

UAE Economic Structure

This article examines the structural economic developments of the UAE and the separate Emirates, emphasising determinants of sectoral growth such as the utilization of factors of production, technological change, and the investment level. The article is based on a study that has used a Cobb Douglas production function approach supported by a growth accounting framework to allow for benchmarking sectors and Emirates¹.

During the period under consideration (1985/2003), the UAE economy has grown by over 5% annually. Growth rates however, varied greatly between Emirates: on the one hand, growth lagged behind UAE average in Abu Dhabi (3.6%), Northern Emirates (4.5%) and Sharjah (4.7%), while on the other hand Dubai showed growth well over average, as annual GDP-growth amounted to an impressive 7.4% on average over the 1985/2003 period.

Only Dubai has positive scores on all factors in the growth accounting analysis: factor use increased most, total factor productivity has improved, and changes in idle capacity contributed positively to GDP-growth. Please refer to table 1.

Table 1: UAE growth accounting, 1985/2003 (excluding oil)

	Abu Dhabi	Dubai	Sharjah	North Emirates	UAE
Annual average change in %					
GDP growth	3.6	7.4	4.7	4.5	5.1
of which: (the above row is the sum of the rows below)					
Labour growth	2.5	3.0	2.1	2.4	2.6
Capital growth	3.1	3.4	2.2	3.0	2.6
TFP growth	-1.7	0.7	2.0	-1.9	-1.3
IC change	-0.3	0.3	-1.7	0.9	1.1

TFP=Total factor productivity; IC=Idle capacity

For each of the years 1985, 1993 and 2003, the level of technological development of the UAE has been assigned a value of 100, and the level of technological achievement in the Emirates has been expressed as a percentage thereof. Technology (also known as total factor productivity) is defined here as the efficiency with which the factors of production labour and capital are combined to produce GDP, next to external factors such as stability, legislation and infrastructure. Results show that the level of technological development is the least in Northern Emirates, and is currently highest in Dubai. Historically, it was highest in Abu Dhabi, but recently, the latter is losing ground against Dubai and Sharjah; the current levels are almost the same for Abu Dhabi and Sharjah.

By sector of industry, Manufacturing shows a high level of technological development in Abu Dhabi, while other Emirates - especially Sharjah and Northern Emirates - lagging behind the average level for the whole UAE.

For trade, hotels & restaurants and transport, storage & communication and finance & insurance, the level is highest for Dubai, while all other Emirates lag behind the UAE average.

The investment rate (investment as percentage of GDP) is currently around 30% in the UAE; this holds for all emirates except Sharjah, which had an investment rate significantly lower than average since 1997.

¹ Rettab, B. And T. Kwaak (2005) "The Structure of Economic Development in UAE: Benchmarking Dubai against the other Emirates", DCCI.

Generally speaking, and for all Emirates, there is no stable development of the investment rate, whereby short periods of increase are followed by longer period of decrease. This observation holds as well for strong sectors such as transport, storage & communication in Dubai which are characterised by a weak tendency to turn back towards equilibrium. This may lead however to long and strong periodical cycles.

In real estate & business services, the situation is rather different. The investment rate points to a strongly increasing rate: the sky seems to be the limit here, as the dynamic long term equilibrium is much larger than historically observed values; this points at the risk of over-heating in this sector.

The UAE – with the notable exception of Abu Dhabi – has been characterised by a decrease in the relative cost of labour during 1985/1994, while it kept rather stable since then. For all emirates except Abu Dhabi, this has resulted in labour use growing faster than the stock of capital in the first period, and labour use and the capital stock growing in about the same amount during the last decade.

As regards utilization rate of installed production capacity, for Dubai, it can be observed that much of the variation observed at the macro level is in fact determined in one sector of industry, i.e. trade, restaurants & hotels. In this sector, the utilisation rates amount to no more than 57% in 1985, peaking at 100% in 1997, and then dropping sharply – especially after 2000 – to a low 71%. The sector seems to react only very slowly to shocks, meaning that the sector may go through long and deep cycles that affect – due to the large share of the sector in the Dubai economy – even the macro-economic performance of Dubai.

The main problem for Dubai is the lack of equilibrium-restoring short-term dynamics. So, once the utilisation rates starts deviating from its equilibrium, it will take a long time before equilibrium is restored; in other words, the utilisation rate exhibits long – though not deep – cyclical movements. This is for instance illustrated by the fact that 1991 -1999 period shows a continuous rise of the utilisation rate.

Lack of equilibrium restoring mechanisms could be attributed to the fact that at micro level, the economy is still dominated by conventional modes of production and in particular the traditional management style merely associated with family entrepreneurship. The latter makes enterprises less aggressive in their growth strategies, which is partially due to historically existent production structures and prevalent economic settings. Other underlying mechanisms relate among others to economy of scale and limited market leadership. The majority of production units are small and trend setters are few.

Policies to be recommended should therefore emphasise intensified sectoral reform. However, generic policies are of more importance here. As Dubai in particular and the UAE in general opt for more open market strategies, it implies enhancing market dynamics through evolving more competition policies of which below policy measures are supportive: (i) policies to lessen or eliminate existent entry and exit barriers, (ii) policies to introduce more challenging and supportive legislation (iii) policies to liberalise the capital market (iv) policies to introduce flexible short-term market dynamics such as those relating to bankruptcy and transition to public holding (v) policies to enhance perspective technology such as R&D, patenting, innovation, intra-and -international-cooperation.