDPpc started to decrease until around 1988. In the 1970s the UAE was still mostly unknown to a wider public in the West but was already enjoying the dividends from oil extraction (oil exports started in 1962, but the significant developments in the oil and gas sector happened in the 70s) and popular reforms of the late Sheikh Zayed. Moreover, as the graph below demonstrates, oil prices spiked in late 1973 due to the OPEC oil embargo, positively affecting UAE oil revenues in the years that followed.
Figure 15 - Oil price fluctuations significantly affect the economy

Source: World Bank, Commodity Markets

In 1980 the oil glut began. Oil prices slumped and remained low until 1998 - as the graph above shows - driving the UAE’s oil revenues down and leading to a contraction in the economy over the following eight years. The economy of the UAE, expressed in real GDP, shrank by about 25% in the 80s, but real GDPpc decreased by almost 50% during the same period.

Unlike other oil-dependent countries, the UAE realized early the need for diversification. Dubai’s ruler had already invested in building the emirate up as a trade hub before the unification of the UAE. As early as 1972 the UAE kept pushing investments in trade, by building the Port Rashid in Dubai. In 1979 the Jebel Ali Port was completed, and in 1985 the first GCC free zone was established – Jebel Ali Free Zone. The decade of the 1980s was an important transition period for the UAE economy. With the opening of Abu Dhabi airport in 1982, Fujairah port in 1983 and the launch of the Emirates airline in 1985, diversification efforts soon proved fruitful. Starting in the year 1989, the economy was expanding again. The graph below depicts the UAE’s diversification efforts, by showing the changing composition of GDP over time. In the Agenda 2021 the country has set itself a goal to further increase non-oil real GDP growth.
Figure 16 - The importance of non-extractive sectors is increasing

During the 90s real GDPpc remained stable – strong economic growth, despite low oil prices, was offsetting the effects of population growth. The Asian financial crisis of 1997 had almost no effect on the UAE’s economy. In the 2000s the UAE continued to see the effects of its diversification strategy. Oil prices were soaring at that time, and it could thus appear that, throughout the 2000s, the importance of the oil industry was growing again. Yet, if we adjust revenues from oil and gas for the change of prices (taking 2005 as the base, where the oil price index is 1), we can see that the importance of the oil industry for the UAE has indeed been steadily dropping since 1991.

Source: Federal Competitiveness and Statistics Authority, National Accounts
Figure 17 - The UAE has followed a diversification strategy since its early years

In 2006 the country’s economic growth peaked at 9.8%. The value added of the non-oil sector grew by 9% that year and by 9.3% in 2007. Considering the country’s status as the financial capital of the Middle East, the financial and economic crisis of 2007-2008 caused a major asset sell-off, prices were tumbling, numerous infrastructure and development projects were canceled, and banks stopped giving out loans that could have provided a boost to the economy that contracted by 5.2%. Global supply chains were severely impacted, and the manufacturing industry was affected the worst, shrinking by 14.1%. Real GDP per capita tanked, decreasing by 14.8%. Yet, the economy recovered fairly well, and in 2010, the UAE saw already a robust 1.6% of growth, followed by an outstanding 6.9% in 2011 - an upward trend that has since continued.

Considering that, despite all the diversification initiatives, 26% of the Emirates’ GDP is still based on oil and gas, it’s no wonder that the oil price decline that started slowly and innocuously in 2012 and ended in oil losing more than half of its peak value in 2014-2015 caused economic growth to slow down. This price slump was followed by a decline in another important sector: real estate prices in Abu Dhabi and Dubai started to drop due to a supply glut, and the trend still continues as of spring 2019. Also, the introduction of a VAT in 2018 dampened growth.
Table 2 - Accommodation & food was the fastest growing sector in the 2014-2018 period

<table>
<thead>
<tr>
<th>Fastest growing sectors</th>
<th>Growth</th>
<th>Slowest growing sectors</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accommodation &amp; food</td>
<td>6.7%</td>
<td>Construction</td>
<td>0.6%</td>
</tr>
<tr>
<td>Education</td>
<td>5.5%</td>
<td>Logistics</td>
<td>0.8%</td>
</tr>
<tr>
<td>Information and communication</td>
<td>5.2%</td>
<td>Professional services</td>
<td>1.2%</td>
</tr>
<tr>
<td>Arts &amp; recreation</td>
<td>5.1%</td>
<td>Public</td>
<td>1.5%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>5.0%</td>
<td>Oil and gas</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

Source: Federal Competitiveness and Statistics Authority, National Accounts

We can see growth rates in the mentioned and other sectors in the table above, which captures the compound annual growth rate (CAGR) based on constant 2010 prices. The accommodation and food sector is the fastest growing one - it outpaces the overall GDP growth rate in the same period almost by 160% (6.7% and 2.6% respectively). Hotels are expanding in preparation of the EXPO 2020, room supply outpaces demand, and this causes a downward pressure on hotel prices, which show a steady decline in the past several years. Two other big sectors that showed outstanding growth in the past five years are real estate (5.9% of 2018 GDP and 5% CAGR) and information and communication (3% of 2018 GDP and 5.2% CAGR). Education, arts and recreation are smaller sectors, but had high growth rates, too. On the other hand, the construction sector shows the worst growth rate: 0.6% CAGR, which is more than 4 times lower than overall GDP growth in the same period. The professional services sector, which is usually closely linked to the state of the economy, also shows a subpar growth rate of 1.2%.

Despite all this, the economy in the UAE is growing. In 2017 real GDP growth was 0.8% and in 2018 1.4%. This could quickly change, however. The rising tensions in the region and beyond can affect investor confidence, and the popularity of protectionism could hurt the UAE as a trade and finance hub. On the other hand, such negative effects could be partly offset by an increase in oil prices, which usually follows rising tensions in this particular part of the world.
Figure 18 - GDPpc PPP shows that the UAE enjoys a lower cost of living than the USA

Source: World Bank, World Development Indicators

On the graph above we can see that the UAE’s real GDPpc is significantly higher when expressed in international dollars than when expressed in USD. GDP expressed in terms of purchasing power parity (PPP) removes the influences of exchange rate fluctuations and differences between countries in price levels from the picture. PPPs measure the total amount of goods and services that a single unit of a country’s currency can buy in another country. Overall, real GDPpc and real GDPpc PPP move more or less in parallel, although the gap between them has decreased in the last decade. The existence of this gap means that the cost of living in the UAE is overall lower than in the United States, and that the AED has actually a higher purchasing power in the country. The gap shrinks when the relative price level approaches the nominal exchange rate and increases when the relative price level moves away from the nominal exchange rate. As we will see later, when discussing monetary policy, the AED is currently, because of the peg to USD, undervalued.
Unemployment historically low in the UAE

**Figure 19 - Unemployment in the UAE is in the low single digits**

The UAE’s unemployment, due to the country’s visa sponsorship system (also known as *Kafala*), is relatively low. This system forces a person who lost his or her job to find a new one quickly or leave the country. The effects of such a policy can also be seen on the basis of the labor force participation rate on the graph below.

**Figure 20 - Emiratis participate less in the labor force than expats**

**Source:** World Bank, World Development Indicators

**Source:** Federal Competitiveness and Statistics Authority, Labor Force Statistics
First of all, we can see that although over 90% of middle-aged Emirati men participate in the labor market, this rate is still lower than that of non-Emirati men. Non-Emirati men maintain an almost 100% participation rate for most of their adult lives in the UAE. Differences in labor force participation are more apparent at the ends of the age spectrum. Young Emirati men have less pressure to start a career - they enter the job market later - and Emirati men tend to retire significantly earlier than non-Emiratis.

Second, Emirati women between 25 and 40 participate in the labor market almost at the same level as non-Emirati women. This shows that, in general, the younger Emirati female population has both a desire and a possibility to be a part of the country’s labor force, but also that overall female participation is still about 30% below male participation.

For the most part, unemployed people in the UAE are frictionally unemployed; frictional unemployment is natural unemployment that exists due to the time workers spend in job search and/or decision making in the course of normal economic and professional change. Due to this fact, the country has enjoyed an unemployment rate that most other countries can hardly replicate: an average of 2.28% for the past 28 years with a peak of 3.12% in 2005. The peak cannot be attributed to any crisis – the economy was going through a period of rapid expansion at the time. The trend suddenly reversed when another effect of the rapid expansion - inflation - came into play. On the graph below, we can see that even the financial crisis of 2008 and the recent economic slowdown did not affect unemployment much.

*Figure 21 - Unemployment remains low regardless of economic ups and downs*

![Unemployment and GDP growth](chart.jpg)

*Source: World Bank, World Development Indicators*
Youth unemployment is higher - which can be attributed to the fact that children under 18 are treated as dependents and allowed to stay under parents’ visa - but follows the general trend closely. The picture changes when considering gender aspects: female unemployment is significantly higher. One reason for such big differences could lie in the fact that married expat women often come to the UAE on a spouse visa and, as dependents, are not subject to the same pressure in finding a new job quickly, thus spending more time looking for a role. Wives wanting to sponsor their husbands face more limitations; for example, depending on the emirate, an expat woman can only be an engineer, a teacher, or a doctor/nurse.

Education is not a guarantee for a job in the UAE - on the whole, the majority of unemployed have some sort of post-secondary education. Yet, the share of unemployed differs significantly between post-secondary non-tertiary, bachelor or equivalent, and higher education: there seem to be obstacles for persons with a lower tertiary education to make the step into the job market. Education makes a big difference between Emiratis and non-Emiratis. Lower educated Emiratis are struggling to find a job, when compared to non-Emiratis - or do not find jobs they consider attractive. However, the situation reverses when Emiratis gain post-secondary to tertiary education: the percentage of unemployed Emiratis at these levels is significantly lower than that of non-Emiratis, which can be attributed to the Emiratization policy in the country.
Despite various changes to the UAE visa rules, including longer employment visa and visas for students, and external pressure, it is unlikely that the system will be abolished or changed in any major way in the foreseeable future. Drastic change would mean a significant impact on the UAE’s economic model, in which the labor market’s ability to adjust quickly to demand plays a central role, and the Emiratis’ way of life. There are neither welfare mechanisms for non-citizens, nor State revenue sources to support them. More importantly, changes could tip the population disbalance more towards immigrants, risking tensions between...
population groups. Considering that there are no economic gains and only minor political ones, but some major drawbacks for the Emirates, we can expect that the system that keeps the unemployment rate low will remain in place in the longer term.

The UAE’s economy is nowadays about six times as big as in the 1970s. The UAE’s small national population could not have provided the savings and human capital needed to make such impressive economic development possible. The breathtaking growth rests on two factors that are unique to the region: wealth in natural resources and availability of cheap labor. These two factors have enabled the UAE to catapult its citizens out of poverty, and leapfrog to modern infrastructure, industries and social welfare systems, by bypassing the slower process of capital accumulation necessary for economic development in other regions.

As the Emiratization policy and the Government’s work towards a knowledge economy start to bear fruit, we will see more and more Emiratis in the labor market. The younger generation of Emiratis is more educated than ever, and both genders are interested in being an active force in the country's development. The average labor participation rate of UAE nationals will increase, partly reducing the need for imported workforce in the higher skilled jobs. The blue-collar segment will continue to rely on guest workers.

Fluctuating prices have little effect on employment

*Figure 25 - Prices were growing moderately in the last decade*

Prices of goods and services change over time, reflecting different developments in the economy; the change in the overall price level is called inflation. There are two main approaches to measure it: by means of the GDP deflator and the consumer price index (CPI). The GDP deflator shows changes in price levels only for domestically produced goods and services. The CPI focuses on the overall price level of goods and services that affect consumers; it can include imports. The graph below shows the composition of the UAE’s consumer basket used for calculating the CPI.
**Figure 26 - Rent, utilities and transportation play the dominant role in the CPI**

Composition of consumer basket in UAE as per last update (2014)

Source: Federal Competitiveness and Statistics Authority, Consumer Price Index Statistics

The consumer basket in the UAE is developed by the FCSA based on the Household Income and Expenditure Survey. The last update to the consumer basket was done in 2014, replacing the basket from the year 2007. While the consumer basket is established only periodically, by a government authority, the GDP deflator reflects changes in consumer patterns automatically. There are separate CPIs for each of the seven emirates, as well as the UAE as a whole. Unlike the majority of OECD countries, the UAE does not have a long-established history of inflation tracking through the CPI, nor in inflation targeting (as the AED is pegged to the USD, and monetary policy is not primarily used to control inflation).

Usually, GDP deflator and CPI show a similar picture: prices were soaring for the biggest part of the previous decade until the global financial and economic crisis. In 2009 inflation dropped significantly; the GDP deflator saw the most dramatic drop, reflecting the price changes of domestically produced goods and services, amplified by the significant decrease in prices of the main Emirati export - oil. In the post-crisis years there was minimal inflation of about 1%. Price levels for the entire economy were changing faster, following the lead of oil. The sharp increase in the CPI in 2014-2015 is due to the sudden spike in housing prices in Q3 2014 and the removal of water and electricity subsidies, which together weigh heavily on the entire consumer basket. In January 2015, along with the drop in oil prices, the housing market plummeted, inducing an economic slowdown - and lower inflation. The GDP deflator moved dramatically in the opposite direction, influenced, once again, by the oil industry. The decline of rental prices, especially in the emirates of Dubai and Abu Dhabi continued to exert pressure on the CPI in the years 2016 and 2017. The rising CPI in 2018 coincides with the introduction of the VAT on 1 January 2018.
These ups and downs in the price level did not affect unemployment much. We can see to a limited extent the typical dependency – employment is growing when inflation is increasing and is dropping when inflation is decreasing. Yet, even the sudden drop in inflation in 2009 correlates only with a marginal increase in unemployment. The same labor market response can be seen in the 2015-2017 period; it can again be explained by the UAE’s particular labor market system, which allows for a rapid adjustment of the labor force to changes in economic circumstances.

As expected, the youth unemployment rate shows a higher volatility - young people with less experience usually have more difficulties finding a job and they are the first to be fired when businesses experience problems. For this reason, as a general rule, youth unemployment serves as a good indicator of challenging times in the economy. We can see a sudden increase in youth unemployment in 2009, following the global financial crisis. But more interesting is the year 2017: the economic slowdown that started in the UAE in 2014 and entailed different issues in subsequent years led to a restructuring of the labor market visible in the graph below.
Figure 28 - Youth unemployment highlights the economic difficulties of 2017 and 2018

Source: World Bank, World Development Indicators and Federal Competitiveness and Statistics Authority
(IN)EQUALITY AND SOCIAL INDICATORS: DIVERSE YET STABLE SOCIETY THAT LEADS PROGRESS IN THE REGION
In this section we will look beyond the economic indicators of the previous section. We look at how economic prosperity is allocated across the society, and at how it translates into society’s overall well-being. Socio-economic variables like inequality or a population’s overall health can influence stability, productivity, and other factors relevant to businesses and organizations. Inequalities can be considered as problematic in two regards: they can cause inefficiencies from economic and human development perspective, and they can be sources of grievances and, in the worst case, social unrest and instability.

Covering socio-economic topics in this paper does not have the purpose of making an ethical judgement. It has the purpose of, on the one hand, giving the reader a better sense of the social realities and dynamics in the UAE that may be relevant to business and organizational considerations, and, on the other hand, to assess if there are any risks flowing from social questions.

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Main insights

In a global comparison, the MENA region is characterized by high inequality. The UAE are no exception, although they are usually the least unequal in regional comparisons, and although the Government is taking steps to gradually decrease inequality.

Where inequality in the UAE is related to economic participation, for example by restricting movement across the labor market, or keeping women from making their contribution, they do have an effect on economic efficiency. Inequality does not, however, lead to any meaningful social tensions within the country. This inequality puzzle can partially be explained by the cultural values ingrained in representative population groups in the UAE, which are characterized by a high acceptance of power distance.

Outlook

Gender and income inequality will further decrease in the mid-term. On the one hand, we expect the Government to continue efforts to empower women, and, along with these efforts, we expect that the national population as well as women themselves will increasingly embrace this strengthened role. On the other hand, the Emiratization policy and the shift in the economy away from lower productivity and lower skills sectors could lead to a stronger alignment of wages and income. Unless geo-political conflict in the region escalates, the UAE will remain a safe and socially stable country.

For businesses

Businesses need to get acquainted with the high levels of diversity in the UAE, as well as with underlying cultural norms and expectations, if they want to start, grow and manage successful operations. The UAE Government grants great freedoms to businesses in commercial questions. Maintaining very clear rules for all players in the economy and maintaining the Government’s sovereignty in steering the country and maintaining its cohesion, however, is of paramount importance to the leadership. Businesses and organizations also need to understand these rules of the game - political activism is not an option.

For the Government

Proceeding with ongoing initiatives that gradually allow for all talent to contribute to the economy and the society, while buoying social cohesion and contentment is surely the way to go.
Inequality on many levels, but also steady progress

Official statistics on poverty and inequality - such as the Gini coefficient, the most commonly used indicator of equality or inequality in an economy - do only exist to a very limited extent in the UAE. The UAE provides its citizens with a comprehensive welfare system - the 2018 federal budget allocated more than 40% (20.6 billion AED or 5.6 billion USD) to the provision of social services, with the emphasis on education, healthcare, and community development. Against the backdrop of low oil prices as of 2014, various subsidies, such as for utilities, have been significantly reduced, shifting a bigger financial burden onto the Emiratis. Still, poverty does play a marginal role in this context.

The provision of these social services does not apply to the UAE’s expatriate community. Estimates state a poverty rate in the UAE of 19.5%, where the poverty line is defined as an income of 80 AED (22 USD) a day. As we have discussed previously, there is a major expatriate workforce in the UAE; the blue-collar segment of this workforce makes up the majority of the population living below the poverty line. The World Inequality Database’s estimates of income distribution in the country reveal a situation where the bottom 50% earn less than 9% of income, whereas the top 1% receive about 30% and the top 10% about 63%.

Figure 29 - The top 10% earn about 63% of income

Source: World Inequality Database

Scarcity of data and high levels of inequality, however, are common characteristics across the MENA region. According to researchers that are also part of the World Inequality Database’s team, the Middle East is the most unequal region in the world, with both enormous inequality between countries and large inequality within countries.
Figure 30 - Income inequality is very high in the Middle East

Source: VoxEU.org

The same researchers argue that the Middle East is characterized by a dual social structure, with a very wealthy group in the top, and a broad mass with very little income. A middle class is almost non-existent, as shown by the fact that the middle 40% of the income distribution is left with less than the top 10%. This is different in Western Europe, and a bit less in the US, where the middle 40% have a larger share of the income pie compared to the top 10%.
Among the countries in the MENA region, inequality is largely due to the geography of oil ownership and how well countries were able to translate oil revenues into permanent sources of affluence. There is a major gap in average income between Gulf countries and other countries in the region. In 2016 the countries of the Gulf represented 15% of the regional population, but almost 50% of the regional income. Within the UAE inequality occurs mainly along four parameters: qualifications, nationalities, gender and geography. We will briefly look at all these parameters in the following paragraphs.

Economic developments in the UAE have created manifold job opportunities - in the public and private sector. Most Emiratis prefer to work in the public sector, which is associated with higher salaries, benefits, and social status. Nevertheless, even in the public sector, the UAE relies on external expertise - across its Ministries an average 25% of employees are non-nationals (the rates vary considerably across Ministries, with the Ministry of Foreign Affairs only employing 4% non-nationals, and the Ministry of Health employing 65% non-nationals). The Government solicits external experiences and best practices to reach its goals, including through professional services. Ultimately, though, that knowledge should be transferred, and nationals brought into positions of authority.

According to Government information from 2016, the share of UAE nationals in the workforce overall is just above 7%, and just above 3% in the private sector (up from about 2% in 2009). To reduce structural divisions in the labor market, improve the national talent pool and overcome national imbalances in the workforce, the UAE Government launched the Emiratization (Tawteen in Arabic) campaign. It is part of the “building a competitive knowledge economy” cluster of the Vision 2021, and mandates and promotes the inclusion of Emiratis in the labor market, especially in the private sector.
Wage differences in the private sector are considerable and often correlate with nationalities: OECD expatriates are the highest paid, followed by Emiratis, and Arab, East Asian, and South Asian expatriates. In the frame of the Emiratization campaign Emiratis are encouraged to take private sector positions in strategic industries, and with managerial responsibilities. Expatriate workers, on the other hand, are found in all sectors and on all levels, carrying out the lowest-paid construction and domestic work as well as the highest paid managerial and leadership responsibilities.

Overall, the UAE workforce in the private sector is highly diverse; an average company employs about 6.5 nationalities. But it is also unbalanced: the majority of workers are male (93%), uneducated (55% below high-school level), unskilled (77%), young (60% under 35), are nationals of South Asian countries (80%), and work in lower wage sectors, such as construction (50.1%), trade (15%) and manufacturing (11%). OECD expats are, by and large, educated above average and they also constitute the biggest group of professionals and managers. Foreign workers from the MENA Arab countries come in second in terms of occupational skills, while 90% of the South Asian workforce are unskilled and 75% of the UAE nationals in the workforce are semi-skilled.

The median actual wage in the UAE is AED 1500 (USD 1 = AED 3.67) per month, while that of a manager (AED 20031) is roughly 16 times higher than that of an unskilled worker (AED 1240). A professional worker’s wage is about 43% and a semi-skilled worker’s 20% that of a manager. This gives a Gini coefficient of 0.62 in terms of actual monthly wages; this is high in comparison to other countries.

When differences in age, education, skill levels etc. are accounted for, differences in wages remain that can be attributed to nationalities - for both male and female workers. Expatriate workers from OECD countries are paid well above all other groups. They are followed by Emiratis, GCC expats, other Arabs (non-GCC), Asian and then African workers.

Although financial benefits are not a complete measure of individual prosperity and career development, and may not always balance social and emotional costs linked to relocating and working in the UAE, it is noteworthy that jobs in the UAE seem to pay more than those in countries of origin. For example, low skilled workers in India could expect about USD 77 per month - but USD 354 per month in the UAE. Semi-skilled workers in the Philippines could make less than USD 176 a month - but from USD 570 to 900 in the UAE. Such differences exist across skill levels and nationalities; the UAE wage levels are about double that of the levels in the countries of origin.1

Inequalities among workers linked to limited mobility in and the dual structure of the labor market (which differentiates between nationals and non-nationals), lead to some economic inefficiencies, as human capital may not always be allocated where it can add most value. From a social perspective, the high numbers of foreign workers flowing into the UAE, as well as inequalities among them, have an impact on both the UAE and the countries of origin. In the UAE, this reality does upset the demographic balance, put pressure on the Emirati culture and identity, hold risks to national security, and strain public services and infrastructure. While countries of origin benefit from remittances and reduced unemployment, they are confronted with concerns over the protection of workers’ rights in the UAE. International labor organizations continue to criticize labor laws in Gulf States overall for being insufficient and poorly enforced, despite efforts by the UAE to improve standards.

1 The analysis of wage differences in private companies is based on the UAE Wage Protection System and Administrative Database (WPS), through which the payment process of all private businesses is handled. However, the WPS does not cover payments to domestic household workers and workers in economic free zones. The UAE has about 45 free zones which offer several economic incentives such as exemption from corporate taxes and import/export duties and full foreign ownership with 100% profit repatriation. In 2014, they contributed 33% of the UAE’s non-oil trade.
Turning to gender-related inequalities, we see a picture where, regionally, gender inequality is very high, but within the region the UAE is one of the most proactive countries in promoting gender equality. The United Nations Development Programme (UNDP) ranks the UAE 49 out of 160 countries in the 2017 Gender Inequality Index (UNDP GII), with a value of 0.232 compared to a value of 0.531 for the group of Arab States, and a value of 0.17 for the group of countries with a very high human development index. The UNDP GII reflects gender-based inequalities in three dimensions – reproductive health, empowerment, and economic activity - and can be interpreted as the loss in human development due to inequality between female and male achievements in the three UNDP GII dimensions.

In the WEF’s Global Gender Gap Report 2018 (GGGR), the MENA region ranks last globally on the overall Gender Gap Index, behind South Asia. The index captures the size of the gender gap, that is, the inequalities that women face in terms of political, economic, educational and health-related opportunities and participation compared to men. The UAE is ranked 121 out of 149 in the GGGR 2018. Together with that rank, the UAE was assigned a score of 0.642, which means that the overall gender gap in the country has been closed to about 64%. Within the MENA region, the UAE ranks third - just behind Israel and Tunisia, and before Kuwait, Qatar, Algeria, Turkey, Bahrain, Egypt, Mauritania, Morocco, Jordan, Oman, Lebanon, Saudi Arabia, Iran, Syria, Iraq, and Yemen.

Figure 32 - The UAE so far performs well in women's education and health

As the chart above shows, the UAE’s gender gap is particularly pronounced with regard to economic participation and opportunity - which reflects differences in labor force participation, wages for similar work, estimated earned income, and the number of legislators, senior officials and managers, and professional and technical workers - as well as political empowerment - which reflects the number of women in parliament, women in ministerial positions and the years with a female Head of State. Still, there is an upward trend in almost all areas.

In fact, after the 2015 elections of the Federal National Council (FNC), eight of the newly elected 20 Council members were women. In the same year the FNC also got its first female speaker. A law was passed that in the 2019 FNC elections, 50% of council members must be female. The current UAE Minister squad consists of 29 Ministers - eight of them, about 30%, are women. The Vision 2021 contains a target for 50% of cabinet members to be female by 2021. A Gender Balance Council is mandated with enhancing the work environment for women. While the majority of Gulf States have maintained a more conservative point of view on women’s equality and economic participation, a few States are working to relax customs. The UAE is in the forefront regionally when it comes to encouraging women to work. Nevertheless, women still make up less than 10% of the total workforce: from 7% in 2011 to 9% in 2016. Obstacles to seeking a formal job persist, including family responsibilities and social norms, and women who do work still report discrimination.

In terms of inequalities within the UAE based on geography, Abu Dhabi is not only the largest of the seven emirates, but also the richest regarding oil deposits and revenues from oil exploitation. The total domestic oil reserves are split as follows: Abu Dhabi 94%, Dubai 4%, Sharjah 1.5%, and Ras al-Khaimah 0.5%. The other emirates rely on Abu Dhabi to an extent to finance the federal budget. Dubai has managed to emerge as a vibrant cosmopolitan city through widespread economic liberalization. The other five emirates have benefited from Abu Dhabi’s and Dubai’s success to varying degrees; the bigger the geographic distance the lower the positive impact. The UAE plans to spend 6 billion AED on infrastructure developments across the country, including road networks and federal buildings. The Khalifa Initiative in the Northern Emirates is designed to ensure that inhabitants of these emirates can enjoy the same facilities as those living in the larger emirates of Abu Dhabi and Dubai.
Above-average contentment within the society

UNDP’s Human Development Index (HDI) is a summary measure for assessing long-term progress in three basic dimensions of human development: a long and healthy life, access to knowledge and a decent standard of living. The performance of a country along these dimensions is expressed as an index figure: Norway, the country that currently leads the HDI, has a value of 0.953, compared to Niger at the bottom of the list with 0.354. Overall life expectancy in the UAE stood at about 78 years in 2017, which is a bit lower than overall life expectancy in OECD countries, but considerably higher than global and regional averages.

Figure 33 - Life expectancy in the UAE is still a bit lower than in OECD countries

Source: World Bank World Development Indicators

The UAE’s HDI value for 2017 was 0.863 — which puts the country in the very high human development category, positioning it at 34 out of 189 countries and territories. Between 1990 and 2017, the country’s HDI value increased from 0.727 to 0.863, an increase of close to 20%. The 2017 HDI of 0.863 was below the average of 0.894 for countries in the very high human development group, but above the average of 0.699 for the group of Arab States. Among the Arab States, the countries which are closest to the UAE and similar in population size were Bahrain and Qatar, which ranked 43 and 37, respectively, in 2017. The Inequality-adjusted HDI (IHDI) - an index that takes into account inequality in all three dimensions of the HDI and therefore indicates the loss in human development due to inequality - is not available for the UAE.
The 2019 WHR ranks the UAE 21 out of 156 countries in terms of overall contentment. The WHRs presents global data on national happiness based on evidence from the science of happiness, showing the quality of people’s lives. The basis of the WHR are three main happiness measures: life evaluations (status of people’s lives), positive affect (frequency of happiness, laughter and enjoyment), and negative affect (frequency of worry, sadness and anger). These measures of happiness are then explained through a variety of subjective well-being measures, including economic well-being, social support, healthy life expectancy, freedom to make life choices, generosity, and perceptions of corruption.

The UAE Government is keen on promoting happiness: it appointed a Minister of State for Happiness in 2016 and launched a National Programme for Happiness and Positivity. These measures contribute to the “cohesive society and preserved Identity” cluster of the Vision 2021 document. The Happiness Minister’s main responsibility is to harmonize all Government plans, programs and policies with a view to achieving a happier society.

Culture acts as source of stability in unequal society

At present, high inequality does not seem to lead to discontent or even tensions in the UAE. On the contrary, as we have seen, overall contentment seems to be rather high in the country. One explanation for this observation may be deeply embedded cultural forces characterizing the nations represented in the UAE. The below graph shows selected representative nationalities, including Emiratis, according to the Hofstede 6-D Model. The salient feature in the graph is the “power distance” dimension, which captures the attitude of a certain society towards inequality. Power distance can be understood as the extent to which the less powerful parts of society expect and accept that power is distributed unequally. The UAE, India, and Philippines score very high on this dimension, which means that people tend to accept an unequal order in which everybody has a place without asking for justification or explanation. “The less powerful people within these countries expect to be told what to do and the ideal boss”, according to Hofstede, “is a benevolent autocrat”.

Figure 34 - Human development improved since 1990

Source: United Nations Development Programme, Human Development Index
The “individualism” dimension captures, in the words of Hofstede Insights, “the degree of interdependence a society maintains among its members. It has to do with whether people’s self-image is defined in terms of ‘I’ or ‘We’. In individualist societies people are supposed to look after themselves and their direct family only. In collectivist societies people belong to ‘in groups’ that take care of them in exchange for loyalty. Loyalty in a collectivist culture is paramount and overrides most other societal rules and regulations.” The UAE, India and the Philippines can be considered as rather collectivistic. “In collectivist societies offence leads to shame and loss of face, employer/employee relationships are perceived in moral terms (like a family link), hiring and promotion decisions take account of the employee’s in-group, management is the management of groups.” For comparison we have also included the United Kingdom - the OECD nationality with the strongest representation in the UAE - which diverges markedly on both dimensions from the other three countries.

These observations in combination with the fact that the UAE leadership is - all in all - seen as legitimate, competent and far-sighted management that has transformed the UAE into a modern, stable, secure and attractive State, can solve the inequality puzzle. The UAE’s socio-political institutions clearly define the rights of the various stakeholders in the country (national, non-national, men, women etc.), shape their expectations for the short and long term, align interests, and create an overall frame in which the majority sees the upsides of the current situation outweigh the downsides.
LONG RUN ECONOMIC PERSPECTIVES: STRONG INSTITUTIONS AND BUSINESS FRIENDLINESS
Sustained economic growth depends to a large extent on sustained increases in productivity. Productivity increases, in turn, depend on physical capital (human-made resources like buildings and machines), human capital (education and knowledge embodied in a country’s workforce), and technological progress (overall advancement in the means of producing services and goods). These factors combined allow the average working person to be more productive, that means to produce a higher value of output.

Among the three factors, technological progress tends to have the biggest impact on productivity - but is also the most elusive one. A country’s capacity to innovate depends on how investment in capital, education and research, translate into innovative and marketable products, services, processes and so forth. It is a complex interplay between the level of such investment, the overall institutional and macroeconomic conditions, market dynamism and sophistication - which depend heavily on a country’ regulatory environment - as well as softer factors such as society’s attitude towards entrepreneurialism and taking risk.

Main insights

The pace of reforms in the MENA region to diversify economies and achieve more balanced and sustainable growth has accelerated in recent years as a response to economic, social and political factors. Nevertheless, there are vast disparities within the region when it comes to the enabling factors of long-term growth, hinting at the fact that economies are not so much hampered by geographical factors, than by policies and leadership that lack proactivity and farsightedness. The UAE’s strong suit are stable political and macroeconomic conditions and the Government’s future orientation. Today’s economic environment is increasingly uncertain, challenging and complex. Recovery after the global financial and economic crisis in the last decade remains vulnerable to a range of risks and potential shocks. Against such a backdrop the certainty provided by a stable institutional framework for organizations working in or with the UAE are crucial to further encourage private investments and overall business activity.

Moreover, the country has made continuous and convincing improvements to its regulatory environment and is generally a top country for doing business. Also, a main strength of the UAE is the well-developed general and ICT infrastructure. The weaker points remain the level of education across the UAE population, constraints in the financial and the labor markets, barriers to trade and some regulations that hinder business dynamism, such as dealing with insolvency and costs of starting a business.

The major challenge, though, remains to translate investments and strong enabling conditions into knowledge, innovation and creative outputs. A country’s capacity to innovate depends on a complex ecosystem, which needs to facilitate ideas becoming successful products, services, processes etc. Judging from the GII - which assigns the UAE rank 21 in overall innovation inputs, but rank 58 in innovation outputs - as well as the GCI, this innovation process is not yet happening to the desired extent. In any case, the UAE Government still has a gap to close to its stated goal of becoming the most innovative economy by 2021.

It should be noted that innovation is increasingly seen not only as high-tech and scientific outputs happening in laboratories or at research institutions in the form of patents, scientific publications and the like, but in a broader sense. While the UAE is still lagging behind in these areas of innovation, it is performing better in broader innovation such as new businesses and organizational models. This bodes well with the UAE Government’s “innovation in all policies” approach, which particularly also aims at activating soft innovation drivers such as creativity and entrepreneurial spirit.

Outlook

We expect that the certainty provided by a stable institutional framework for organizations working in or with the UAE will continue to encourage private investments and overall business activity despite challenging global
economic and political conditions. We also expect that the Government will continue to enhance regulatory and market conditions for businesses further.

For businesses

Education, entrepreneurialism and innovation are key strategic areas for the UAE Government. Businesses can come in with solutions, both in terms of products and services, such as consulting. Businesses can trust that the Government will continue taking steps to improve business friendliness and gradually address remaining obstacles. On the downside, businesses do face some constraints in terms of getting highly skilled employees and should be prepared to get required talent also from outside.

For the Government

To improve the innovation input-output ratio, the UAE Government should continue to remove obstacles to collaboration and trade - in general, more openness and a bigger market lead to more innovation and a more competitive market. Measures supporting trade further also make sense considering that exports have become the main driver of economic growth in the UAE. Measures could particularly include revised regulations concerning the use of VoIP, imports and exports (costs, tariffs, etc.), as well as further investment in intra-regional infrastructure connectivity - in balance with security and safety considerations. The Etihad Rail project, which will be integrated into the GCC railway network, is a positive step in this context.

Furthermore, the Government should continue its strong and proactive course in terms of educational and innovation policies, with a view to raising the mean years of schooling and tertiary enrollment, enhancing the quality of its scientific institutions and increasing the level of R&D spending. To be continued are also reforms to further spur business dynamism, particularly enhancements of the insolvency framework, cost reductions related to starting a business, and easier access to the necessary financial means to start and grow a business. The relatively low tax burden in the UAE is a key incentive for businesses to move to and operate in the UAE - the Government needs to act with great care to execute the newly introduced VAT in a way that the benefits for the Government outweigh clearly the drawbacks for businesses.

A particularly important development will be the move from low productivity to high productivity sectors in the economy. In addition to the measures mentioned, this will require further developments in the labor market so that all available talent, including women, flows where it can add most value. As the composition of the economy needs to change towards higher productivity and higher skills sectors, the Government may consider further improvements to labor rights and visa regulations for highly skilled expats, with the aim of opening up a proper perspective for their residence and investments in the UAE, which may increase their stakes and their willingness to engage in the UAE’s advancement. A law passed in 2019, allowing permanent residency for “exceptional expatriates” who have contributed to the country’s growth, is a positive step in this direction.

It is also important to find ways to facilitate the move from post-secondary and tertiary education into the job market. Internship programs, more vocational and on-the-job training, as well as partnerships between the Government, universities and companies to help higher qualified and young people start their professional lives could help. Moreover, more flexible visa regimes for the 18+ year old population would make it easier for talent to study, find suitable work and engage in the innovation activities of the country, including second generation expats. Continuous efforts to promote Emiratis’ entrepreneurial and innovative spirit in the frame of Emiratization, and to encourage Emirati men and women to fully participate in the labor force and contribute their knowledge, should also facilitate this critical development.
Investments still need to translate into innovation

In this part, we will look at some proxy indicators to gauge how the UAE is investing in its physical and human capital and its technological progress, laying the foundations for long-term growth.

*Figure 36 - Education has significantly improved in the UAE*

One of the three indices on which the previously mentioned HDI is built is the so-called education index. It is based on mean years of schooling (of adults) and expected years of schooling (of children). The mean years of schooling in the UAE in 2017 were 10.8. As evident from the above graph, the UAE has impressively improved its education index - from below 0.5 in 1990 (it was as low as 0.3 in 1980) to above 0.7 in 2017 - although progress has stalled in 2015-17. The UAE’s development in this regard is similar to two main reference economies in the region - Qatar and Saudi Arabia, with Saudi Arabia showing stronger momentum in the recent past. All three Arab economies still have room for improvement compared to leading OECD countries like the United States and Switzerland.

*Source: United Nations Development Programme, Human Development Reports*
Figure 37 - More people are enrolling into secondary schools

Source: United Nations Development Programme, Human Development Reports

Figure 38 - Tertiary education is gradually becoming the norm in the UAE

Source: United Nations Development Programme, Human Development Reports
Gross enrollment captures the number of students enrolled in a given level of education, expressed as a percentage of the official school-age population corresponding to the same level of education - in this case, secondary and tertiary education. A high rate indicates a high degree of participation, and that a country is able to accommodate all of its school-age population. The indicator can exceed 100% due to the inclusion of over-aged and under-aged students, because of early or late entrants, and grade repetition.

The graphs above show that the UAE has considerably increased enrollment ratios in both secondary and tertiary education: in 1990 secondary enrollment stood at 60%, and at 96% in 2016; tertiary enrollment increased from 6% to 37% between 1990 and 2016. This means that, in terms of secondary enrollment, the UAE is now at par with OECD countries like Switzerland and the United States, which oscillate between 90 and just above 100%. In terms of tertiary education, there remains a gap to fill, as reference economies are closer to 60 - 80% in this area.

The Ministry of Education (MoE) oversees all education matters and UAE-based education authorities. It has developed an educational framework, which - according to the Ministry - acknowledges the “need for lifelong learning, enhancing the role of technology in serving the educational process, ensuring the best educational practices and modern curricula and establishing innovation as a lifestyle with a view to building a generation armed with the skills of this age.” Education - developing a first-rate education system more specifically - is at the core of the UAE Vision 2021. The Government has put in place extensive measures to reach stated targets such as a 90% upper secondary graduation rate and getting into the top 20 globally in terms of PISA scores. The 2016 Government reshuffle also brought two new Ministers in the education field. Additionally, a Supreme Council for Education, a Youth Council and the Council of UAE Scientists were established to lend support. Education reforms reach into all education levels; bodies such as the Abu Dhabi Education Council and Dubai’s Knowledge and Human Development Authority are tasked with maintaining accreditation standards and improving teacher qualification standards.

The UAE affords all citizens free education from kindergarten to university; in the federal budget, education is consistently allocated a lion’s share. The MoE was allocated 12 to 13 % of the federal budget in 2016, 17 and 18, ranking it just behind the Ministry of Interior (and, in 2016, the Ministry of Defense). Adding to this other education and training-related allocations, such as to the national universities, the share has amounted to around 20% of the federal budget over the last three years - 10.2 billion AED (about 2.8 billion USD) in 2018. Not only is education free, but it is mandatory for all children aged six to eighteen. This mandate includes Emirati as well as expat children.

Since a few years, expat parents are allowed to send their kids to local, public schools. Still, non-Emirati parents prefer to enroll their children in private, and international, educational institutions. Not only do UAE State schools charge fees for expat pupils, but parents want to provide international curricula and environments to their kids, taught in English or their mother tongue. Demand for private education has thus been growing, and so has the education sector; about 40% of pupils in the UAE attend private schools. As of 2017, the UAE hosts branches of 40 international universities, such as INSEAD and London Business School, in addition to national institutions such as the Emirates University, the Higher Colleges of Technology, and Zayed University. The UAE has become a center of higher education, especially in the GCC area.
In addition to the MoE, the emirates also have their own governing bodies: the Department of Education and Knowledge (Abu Dhabi), the Dubai Education Council and Knowledge and Human Development Authority, and the Sharjah Private Education Authority (created by the Sharjah government in 2018), for example. This is not least an expression that the emirate of Sharjah is increasingly claiming a leading role in education and culture next to Abu Dhabi and Dubai. Several of the best universities for international students, business schools and engineering program can be found in Sharjah, including the American University of Sharjah, the University of Sharjah, and the University of Sharjah College of Business Administration. The formation of the Sharjah Private Education Authority is a commitment of the emirate to further enhance the quality of education in private schools - particularly on the primary and secondary level.

*Figure 39 - R&D is increasing, but lags behind the world average*

R&D expenditure (% of GDP)

Source: World Bank, World Development Indicators

Gross domestic expenditure on research and development (GERD) captures the total expenditure (current and capital) on research and development (R&D) by all resident companies, research institutes, university and government laboratories, etc. It excludes R&D expenditures financed by domestic firms but performed abroad. R&D covers basic research, applied research, and experimental development.
With its R&D expenditure, the UAE has been below regional and global averages, and particularly below OECD members’ average. However, the trend is positive. Overall expenditures on R&D stood at close to 1% of GDP in 2017. The UAE has a stated aim to increase such expenditure to 1.5% of GDP.

**Figure 40 - The private sector drives R&D**

![Graph showing R&D by sector](image)

Source: UNESCO Institute for Statistics

On the graph above we can see that, in the years for which data is available, the biggest part of R&D was performed in the private sector. R&D performed in higher education seems to be increasing. In 2016, about 77% of R&D was funded by private businesses, 17% by higher education institutions and 7% by the UAE Government.

The Global Innovation Index (GII), an index capturing countries’ innovation performance overall, ranks the UAE 18th among 129 economies under its “human capital and research” pillar. Apart from the indicators we have looked at, this pillar also considers elements like PISA average scales in reading, mathematics, and science (UAE ranks 37th), school life expectancy (UAE ranks 72th), the pupil-teacher ratio in secondary education (UAE ranks 23rd), the number of graduates in science and engineering (UAE ranks 50th), tertiary level inbound mobility (UAE ranks 1st), the number of researchers per million population (UAE ranks 35th), average expenditure on R&D of the top three global companies (UAE ranks 18th), and the QS university ranking average score of the top 3 universities (UAE ranks 37th). All in all, the GII highlights the UAE’s strength in tertiary education here, particularly in attracting a diverse student body, and identifies school life expectancy as one of the main areas for improvement.

GERD performed by and financed by business enterprise is also an element of the GII “business sophistication pillar”, which ranks the UAE 26th and 5th, respectively. This pillar captures how well businesses use human capital and research in order to generate the innovation and technological progress needed for long term
growth. The UAE ranks 30th overall under this pillar. In addition to “GERD financed by business enterprise”, the country overperforms in “cluster development” - that is, how well developed and deep clusters (geographic concentrations of firms, suppliers, producers of related products and services, and specialized institutions in a particular field) are - and in “research talent in business enterprise” - which is the number of professionals engaged in the conception or creation of new knowledge, products, processes, methods, and systems. The share of employment in knowledge-intensive services and the percentage of females employed with advanced degrees out of total employed, on the other hand, are areas where the UAE underperforms.

**Figure 41 - The UAE forms capital even during recessions**

Gross capital formation captures the total value of the gross fixed capital formation in the economy plus net changes in the level of inventories. Fixed assets include land improvements, plant, machinery, and equipment purchases, and the construction of roads, railways, and the like, including schools, offices, hospitals, private residential dwellings, and commercial and industrial buildings. Gross capital formation is, on average, around 24% of nominal, and 26% of real GDP in the UAE. This means the UAE continuously adds more to its physical capital than the average OECD members, and is around world average in gross capital formation. The GII ranks the UAE 69th in this field.

What is striking about the graph above is the countercyclical development of investment in capital. While, globally, investment spending slumped during the economic crisis years 2008-09, it spiked in the MENA region, and particularly in the UAE. We can also see that there is another, slightly less pronounced, spike building up between 2013 and 2016.

The graphs below zoom in on the years 2010-18. We can see clearly how overall output growth slowed down starting 2015. In 2015 we see a marked drop in total consumption spending, particularly household consumption. Total consumption spending picked up again slightly in 2017 and 18, propped up by higher government spending. While public as well as private investment spending remained fairly stable - with some more pronounced increases between 2014 and 2016 and drops in 2013 and 2017-18 - inventory levels shot up
between 2013 and 2015 and have since only come down gradually. It is evident that the spike in gross capital formation in 2016 is primarily due to a buildup of inventories, as businesses were responding with delay to an economy growing slower than expected. However, also stronger private investment in 2014-16 contributed to the growth in gross capital formation. After 2016, with inventories gradually decreasing and public and private investment spending staying more or less stable, gross capital formation showed a slight downward trend.

*Figure 42 - Inventories increased significantly in 2013 - 2015*

*Source: Federal Competitiveness and Statistics Authority, National Accounts*
**Figure 43 - Inventories started to decrease in 2016**

The graph below shows that the biggest share of investment spending originates from the private sector. In the years 2014, 15, and 16, private investment spending grew by 11, 5, and 9%, respectively. In 2017, it decreased by 13%, and by 1% in 2018. Public sector investment spending increased between 3 and 10% each year from 2010 to 2016, dropped by 3% in 2017, and remained at that level in 2018.

*Source: Federal Competitiveness and Statistics Authority, National Accounts*
**Figure 44 - The biggest share of investment spending comes from private sector**

![Real gross capital formation per category (million AED)](image)

**Source: Federal Competitiveness and Statistics Authority, National Accounts**

Gross capital formation is an element of the GII infrastructure pillar, under which the UAE ranks 21st out of 129 countries. The country is particularly strong in the areas of information and communication technology access and use (ICTs) and general infrastructure (electricity output, logistics performance), but is only ranked 71st in terms of ecological sustainability. This latter rank is based on PPP$ GDP per kilogram of oil equivalent of energy use, an environmental performance indicator that gauges how close countries are to established environmental policy goals, and the number of ISO 14001 environmental certificates.
Figure 45 - In 2017 the UAE got at par with Switzerland in patent applications

Source: World Bank, World Development Indicators

Patent applications are worldwide patent applications filed through the Patent Cooperation Treaty (PCT) procedure, hosted by the World Intellectual Property Organization (WIPO), or with a national patent office for exclusive rights for an invention - a product or process that provides a new way of doing something or offers a new technical solution to a problem. Resident patent applications are those for which the applicant or assignee is a resident of the State or region concerned.

In the graph above we can see that the UAE is ahead of the largest economy in the region - Saudi Arabia - having filed about 19 patent applications (per 100,000 residents) in 2017. In 2017, it got at par with Switzerland, which has seen a steady decline over the last few years. It should be noted, however, that only 3% of patent applications in the UAE can be assigned to residents (figure from 2017; up from just below 2% in 2011). Moreover, champions in that area, such as the United States of America and South Korea, play in a different league: there has been an average of 180 patent applications per 100,000 residents per year in the USA and an average of 400 in South Korea.

Also, the GII sees the UAE’s weakest performance under the “knowledge and technology outputs” pillar, which covers all those variables that are regarded as expressions of inventions and/or innovations - such as patents. The UAE occupied rank 63 under this pillar in 2019 - down 10 places since 2018. Particular convergence potential remains in the area of knowledge creation, such as patents or scientific and technical publications, as well as in the area of high-technology exports. The UAE’s comparative strength under this pillar lies in foreign direct investment, capturing net outflows of investment from the UAE to the rest of the world.

Furthermore, the GII does not only consider high-tech innovation, but also “creative outputs”, under a separate pillar. The UAE fares better under this pillar, but still “only” makes rank 50 (up 3 places since 2018). There is particular room for improvement in the creation of intangible assets such as trademarks, industrial
designs and in online creativity. On the other hand, the UAE has an edge in the production and export of creative goods and services.

Nevertheless, the country’s Vision 2021 lists the promotion of entrepreneurship, innovation, and research and development and the development of small- and medium-sized enterprises as central objectives and has also taken decided steps to support progress in that direction. In 2014, a National Innovation Strategy was launched, aiming at making the UAE the most innovative nation globally by 2021, and the year 2015 was dubbed the Year of Innovation by the President. In 2015, a 1.2 billion USD plan was announced with the aim of making innovation the driving force in education. The Government also instituted a CEO for innovation post in every Government department. Finally, 2 billion UAE dirhams (about 600 million USD) were allocated to the Mohammed bin Rashid Innovation Fund in the 2017 federal budget, supporting individuals and organizations in realizing innovative ideas and projects.

Taking the GII as reference, the UAE’s progress in the field of innovation has been mixed: the overall GII ranks the UAE 36th out of 129 countries in 2019. Summing up 19 economies in a “Northern Africa and Western Asia” region, Israel and Cyprus achieve the top two spots in the region for the seventh consecutive year. Third in the region is the UAE, which moves up two places in the global ranking from 2018. It’s worst rank in 2015 was 47, and the best 35 in 2017, with several ups and downs between these ranks between 2013-19.

**Year over year, the UAE becomes more business-friendly**

The level of development of a market and the nature and dynamism of business activity, such as investment decisions and R&D, depend on the economic institutions and framework in a country. Regulations can enhance or constrain business activity, as do decisions concerning property rights and their protection. We will mainly refer to the WB’s Ease of Doing Business Report to assess the UAE’s regulatory set-up. Doing Business measures regulations affecting eleven areas relevant to businesses:

1. starting a business: procedures, time, cost and paid-in minimum capital to start a limited liability company
2. dealing with construction permits: procedures, time and cost to complete all formalities to build a warehouse and the quality control and safety mechanisms in the construction permitting system
3. getting electricity: procedures, time and cost to get connected to the electrical grid, and the reliability of the electricity supply and the transparency of tariffs
4. registering property: procedures, time and cost to transfer a property and the quality of the land administration system
5. getting credit: movable collateral laws and credit information systems
6. protecting minority investors: minority shareholders rights in related-party transactions and in corporate governance
7. paying taxes: payments, time, total tax and contribution rate for a firm to comply with all tax regulations as well as post-filing processes
8. trading across borders: time and cost to export the product of comparative advantage and import auto parts
9. enforcing contracts: time and cost to resolve a commercial dispute and the quality of judicial processes
10. resolving insolvency: time, cost, outcome and recovery rate for a commercial insolvency and the strength of the legal framework for insolvency
11. labor market regulation: flexibility in employment regulation and aspects of job quality (this area is only descriptive and not inputted into the Doing Business score)
The ease of doing business score captures the gap of each economy from the best regulatory performance observed on each of the indicators across all economies in the Doing Business sample since 2005. 0 represents the lowest and 100 represents the best performance. The ease of doing business ranking ranks economies from 1 to 190 based on their scores. To choose scores and ranks, typical business processes are performed and evaluated in centers of business activity in each country. For the UAE this is Dubai - as the most populous Emirate with a reputation of being a financial hub, and a very business-friendly environment that historically attracts investors from around the world.

Out of 190 countries, the UAE was ranked 11th in the Doing Business 2019.

The UAE is a champion when it comes to creating an enabling business environment. Out of 190 countries, it was ranked 11th in the Doing Business 2019, with a score of 81.28. This makes the UAE the clear leader within the MENA region: the second regional economy, Morocco, comes in on place 60. Saudi Arabia, the biggest economy in the region, ranked 92nd. Within the group of high-income countries, the UAE has the 9th best business environment, just after New Zealand (ranked number one in the overall Doing Business 2019), Singapore, Denmark, Hong Kong SAR, China, South Korea, Norway, the United States of America and the United Kingdom, and ahead of countries like Sweden, Taiwan, Lithuania, Estonia, Finland and Australia. The graph below shows the UAE’s score and ranking compared to reference countries and groups of countries.

Figure 46 - The UAE among the top countries in ease of doing business

Zooming in on the individual areas that make up the global Doing Business the UAE scores particularly high on “getting electricity”, “paying taxes” and “starting a business”. Comparatively low are the scores in “resolving insolvency”, “getting credit” and “trading across borders”. Although the UAE is playing in a different league regionally, it is still interesting to observe that the same strong and weak areas of doing business exist across
the region - as is evident from the below spider chart. The OECD countries, on the other hand, seem to have, at large, a stronger regulatory tradition in “trading across borders” and “resolving insolvency”.

**Figure 47 - Getting credit is still quite challenging**

*Source: World Bank, Doing Business*
Figure 48 - Trading across borders is surprisingly challenging

Source: World Bank, Doing Business

The UAE ranks 1st in the global Doing Business 2019 on “getting electricity”, after having continuously improved its score in this area from 89.01 to 100 between 2010 to 2019. “Getting electricity” captures the procedures, time and cost required for a business to obtain a permanent electricity connection for a newly constructed warehouse. Additionally, it measures reliability of supply, transparency of tariffs and the price of electricity. The sub-components that make up the UAE’s score are the following:

Table 4 - The UAE leads the way in ease of getting electricity

<table>
<thead>
<tr>
<th>Indicator</th>
<th>UAE</th>
<th>MENA</th>
<th>OECD high income</th>
<th>Best regulatory performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Procedures (number)</td>
<td>2</td>
<td>4.7</td>
<td>4.5</td>
<td>3 (25 economies)</td>
</tr>
<tr>
<td>Time (days)</td>
<td>10</td>
<td>72.4</td>
<td>77.2</td>
<td>18 (3 economies)</td>
</tr>
<tr>
<td>Cost (% of income per capita)</td>
<td>0</td>
<td>479.9</td>
<td>64.2</td>
<td>0 (3 economies)</td>
</tr>
<tr>
<td>Reliability of supply and transparency of tariff index (0-8)</td>
<td>8</td>
<td>4.2</td>
<td>7.5</td>
<td>8 (27 economies)</td>
</tr>
</tbody>
</table>

Source: World Bank, Doing Business

From 2010 to 2019 the UAE has achieved considerable improvements for businesses in these areas, by reducing the number of procedures required from 4 to 2, the days required for completing the procedures from 55 to 10, and reducing the cost related to the procedures to zero.
Figure 49 - It has become significantly easier to get electricity in the last decade

Source: World Bank, Doing Business

The next area, in which the UAE scores particularly high is “paying taxes”. The score in this area improved from 93.89 to 99.44 from 2010-19, giving the country place 2 among 190 in the ranking. Here, the Doing Business records taxes and mandatory contributions that a medium-size company must pay or withhold in a given year, as well as the administrative burden of paying taxes and contributions and complying with post-filing procedures (VAT refund and tax audit). The most recent round of data collection was completed in May 2018 covering calendar year 2017; this means that the introduction of the VAT in the UAE in 2018 is not yet reflected.

Table 5 - In 2017 the UAE scored particularly high in the “paying taxes” area

<table>
<thead>
<tr>
<th>Indicator</th>
<th>UAE</th>
<th>MENA</th>
<th>OECD high income</th>
<th>Best regulatory performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payments (number per year)</td>
<td>4</td>
<td>17.7</td>
<td>11.2</td>
<td>3 (Hong Kong SAR, China)</td>
</tr>
<tr>
<td>Time (hours per year)</td>
<td>12</td>
<td>196.7</td>
<td>159.4</td>
<td>49 (Singapore)</td>
</tr>
<tr>
<td>Total tax and contribution rate (% of profit)</td>
<td>15.9</td>
<td>32.7</td>
<td>39.8</td>
<td>26.1% (32 economies)</td>
</tr>
<tr>
<td>Post filing index (0-100)</td>
<td>-</td>
<td>50.08</td>
<td>84.41</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: World Bank, Doing Business

We can see that the UAE has made particular efforts to reduce the burden of paying taxes, by slashing the payments required per year. The overall tax burden, however, has been rising. Currently, businesses in the UAE pay social security contributions and other fees (land transfer/registration fee, trade license renewal fee,
vehicle registration etc.). We can preview that this trend will continue when the latest information on taxes is reflected. Some deterioration may also occur related to complying with and obtaining VAT refunds.

**Figure 50 - The overall tax burden is rising**

Source: World Bank, Doing Business

The third highest-scoring area is “starting a business”, which measures what it takes for a for a small- to medium-sized limited liability company to start up and formally operate. In 2019 the UAE ranked 25th in this area out of all 190 countries, with a score of 94.06 (up from 83.81 in 2010). The table below shows in detail the performance on all components that make up the starting a business score, i.e. the number of procedures required to legally start and formally operate a company, the cost and the time required to complete each procedure, and the paid-in minimum capital. Differences between male and female entrepreneurs are also captured.
Figure 51 - Entrepreneurship is encouraged

<table>
<thead>
<tr>
<th>Indicator</th>
<th>UAE</th>
<th>MENA</th>
<th>OECD high income</th>
<th>Best regulatory performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Procedures men (number)</td>
<td>2</td>
<td>7.2</td>
<td>4.9</td>
<td>1 (New Zealand)</td>
</tr>
<tr>
<td>Time men (days)</td>
<td>3.5</td>
<td>20.5</td>
<td>9.3</td>
<td>0.5 (New Zealand)</td>
</tr>
<tr>
<td>Cost men (% of income per capita)</td>
<td>22.8</td>
<td>22.6</td>
<td>3.1</td>
<td>0 (Slovenia)</td>
</tr>
<tr>
<td>Procedures women (number)</td>
<td>3</td>
<td>7.9</td>
<td>4.9</td>
<td>1 (New Zealand)</td>
</tr>
<tr>
<td>Time women (days)</td>
<td>4.5</td>
<td>21.2</td>
<td>9.3</td>
<td>0.5 (New Zealand)</td>
</tr>
<tr>
<td>Cost women</td>
<td>22.8</td>
<td>22.6</td>
<td>3.1</td>
<td>0 (Slovenia)</td>
</tr>
<tr>
<td>Paid-in capital (% of income per capita)</td>
<td>0</td>
<td>8.1</td>
<td>8.6</td>
<td>0 (117 economies)</td>
</tr>
</tbody>
</table>

Source: World Bank, Doing Business

While the costs of complying with all necessary procedures for starting a business have doubled from 2010 to 2019, important improvements have been achieved regarding the number of procedures necessary and the time spent on these procedures, as the graph below indicates.

Figure 52 - Year by year, red tape is cut

Source: World Bank, Doing Business
For a closer look at the low performing areas, we turn to “resolving insolvency”, where the UAE achieved a 49.67 score and rank 75 in 2019. This area captures the years required to recover debt, the related cost, and the outcome of insolvency proceedings. These inputs are used to calculate the recovery rate by secured creditors through reorganization, liquidation or debt enforcement (foreclosure or receivership) proceedings. The area also captures the strength of insolvency framework.

Table 6 - Resolving insolvency is still a problem area

<table>
<thead>
<tr>
<th>Indicator</th>
<th>UAE</th>
<th>MENA</th>
<th>OECD high income</th>
<th>Best regulatory performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recovery rate (cents on the dollar)</td>
<td>28.4</td>
<td>26.3</td>
<td>70.5</td>
<td>None in 2017/18</td>
</tr>
<tr>
<td>Time (years)</td>
<td>3.2</td>
<td>2.8</td>
<td>1.7</td>
<td>0.4 (Ireland)</td>
</tr>
<tr>
<td>Cost (% of estate)</td>
<td>20</td>
<td>13.8</td>
<td>9.3</td>
<td>1 (Norway)</td>
</tr>
<tr>
<td>Outcome (0 as piecemeal sale and 1 as going concern)</td>
<td>0</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Strength of insolvency framework index (0-16)</td>
<td>11</td>
<td>5.9</td>
<td>11.9</td>
<td>None in 2017/18</td>
</tr>
</tbody>
</table>

Source: World Bank, Doing Business

Still, the UAE was able to improve the business environment in this area. In 2010, its score for resolving insolvency was 28.91 (compared to 49.67 in 2019). Enhancements were achieved in the insolvency framework, which indicates improvements in the commencement of proceedings, management of debtor’s assets, reorganization proceedings and creditor participation. Uneven, but recognizable, improvements also occurred with regard to the recovery rate, as the graph below shows.
Figure 53 - The insolvency framework has improved recently

The “getting credit” area assesses the sharing of credit information and the legal rights of borrowers and lenders with respect to transactions through two lenses: the depth of credit information (rules and practices affecting the coverage, scope and accessibility of credit information available through a credit registry or a credit bureau) and the strength of legal rights (degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending). The UAE reached a score of 70 on this indicator in 2019, and overall rank 44.

Table 7 - Stronger legal rights would facilitate borrowing

<table>
<thead>
<tr>
<th>Indicator</th>
<th>UAE</th>
<th>MENA</th>
<th>OECD high income</th>
<th>Best regulatory performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strength of legal rights index (0-12)</td>
<td>6</td>
<td>2.2</td>
<td>6.1</td>
<td>12 (5 economies)</td>
</tr>
<tr>
<td>Depth of credit information index (0-8)</td>
<td>8</td>
<td>5.1</td>
<td>6.7</td>
<td>8 (42 economies)</td>
</tr>
</tbody>
</table>

Source: World Bank, Doing Business

In this area, the UAE has improved from a score of 40 to 70 from 2014-19, by improving both relevant indices - although room for improvement remains in the area of borrowers’ and lenders’ rights.
The GII additionally features an “ease of getting credit” indicator and a “domestic credit to private sector” indicator, for which the UAE ranks 40th and 38th, respectively. Also, the WEF Global Competitiveness Index (GCI) 4.0 2018 highlights potential for further improvement in this area: the GCI 2018 ranks the UAE 31st out of 140 economies in terms of its financial system, with particular reform focus on the credit gap (UAE ranks 118th), insurance premiums (UAE ranks 77th), non-performing loans (UAE ranks 74th), the soundness of banks (UAE ranks 50th), and domestic credit to the private sector (UAE ranks 39th).

“Trading across borders” records the time and cost associated with the logistical process of exporting and importing goods, by measuring the time and cost (excluding tariffs) associated with three sets of procedures: documentary compliance, border compliance and domestic transport within the overall process of exporting or importing a shipment of goods. In this area the UAE got a score of 71.50 in 2019, and overall rank 98.
Table 8 - There are still obstacles to international trade

<table>
<thead>
<tr>
<th>Indicator</th>
<th>UAE</th>
<th>MENA</th>
<th>OECD high income</th>
<th>Best regulatory performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time to export border compliance (hours)</td>
<td>27</td>
<td>58</td>
<td>12.5</td>
<td>1 (19 economies)</td>
</tr>
<tr>
<td>Cost to export: border compliance (USD)</td>
<td>462</td>
<td>442.4</td>
<td>139.1</td>
<td>0 (19 economies)</td>
</tr>
<tr>
<td>Time to export documentary compliance (hours)</td>
<td>6</td>
<td>67.9</td>
<td>2.4</td>
<td>1 (26 economies)</td>
</tr>
<tr>
<td>Cost to export: documentary compliance (USD)</td>
<td>178</td>
<td>244.6</td>
<td>35.2</td>
<td>0 (20 economies)</td>
</tr>
<tr>
<td>Time to import border compliance (hours)</td>
<td>54</td>
<td>105.4</td>
<td>8.5</td>
<td>0 (25 economies)</td>
</tr>
<tr>
<td>Cost to import border compliance (USD)</td>
<td>678</td>
<td>536</td>
<td>100.2</td>
<td>0 (28 economies)</td>
</tr>
<tr>
<td>Time to import: documentary compliance (hours)</td>
<td>12</td>
<td>75.5</td>
<td>3.4</td>
<td>1 (30 economies)</td>
</tr>
<tr>
<td>Cost to import: documentary compliance (USD)</td>
<td>283</td>
<td>269</td>
<td>24.9</td>
<td>0 (30 economies)</td>
</tr>
</tbody>
</table>

Source: World Bank, Doing Business

“Trading across borders” is the only area among the 10 areas making up the overall Doing Business, where the UAE has not made remarkable improvements over the last decade - which is surprising given the increasing importance of trade to the UAE’s sustained economic growth. In fact, there have been no changes since 2014 in time nor cost related to documentary or border compliance procedures. Additionally, the GII 2019 identifies the applied tariff rate in the UAE as a weak point, ranking the UAE 81th in this area. Similarly, the WEF GCI 2018 identifies room for improvement regarding trade tariffs and the complexity of tariffs.

As Doing Business does not assign scores or ranks in the area of labor market regulation, we are turning to the WEF GCI 4.0 2018 to assess how conducive the UAE environment is in this aspect. The GCI ranks the UAE 42nd out of 140 countries, with a score of 63.4. This places the UAE above the MENA average of 52.3, but below the average of the group of high-income countries of 66.4, and that of Europe and North America of 66.2. In terms of labor market flexibility, the UAE scores quite high (rank 25), particularly in areas such as redundancy costs, hiring and firing practices, and ease of hiring foreign labor, whereas workers’ rights are an area of concern. In terms of meritocracy and incentivization in the labor market there is more room for improvement (UAE occupies rank 61), which is particularly due to a lack of female participation in the labor force.
There is still room for improvement in labor market regulations

Source: World Economic Forum, World Competitiveness Index 4.0 2018 dataset

One area not covered by the WB’s Doing Business is market size, which also plays a role in the overall development and sophistication of a market. Larger markets (in terms of GDP, but also the share of imports and exports) tend to lift productivity through economies of scale and facilitate innovation. Moreover, large markets create positive externalities related to the accumulation of human capital and transmission of knowledge. The GI2019 ranks the UAE 32nd in terms of domestic market scale, the WEF GCI 2018 28th in terms of market size.

The overall development of the business environment in the UAE - as shown by the graph below - has been impressive, and consistent. Each year since the introduction of Doing Business has the UAE taken regulatory measures to improve the country’s business environment. This is an undeniable demonstration of the country’s solid commitment to building an economy in which the private sector is the motor.
Figure 56 - The country has made impressive progress on Doing Business scores

In the last five years alone, numerous tangible measures were implemented, for example, in Dubai:

- To make starting a business easier online registration was improved, name reservation and articles of association notarization streamlined, and registration procedures merged with the Ministry of Human Resources and General Pensions and Social Security Authority.
- Getting electricity was made easier by eliminating all costs for commercial and industrial connections of up to 150 kilo-Volt-Amperes (kVA), streamlining the connection process and eliminating interactions between the customer and the utility to obtain external works, eliminating the security deposit for connections under 150 kVA, and reducing the time required to obtain a new electricity connection by implementing a program with strict deadlines for reviewing applications, carrying out inspections and meter installations. Also, compensation for power outages was introduced, and the time needed to provide a connection cost estimate reduced.
- Registering property was made easier by increasing the transparency of the land administration system and of the country’s land registry. Also transferring property was made easier by introducing new service centers and a standard contract for property transactions.
- Dubai strengthened access to credit by introducing the possibility of granting a nonpossessory security right in a single category of movable assets without requiring a specific description of the collateral, by allowing out of court enforcement of the security interest, and by establishing a unified and modern collateral registry. Also improved was access to credit information by starting to provide consumer credit scores to banks and financial institutions. The credit bureau improved access to credit information by starting to exchange credit information with a utility.
- With regard to construction permits, strengthened construction quality control was achieved by imposing stricter qualification requirements for professionals reviewing drawings. The UAE also reduced the time and cost to obtain a building permit by eliminating a procedure and made dealing with construction permits easier by implementing risk-based inspections, merging the final inspection
into the process of obtaining a completion certificate, and streamlining the process for obtaining the
civil defense approval.
- Resolving insolvency was made easier by adopting an insolvency law that introduces a reorganization
procedure and facilitates continuation of the debtor’s business during insolvency proceedings.
- Minority investor protection was enhanced by increasing shareholders’ rights and role in major
corporate decisions, clarifying ownership and control structures, and requiring greater corporate
transparency, by barring a subsidiary from acquiring shares in its parent company and by requiring
that a potential acquirer, upon reaching 50% or more of the capital of a company, make a purchase
offer to all shareholders. The UAE furthermore strengthened minority investors’ protection, by
introducing additional approval requirements for related-party transactions and greater requirements
for disclosure of such transactions to the stock exchange; by introducing a requirement that
interested directors be held liable in a related-party transaction that is unfair or constitutes a conflict
of interest; and by making it possible for shareholders to inspect the documents pertaining to a
related-party transaction, appoint auditors to inspect the transaction and request a rescission of the
transaction if it should prove to be unfair.
- In terms of business-friendly labor market regulation, Dubai reduced the duration of a single fixed-
term contract from 48 to 24 month.
- Finally, measures were taken to make enforcing contracts easier by implementing electronic service
of process, introducing a new case management office within the competent court and by further
developing the “Smart Petitions” service allowing litigants to file and track motions online.

The UAE is global leader in political institutions

The overall political and governance set-up of a country is the foundation on which all actors plan, decide and
act. High-quality public institutions - including a strong regime for the protection of property rights, low levels
of unethical behavior, corruption, or undue interference with political processes, an efficient government, and
a safe and secure environment - provide all actors with a long-term, stable perspective, which is a prerequisite
for development, innovation, and growth. To assess the UAE’s political framework, we will mainly refer to the
WEF Global Competitiveness Index (GCI) and Reports (GCR).

The GCI considers five areas of importance to the quality of public institutions: property rights, ethics and
corruption, undue influence, government efficiency and security. The table below lists all of
the UAE’s scores - on a scale from 1 to 7 - and rankings - among 137 countries - as per GCI 2017-18.
Its overall rank among 137 countries regarding political institutions is five (with a score of 6.0 on the
1-7 scale), just behind Finland (6.2), Singapore (6.1), New Zealand (6.0) and Switzerland (6.0), and ahead of
Luxemburg (5.8), Norway (5.8), the Netherlands (5.8), Qatar (5.8) and Hong Kong SAR (5.7). For the majority of
the political institutions sub-components, the UAE ranks among the top ten, for a few among the top 20, and
only for one indicator - intellectual property protection - beyond the top 20 (rank 21).
### Table 9 - The country serves as an example of great political institutions

<table>
<thead>
<tr>
<th>Sub-component</th>
<th>Rank/137</th>
<th>Value (scale 1-7)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Property rights</strong></td>
<td>15</td>
<td>5.9</td>
</tr>
<tr>
<td>- Property rights</td>
<td>14</td>
<td>5.9</td>
</tr>
<tr>
<td>- Intellectual property protection</td>
<td>21</td>
<td>5.7</td>
</tr>
<tr>
<td><strong>Ethics and corruption</strong></td>
<td>3</td>
<td>6.3</td>
</tr>
<tr>
<td>- Diversion of public funds</td>
<td>3</td>
<td>6.2</td>
</tr>
<tr>
<td>- Public Trust in Politicians</td>
<td>2</td>
<td>6.3</td>
</tr>
<tr>
<td>- Irregular payments and bribes</td>
<td>6</td>
<td>6.4</td>
</tr>
<tr>
<td><strong>Undue influence</strong></td>
<td>8</td>
<td>5.7</td>
</tr>
<tr>
<td>- Judicial independence</td>
<td>16</td>
<td>5.8</td>
</tr>
<tr>
<td>- Favoritism in decisions of government officials</td>
<td>2</td>
<td>5.7</td>
</tr>
<tr>
<td><strong>Government efficiency</strong></td>
<td>2</td>
<td>5.6</td>
</tr>
<tr>
<td>- Efficiency of government spending</td>
<td>1</td>
<td>6.2</td>
</tr>
<tr>
<td>- Burden of government regulation</td>
<td>2</td>
<td>5.4</td>
</tr>
<tr>
<td>- Efficiency of legal framework in settling disputes</td>
<td>5</td>
<td>5.7</td>
</tr>
<tr>
<td>- Efficiency of legal framework in challenging regulations</td>
<td>13</td>
<td>4.9</td>
</tr>
<tr>
<td>- Transparency of government policy making</td>
<td>10</td>
<td>5.7</td>
</tr>
<tr>
<td><strong>Security</strong></td>
<td>2</td>
<td>6.3</td>
</tr>
<tr>
<td>- Business cost of terrorism</td>
<td>7</td>
<td>6.2</td>
</tr>
<tr>
<td>- Business cost of crime and violence</td>
<td>4</td>
<td>6.3</td>
</tr>
<tr>
<td>- Organized crime</td>
<td>7</td>
<td>6.4</td>
</tr>
<tr>
<td>- Reliability of police services</td>
<td>5</td>
<td>6.5</td>
</tr>
</tbody>
</table>

**Source:** World Economic Forum, The Global Competitiveness Index dataset 2007-17

The GCI 2018-19 introduced “social capital”, “e-participation” and “future orientation of government” as additional indicators of the quality of governance and political institutions. The social capital indicator measures national performance in three areas: social cohesion and engagement, community and family networks, and political participation and institutional trust. The E-Participation Index measures the use of online services to facilitate the provision of information by governments to citizens (“e-information sharing”), interaction with stakeholders (“e-consultation”) and engagement in decision-making processes (“e-decision making”). “Future orientation of government” captures to which extent the government adapts legal frameworks to digital business models, ensures a stable policy environment, responds effectively to change
(e.g. technological changes, societal and demographic trends, security and economic challenges), and has a long-term vision in place. The UAE was ranked 27th, 17th and 4th out of 140 countries, respectively. All in all, therefore, the country provides political and governance foundations that are highly conducive to further development.

The graph below compares the UAE’s scores on political institutions to the regional averages of Europe and North America and MENA. It demonstrates that the UAE is not only outperforming other economies in its region by a large margin, but also the economies of Europe and North America.

*Figure 57 - The UAE Government is ethical and efficient*

![Graph showing political institutions regional comparison](image)

*Source: World Economic Forum, The Global Competitiveness Index dataset 2007-17*

The graph below shows that the UAE has made continuous and impressive progress in terms of improving the fundamental conditions for long-term growth in the country. With some setbacks at the turn of the decade, the UAE managed to improve from rank 19 in 2011 to rank 5 in 2018. By the same token, it improved its overall score from 5.25 in the weakest years to 5.97 in 2018. The five sub-areas (property rights, ethics and corruption, undue influence, government efficiency and security) show the same pattern - with the exception of security, which has remained more stable around a value of close to 6.5.
**Figure 58 - Public institutions have made impressive progress**


**Figure 59 - There is evident improvement in the majority of areas**

Considering the sub-component security, the UAE comes in as 2nd out of 137 countries with a score of 6.3, just after Finland with a score of 6.6. This sub-component captures the business community's estimation of the extent to which:

- the threat of terrorism imposes costs on businesses;
- the incidence of crime and violence imposes costs on businesses;
- organized crime (mafia-oriented racketeering, extortion) imposes costs on businesses; and
- police services can be relied upon to enforce law and order.

Regionally, the differences are considerable. Three regional economies - Oman, Qatar and the UAE - managed to significantly improve the overall security environment between 2007 and 2010 and to maintain this environment to a large extent over the following years. Other economies, including Bahrain, Israel, Kuwait and Saudi Arabia, have experienced a deterioration of their overall security situation starting around 2010/11. Over the last five years, the UAE particularly enhanced the reliability of its police services, while businesses report a slight increase in costs due to the threat of terrorism, crime and violence, and organized crime.

*Figure 60 - The UAE is the most secure country in the region*

![Graph showing security sub-component comparison](source: World Economic Forum, The Global Competitiveness Index dataset 2007-17)
In terms of the ethics and corruption sub-component, Singapore is number one out of 137 with a score of 6.4. The UAE ranks third with 6.3. This sub-component captures the business community's assessment of:

- how common illegal diversion of public funds to companies, individuals, or groups is;
- the ethical standards of politicians;
- how common it is for firms to make undocumented extra payments or bribes connected with imports and exports, public utilities, annual tax payments, awarding of public contracts and licenses, and obtaining favorable judicial decisions.

Regionally, we can again observe striking differences - with Qatar and the UAE leading the field and Kuwait at the bottom of the field. In 2015/16 the UAE in fact passed Qatar and is now leading. While Qatar and the UAE were able to achieve continuous progress on this sub-component since 2007, the other countries show a more uneven pattern with improvements till 2010/11 followed by regression. The UAE is doing particularly well in the area of irregular payments and bribes, but has also recorded steady improvements in the other two areas of this sub-component: diversion of public funds and public trust in politicians.
Figure 62 - The UAE is one of the least corrupt countries in the world


Figure 63 - Leaders are trusted to behave ethically


On the undue influence subcomponent, the UAE’s performance is slightly weaker: Finland ranks 1st in this area with a score of 6.2, the UAE comes in 8th with 5.7. This sub-component indicates how independent the judicial
system is from influences of the government, individuals, or companies, as well as to what extent government officials show favoritism to well-connected firms and individuals when deciding upon policies and contracts.

Once more, Qatar and the UAE are the regional forerunners in this area, with the UAE in the lead since 2016/17. We see a similar pattern as in the previous graphs, albeit on a lower level: the UAE records a steady upward trend, whereas other economies’ development is more uneven and often shows a deterioration starting in 2010/11. Zooming in on the UAE, we see a slight dip in both, judicial independence and favoritism from 2008 to 2012, and a consistent improvement since then.

*Figure 64 - Connections do not matter much in dealing with the Government*

*Source: World Economic Forum, The Global Competitiveness Index dataset 2007-17*
Figure 65 - Government officials and judges are becoming more independent

Undue influence subcomponents, UAE development (2007-18)


Although the UAE’s score on “government efficiency” is relatively low - 5.6 - it still ranks 2nd on this sub-component out of 137 countries. Singapore is number 1 in this area with 5.8. This subcomponent captures how the business community assesses the following:

- how efficient government is in spending public revenue;
- how burdensome is it for companies to comply with public administration’s requirements;
- how efficient the legal and judicial systems are for companies in settling disputes;
- how easy it is for private businesses to challenge government actions and/or regulations through the legal system; and
- how easy it is for companies to obtain information about changes in government policies and regulations affecting their activities.

The regional pattern is consistent: Qatar and the UAE are in the lead and could record improvements for most of the period 2007-18. Also, in this area, the UAE has recently surpassed Qatar. The other economies show a more uneven trend, particularly starting 2010/11. The UAE, again, witnessed a slump between 2009 and 2012, but could since make progress in all fields. The UAE Government was particularly highly rated in terms of the efficiency of its spending.
We conclude this chapter with a look at the WEF Executive Opinion Survey featured in the GCI 2017-18. In this context, respondents were asked to select the five most problematic factors for doing business in their country.
from a list of factors, and to rank them between 1 (most problematic) and 5. The scores below correspond to the responses weighted according to their rankings, and underline many of the points highlighted in the preceding analysis.

**Figure 68 - Financing, inflation and workforce qualification are the main concerns**

![Chart](chart.png)

**Source:** World Economic Forum, Global Competitiveness Index 2017-2018
SHORT-RUN ECONOMIC PERSPECTIVES: MONETARY POLICY AS A BARRIER TO FUTURE BALANCED GROWTH
Most economies of the world have adopted a Keynesian approach to economics in one form or another to smoothen business cycles, that is, to limit the effects of recessions and control inflation during economic expansions. The UAE is no exception, despite their seeming laissez-faire approach. Actually, the Emirati Government is highly involved in the economy, steering its development through various means available to them - policies, regulations and laws. In this chapter we will take a look at the country’s fiscal and monetary policies and investigate how effective they are.

Main insights

The UAE Government conducts a very hands-on economic policy. It is using fiscal policy to tame business cycles, but there is only a limited role for monetary policy due to the AED peg to the USD.

Since 2015, economic growth has been more mixed due to a number of factors impacting both demand and supply. In 2017 and 2018 growth has been positive but on a low level of 0.8 and 1.4%, respectively. To support the economy the Government is currently following an expansionary fiscal policy. However, the effects of this policy are partially offset by monetary policy, which has been contractionary. If not for the fiscal stimulus in 2018, the UAE economy would probably have contracted in that year.

One of the factors responsible for slower growth has been a credit crunch, which is due to, among other factors, higher interest rates. Government debt has remained on a low level, despite high deficits in a few recent years. Risks related to government debt remain low as well. International trade is the key driver of GDP growth in the UAE and depends strongly on exchange rates.

Outlook

We expect no new taxes in the UAE in the short to medium term. The VAT of, currently, 5% has become an additional fiscal policy tool - and could still undergo some adjustments in the medium- to long-term. Federal bonds can become an additional tool for the Government to acquire the necessary funds for balancing the economy without raising taxes or tapping into sovereign wealth funds.

Depegging makes a lot of macroeconomic sense and will happen in the mid-term. If the depegging happens, an appreciation of the AED can be expected, hurting exports in the short term, but supporting them in the mid- to long-term. We expect no issues with regard to the Government’s solvency.

For businesses

The UAE Government wields high discretionary power and resources to balance the economy, providing businesses with a stable environment. Despite the introduction of the VAT, the UAE remains a low tax haven, and the Government has every interest to cultivate this status.

In terms of opportunities, international trade is continuously gaining in importance and the UAE Government will surely take additional measures to facilitate business in this area. Federal bonds could become a promising and safe way for investing money. We expect the difficulties related to getting credit to decrease in the near future, linked to an upswing in the economy, as well as structural measures that the Government will implement to strengthen this important element of the overall business environment.

For the Government

Two important steps to increase stability and balanced growth of the economy will be the reduction of tariffs and the depegging of the AED from the USD. The sooner this latter measure can be taken the better, given the economic imbalances created by the current monetary policy.
Fiscal policy unlikely to change in coming years

In the UAE economic development is highly intertwined with Government decisions. The Government takes a hands-on approach to steering the economy, which is not least reflected in the Emirati fiscal policy. Fiscal policy is developed in the Macroeconomic and Fiscal Policy Department, which reports to the Under Secretary of the Ministry of Finance.

**Figure 69 - Taxes levied on oil and gas companies are the main source of revenue**

![Sources of government revenue (2018)](image)

*Source: Federal Competitiveness and Statistics Authority, National Accounts*

It may come as a surprise to some readers that taxes are a major source of federal Government revenue, despite the fact that the country is famous for having no corporate or private income taxes. This is not even due to the VAT, which was introduced only recently (on 1 January 2018). The main sources of revenue are taxes levied on the oil and gas industry (displayed as “crude oil revenues” in the chart above). Additionally, there are taxes on foreign banks and various customs tariffs.

Cutting or raising taxes is one of governments’ main fiscal policy tools, next to increases or decreases in government transfers and in government purchases of goods and services. Due to the limited role taxes play in the UAE, government spending (government purchases and transfers) is the main tool of the UAE Government when it comes to fiscal policy. Taking a look at the federal budget in the graph below, we can see that the UAE Government’s spending followed closely the development of the economy in the early decades of the Federation: higher spending in times of GDP growth (and higher oil prices), lower spending when GDP was falling. However, in the past two decades a switch to the Keynesian approach is noticeable – fiscal policy has become countercyclical. In times of expansion (mid 2000s, early 2010s) – the Government slowed down spending, often making cuts, and preventing a strong increase of the inflation rate. This often, but not always, resulted in fiscal balance surpluses, as we can see from the graphs below. In times of recession, we can see an expansionary policy in action: a significant increase in spending in 2009, followed by an increase in spending in
2015 - showing as budget deficits. The 2019 federal budget is a clear sign that the Government is acting against an economic slowdown.

To better understand the Government’s approach, we can turn to actual numbers from the crisis years 2008 and 2009. The Government started to act in 2008, by increasing development spending by 91% - from 17.3 billion AED to 32.9 billion (4.7 billion USD and 9 billion USD, respectively). Government labor expenses increased by 71%, and subsidies and transfers by 39%. The trend continued in 2009, when development spending grew by additional 41%, wages and salaries by 18%, and subsidies/transfers by 10%. These measures were reflected in the fiscal balance of that year: in 2009 the UAE’s budget deficit reached a record high of 16.8% of GDP.

*Figure 70 - The Government increases the budget when the economy faces difficulties*

Source: Ministry of Finance and Federal Competitiveness and Statistics Authority
Figure 71 - The government was running a fiscal deficit for the biggest part of the decade

![Fiscal Balance (as % of GDP)](image)

Source: Federal Competitiveness and Statistics Authority, National Accounts

Development spending decreased in 2010, but the Government’s expenditures did not go back to pre-crisis levels. The fiscal balance remained negative for most of the 2010s, despite high oil prices in the beginning of the decade. The situation was suddenly exacerbated in 2014, when the oil price dropped. The UAE Government started to search for a new source of revenue with a view to ensuring the sustainability of its fiscal policy through more independence from oil and gas revenues. This is when the idea of a GCC-wide VAT was born - and the VAT was introduced, as we mentioned already, at the beginning of 2018.

As we have seen already, in 2018 oil prices increased once again, and the oil sector grew by 2.8%. The growth in other sectors was substantially more modest. Investment spending (in the form of gross fixed capital formation and change in inventories) and consumer spending dropped by 6.5% and 0.5%, respectively, in 2018. When we dig deeper, we discover that imports dropped by 3.2% and exports increased by 0.84%. Nevertheless, GDP grew in 2018, which is actually due to this substantial drop in imports and the increase in exports driven mostly by the oil and gas industry (crude oil, natural gas and petroleum product exports grew by 8.7%). When the VAT was introduced in 2018 it negatively affected consumer spending, and, in turn, GDP growth. Moreover, consumer confidence was down in the beginning of 2018, the local stock exchange was still far below pre-2015 levels, real estate value continued to decline, accumulated inventories were still high, and investors did not have much incentive to spend more. Basically, the economy was experiencing a decrease in demand and a negative demand shock. Countering a negative demand shock with higher Government spending usually is a smart strategy.

Yet, despite the demand shock, inflation was 3.07% in 2018 (and had increased markedly since 2016). This is a sign that the economy was likely also facing a negative supply shock, which could be attributed to the introduction of the VAT as well. Companies in all industries were confronted with higher costs associated with tax compliance, with hiring tax experts or paying non-compliance fines. Additionally, oil prices in 2018 were on the rise and local businesses were facing higher input prices (e.g. the average price of unleaded gasoline 95
increased by 25% in 2018). Salaries were growing as well, amplifying the negative supply shock. A negative supply shock is more difficult to fix. Yet, we can argue that the new laws passed in the frame of the Agenda 2021 in 2018 (and later in 2019), aimed at making the country even more business and foreign investor friendly, were trying to positively influence supply.

As the UAE Government moves to support aggregate demand to counterbalance the slowing economy, it could drive the price level up further. However, the most recent developments of the price level (see CPI information in the graph below), indicate that, in the end of 2018 and at the beginning of 2019, the country was actually experiencing a deflation. This even though GDP was growing in Q1 2019. This means that, after all, aggregate demand is the key issue and even the expansionary fiscal policy is affecting prices only to a limited extent. It also hints at bubbles that have developed in certain sectors, including real estate development and hospitality; low prices in these sectors exert a strong downward pressure on the CPI. According to our estimates the fiscal stimulus of 2018 should have led to close to 2% of GDP growth in 2018, but total growth for the year only reached 1.4%. On the one hand, monetary policy was limiting the fiscal stimulus' effect (as we will discuss below), on the other hand, without the fiscal stimulus, the economy would probably have experienced a slight recession in 2018.

Figure 72 - Prices were falling at the end of 2018 and the beginning of 2019

Source: Federal Competitiveness and Statistics Authority, Consumer Price Index Statistics
Despite some recent economic woes and budget deficits in some years, the UAE is one of the least indebted economies in the world. Although, on the emirate level, some sovereign bonds were issued before (the first one, worth 1.5 billion USD, by the emirate of Abu Dhabi to help counter the crisis in 2009), only in 2018 a law was passed to allow the issuance of federal bonds.

The federal Government’s debt remained in single digits for most of the 2000s, rising sharply in 2009, when the Government was fighting the aftermath of the global financial and economic crisis. Recovery quickly followed - until 2015, when the Government was forced to borrow again in response to the taking oil prices. Still, the outlook remains very positive. The Emirati Government shows great fiscal discipline and applies a zero-based budget approach to dealing with its finances. This gives the country an Aa2 stable credit rating according to Moody’s.

The situation is somewhat different on the emirate level. The Government of Dubai is facing challenges due to substantial debts: the Government Related Enterprises (GREs) of Dubai carry a debt burden of about 70% of Dubai’s GDP. This situation has led to recent bond downgrades for some of the implicated enterprises; the Dubai Water and Electricity Authority was downgraded to BBB by S&P, and DIFC investments received BBB-, which is just a notch above junk status. Dubai’s debt situation is counterbalanced by Abu Dhabi, which has shown on multiple occasions that it is willing and able to extend help to Dubai, if the need arises. The first such intervention was a bail out in 2009; recently Abu Dhabi agreed to refinance Dubai’s outstanding debt. Despite such fiscal challenges on the emirate level, the outlook for the federal Government is positive.

Figure 73 - External financing is barely used by the Government

Source: International Monetary Fund
It is highly unlikely that the UAE’s fiscal policy will change in any significant manner. The vast wealth accumulated by the UAE federal and local Governments (the UAE manages sovereign wealth funds of approximately 1.3 trillion USD, making the country the second largest sovereign investor, just after China) allows the Emirati Government to weather almost any storm. The economic fallout associated with the introduction of the VAT, and the unstable geo-political and geo-economic situation in the region and beyond - which may cause caution among businesses and investors - mean that it is not in the Government’s interest to introduce any new taxes in the short- to medium-term. The introduction of corporate taxes would sabotage the Government’s work to attract investors, and a personal income tax would damage consumer spending and turn away a significant portion of the country’s highly skilled human capital.

Moreover, the Emirati Government does not need to use taxes as automatic stabilizers of the economy to an extent that other developed economies do. As the UAE Government, due to the unique political system, can reach and implement decisions comparatively quickly, discretionary fiscal policy is effective and provides greater flexibility. This does not mean, however, that we won’t see changes to the VAT. This tax will be another tool, besides government spending, in the Government’s repertoire to smoothen business cycles. It will provide an additional, although minor, revenue stream of currently 6% of total government revenue, shielding it from the effects of oil price volatility.

Monetary policy currently contradicts fiscal policy

Monetary policy in the UAE is decided by the CBUAE, which currently has an objective of promoting and protecting the stability of the financial system. In this case stability doesn’t mean smoothing business cycles, but ensuring a predictable exchange rate; since November 1997 the AED is pegged to USD. This forces the UAE Government to keep USD at hand to maintain the peg, but this is easy to achieve for the Emirates, because the oil trade is done in USD.

The USD peg means that, despite the possibility to influence liquidity and money supply, the CBUAE has little wiggle room, as the stability of the exchange rate always takes precedence. The Central Bank’s short-term lending rate – the repo rate - follows closely the US Federal Funds Rate.
This policy choice caused troubles in the mid 2000s, when oil prices surged and the country faced high growth, and, as a result, high inflation. The CBUAE could not use monetary policy to counterbalance the business cycle. This situation led to talks about establishing a common GCC currency in Saudi Arabia, Oman, the UAE, Qatar and Bahrain. The countries were unable to reach a consensus, and, thus, the talks were abandoned in 2009.

The weak USD at the beginning of the current decade helped the UAE recover from the consequences of the financial and economic crisis – by attracting international tourism and boosting exports. However, the situation was exactly reversed in 2015, when the USD was appreciating against other major currencies. This was bad timing for the Emirates, which saw falling oil prices, real estate market issues, and an overall slowdown in the economy at that time. The biggest trade partners of the Emirates - the Eurozone countries, India and Switzerland – were confronted with more expensive goods and services.
Figure 75 - The AED is appreciating against other currencies following the USD

Considering that the CBUEA sees the stability of the system as its main objective, it started to question the sustainability of such a constrained monetary policy. Since 2018 there are talks about a potential depegging and a switching to a basket of currencies. Such a move would not affect oil exports per se, as the oil trade would remain in USD, but it would add some complexity to forming a budget, which is still highly dependent on oil revenues. In 2018 a new law was passed giving more powers to the Central Bank in establishing the exchange rate and promoting liquidity, with the aim of helping the Ministry of Finance achieve balanced growth in the economy.

As international trade, tourism and other sectors become more important than oil, we will see more and more reasons for the depegging. Depegging would give the CBUEA freedom to support the economy, when it is needed. The current situation is the best example of such a need: the Government is aggressively pursuing an expansionary fiscal policy to boost aggregate demand, yet the CBUEA has been raising interest rates and appreciating the AED, following the Fed’s decision. The monetary policy is thus contractionary and offsetting the fiscal stimulus. All factors considered; we expect to see the switch to a basket of currencies in the coming decade.

International trade dependent on exchange rate

Emiratis have been engaging in trade for centuries, and nowadays the country is a major trading hub, being ranked number 16 in the world by the WTO and number 1 in the Middle East. International trade depends heavily on price levels, which, in turn, depend on currency exchange rates. In this chapter we will analyze the situation of the AED and take a look at recent developments in the UAE’s trade profile.
As expected, because of the currency peg to the US Dollar, we do not see any dependence between the nominal exchange rate and the relative price level (the PPP conversion factor ratio provided by the WB is used here to display the difference in the price levels of the UAE and the USA). At the same time, we see that the AED is substantially undervalued when compared to the USD: for 2.1 AED we could buy the same amount of goods in the UAE as 1 USD would have bought us in the USA in 2018. This means that the peg currently makes Emirati exports more competitive, and the peg’s removal could lead to appreciation of AED in the short run, which, in turn, would lower competitiveness.

Source: World Bank, World Development Indicators
To analyze currencies more in-depth we can use effective exchange rates (real and nominal) provided by the Bank for International Settlements (BIS). Both exchange rates are weighted against a basket of currencies of a country’s trade partners. The real effective exchange rate (REER) is additionally adjusted for inflation.

When the AED is appreciating in relation to the currencies of the UAE trading partners, NEER and REER are rising. We can see that NEER was especially high in the early 2000s, because of the moderately high inflation during that period. It started dropping around 2007 and remained close to the index value of 100 until 2014. With the USD appreciating in 2014 against many other major currencies (including EUR), the AED appreciated as well, making Emirati non-oil exports less competitive as a result (oil is traded in USD and, as a commodity, is not affected by foreign exchange fluctuations as much).

From this chart it becomes evident that the Dirham’s effective exchange rate is moving in the opposite direction of the country’s business cycle: it depreciated in the mid 2000s and early 2010s when the country’s economy was booming, and it appreciated during the crisis years 2007-09 and the economic slowdown starting in 2014/15. In this way, currency aspects exacerbate business cycles, making the UAE economy more volatile: as the economy is expanding, the low REER encourages additional exports, leading to even higher GDP growth. The opposite is also true: when the economy is going through low or negative growth periods, a high REER discourages exports, further depressing GDP growth. This stresses the importance of dropping the peg, as the UAE relies even more on trade for sustained GDP growth, but less on oil exports, due to its transition to a knowledge-based economy.
Figure 78 - The UAE has many trading partners

The UAE’s non-oil trade (which is significant - oil and gas exports account for 17% of total exports), as per the graph above, is very diversified when it comes to trading partners. There is no dominant trade partner, which gives the UAE additional economic freedom.

Figure 79 - Exports are the key driver of GDP growth

Source: Federal Competitiveness and Statistics Authority, International Trade Statistics

Source: Federal Competitiveness and Statistics Authority, National Accounts
The graph above shows the main trends of the UAE trade in goods and services with other countries expressed as a percentage of GDP. As per UN Manual of International Merchandise Trade Statistics exports are valued at FOB (Free on Board), imports at CIF (Cost, Insurance, and Freight). As we can see, the UAE is a net exporter; exports have more and more become a key driver of the country’s economic growth. Historically the country enjoys a current account surplus, which not only boosts economic growth, but also makes the UAE a source of financing to other countries. A good example of such financing are the multiple Emirati sovereign wealth funds that we mentioned above.

The data show that exports as a share of GDP were growing steadily until 2012. As oil is included in total exports, and the price of oil reached its peak in 2012, it is no wonder that there was no growth (and even a slight decline in 2014) since 2012. Oil prices rebounded in 2018, but other exports were in decline (for reasons discussed further below), causing the downward slope we can see on the graph. Imports were growing rapidly until 2009, but since then their growth (as a percentage of GDP) was minimal.

For both imports and exports 2018 represents a peculiar case. An obvious suspect is the trade with Qatar, given the blockade instituted in June 2017. Trade with this GCC country was thus almost non-existent in 2018 (as evident in the graph below). Yet, we can see that, when expressed in absolute terms, this blockade did not have that big of an effect. 10.9 billion AED in exports and 2.1 billion AED in imports in 2016 mean that the trade between the two countries contributed about 0.7% to the GDP of the UAE. Lifting the blockade represents an opportunity, but the reasons for the remarkable import-export situation in 2018 lie elsewhere.

*Figure 80 - Trade with Qatar was contributing 0.7% towards GDP in 2016*

*Source: Federal Competitiveness and Statistics Authority, International Trade Statistics*
To understand the origins of the 2018 situation, we summarize the recent developments in the economy:

1. a negative supply shock occurred, due to the introduction of the VAT in combination with other factors that increased costs for businesses, driving up prices in the economy, while slowing down output growth
2. decreases in demand and a negative demand shock happened simultaneously, related to lower purchasing power of consumers, decreases in wealth, and lower investment and consumer spending due to - among other factors - growing interest rates
3. a strong USD led to a stronger AED
4. inventory levels remained high

Additionally, as is often the case, economic troubles were magnified by a credit crunch. Recently, it has become more difficult for businesses to get the leverage needed for faster growth, owed to increases of the interest rate, the introduction of the Basel III framework (increasing capital requirements for banks, limiting their lending) and difficulties of existing creditors in repaying their loans. These issues can be discovered in the credit statistics of UAE banks in the chart below. Bank loans to the private sector generally follow the development of the economy with a slight time lag. In 2012-16 loans were growing faster than the economy. The amount of credit issued to the private sector grew by 8.9% in 2015, but when the factors mentioned above started to affect decision making on both sides, the credit growth rate dropped to 1% in 2017, with a slight recovery in 2018. This is an additional obstacle for businesses to invest in growth and drive trade. At the same time, we can see that the situation seems to be improving, and, as the economy grows, getting credit should become easier again.

Figure 81 - Since 2017 businesses are getting less credit

Source: Central Bank of the UAE

The higher prices of UAE products and the strong dollar made the UAE exports less attractive, while imports were sluggish due to the accumulated inventories, the VAT (all imports are subject to VAT), the
aforementioned credit crunch and the lower purchasing power of the population. However, all these challenges are likely to be resolved soon. The UAE Government shows great foresight, continuing to attract foreign entrepreneurs by making the country even more business friendly and utilizing fiscal policy to support economic growth.

All in all, we believe that the Government and the economy would benefit, in the medium-term, from a depegging of the AED. First of all, business friendliness could be damaged by introducing more taxes - although we have no reason to think that the UAE Government will introduce new taxes in the foreseeable future, too much reliance on fiscal policy may lead to a need of additional government revenues in the future. Also, as we mentioned previously, the UAE would benefit from further removing obstacles to collaboration and trade, including by reducing tariffs. However, government revenue from tariffs currently make up a quarter of the total revenues - again, the reliance on fiscal policy limits the UAE in taking measures to further bolster its economy. Moreover, the country’s monetary policy currently forces the UAE Government to enact measures that contradict its fiscal policy. Depegging could affect some local exports in the short-term, as the AED would appreciate, but at the same time it would help with re-exports, which are an important part of the economy as well. In the longer term, having monetary policy at their full disposal would allow the UAE to take much more effective steps to support trade and the economy overall, and to ensure balanced and sustainable growth.
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