

Nov 04, 2016 by **John D'Agostino**

Doubting Dubai's Doubters ^[1]

The *schadenfreude* surrounding Dubai World's request for a partial debt standstill is understandable, however lamentable. Dubai has the unfortunate timing of having experienced its tremendous evolution, and subsequent stumble, at the peak of populist displeasure with leveraged driven growth. The lack of specifics surrounding the crisis is partially Dubai's fault. Seemingly advised by the same PR team as Tiger Woods, the crisis management strategy of 'say nothing' is resulting in Dubai finding itself tried and convicted in the court of public opinion without so much as offering a defense.

This strategy becomes somewhat understandable if one considers the difficult job Dubai has in balancing modernity with Arab tradition, Islamic law, tribal/family politics and inter-emirate competition. Those of us who did business in Dubai learned early not to confuse the progress there with regards to property rights and the rule of law with a Western government or society. Dubai is not Western and never claimed to be Western. What it truthfully claimed to be was a modern Middle East state that emulated (certain) progressive Western cultural and economic policies – something we as Americans might seek to encourage rather than dismiss.

In 2004, I helped create the first Middle East based energy commodities exchange in Dubai. This project received little fanfare. Yet it highlighted Dubai's willingness to embrace transparency and international regulatory oversight in the spirit of true partnership with the West – a step towards integrating the region into the global financial marketplace.

A few experiential observations may be useful as the world tries to understand the situation:

1. Dubai World is not the Dubai government, but a quasi-government entity. This distinction is important. Dubai World is one of several holding companies that make up "Dubai, Inc.", the collection of competing entities established by the government but operated independently. Dubai World restructuring the debt of its underlying companies does not constitute a sovereign default any more than a failure of the U.S. Postal Service (while very troubling) would constitute a default of U.S. sovereign debt.
2. As of now one specific company, Nakheel, is distressed. This makes sense, given Dubai was not immune to the global property market meltdown and Nakheel, as one of the regions' largest real estate developers, consequently suffered. Dubai World's involvement is a result of contractual cross-collateralizations with Nakheel.
3. The decision to have Dubai World lead these negotiations has greatly exacerbated concerns. A construction company requesting a debt standstill is far less troubling and salacious than a quasi-governmental institution seeking the same. It's unclear as to why this decision was made and, more importantly, why it was announced so suddenly, though simple inexperience might have played a significant role.
4. The presumed backstop to Dubai's investments, Abu Dhabi, seems to be taking a

reasonable approach given the circumstances. Rather than writing a blank-check bailout, all evidence is that Abu Dhabi will carefully screen distressed investments for opportunities and extract far stronger terms/control for their money than our own government did recently.

5. When all is said and done, regional investors and banks, not foreign, will likely be the hardest hit. While foreign investment was a major part of Dubai's growth, Gulf State (GCC) investment accounted for the lion's share (GCC banks lent over 60B to Dubai) and will undoubtedly be the ongoing source of short term funding. Dubai's actions alone are unlikely to cause a global systemic shock (the numbers simply aren't big enough), but neighboring GCC states will undoubtedly see a higher cost of borrowing.

6. Dubai is not all ski slopes and shopping malls. The boom period led to build-outs of world class technology, industrial and financial infrastructure. Truly progressive deals were done in a legal and regulatory environment that, while not perfect, was extraordinary given Dubai's adolescence. Dubai leapfrogged the region in terms of promoting financial market transparency and integration.

So while the media (and admittedly Dubai itself) reveled in the extravagance of false islands, indoor ski slopes and the tallest/biggest/most expensive _____, there is a more important story, particularly for the United States. Dubai represented an example of what can happen when a Middle East nation willingly embraces U.S. style capitalist and democratic principles. Contrary to the disastrous scenario of our attempts to force democratic capitalism down the throats of a people, Dubai is proof that America's primary export can still be economic and legal innovation, as well as hope. This phenomenon perhaps deserves to be celebrated, if we can spare a moment from dancing among what we believe to be Dubai's ashes.

The writer is employed in the financial sector, and has traveled and worked in Dubai for 8 years (although he no longer has business interests in the region).
