The bursting of the Dubai debt bubble

By Alex Messenger
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Global markets, thrown into panic following Dubai's announcement last week of a repayment halt on $59 billion in foreign borrowings, have apparently been calmed by indications that Dubai World, the government's main holding company, will enter into debt restructuring negotiations with creditor banks and that the central bank of the United Arab Emirates (UAE) will pump extra funds into the local banking system. That step is aimed at reducing the risk of a run on the banks in the UAE and the Gulf area more broadly.

However, the fact that Dubai has decided to take a more co-operative approach towards its creditors does not make the emirate's situation less serious. In the absence of a bail-out by oil-rich neighbour, Abu Dhabi, Dubai's debt position is intractable.

On 25 November, Dubai World announced that it intended to halt repayments on its $59 billion in foreign debt, most of which is owed to European and British banks, including HSBC and the now UK-government owned Royal Bank of Scotland. The borrowings of Dubai World—which owns the emirate's key real estate and tourism companies as well as, through subsidiary DP World, a global port network—accounts for 40 percent of the borrowings of the Dubai government and the entities it controls.

The repayment halt announcement was followed by three days of heavy slides in most major markets. The atmosphere of panic has been fed by a lack of clarity regarding Dubai's intentions and by the difficulty in identifying at-risk creditors. More than that, the market reaction demonstrates the fragility of the so-called global recovery. The surge in equity, commodity and property markets right across the globe in recent months (with some notable exceptions, including US real estate) has been the result of stimulus packages, a US cheap money policy and the refusal of markets, driven by profit-seeking, to build into price levels the unprecedented explosion of debt that has followed the financial crash. As Gary Jenkins, head of London-based Evolution Securities, told the *Financial Times* earlier this week, "We've had a bounceback and that can fool investors into thinking that underlying conditions have improved dramatically when the truth is they haven't really. All that's improved is the price." Dubai's self-proclaimed debt holiday has served to remind otherwise dazzled markets of how quickly the runaway profits could (and will) evaporate. Dozens of countries (including Greece, Hungary and Argentina) are in debt positions that, until recently, seemed even more precarious than that of Dubai.

The apparent recovery of financial markets is being threatened by the very conditions and contradictions that created the crisis in the first place.

Dubai provides a good example. Throughout the 1990s and 2000s, the UAE, of which Dubai is a part, pegged the dirham, its currency, to the US dollar. It followed that the low interest rate policies pursued by the US Federal Reserve under Alan Greenspan allowed Dubai and other countries with similarly-pegged currencies (chiefly non-exporting countries reliant on finance sector profits and property) to borrow large amounts of cheap dollars. In other words, Dubai, with its glittering towers and pretensions as a global finance and trading hub, only rose from relative obscurity because of US policy. Its own zero-tax policy—key to its financial and trade hub status—made the cheap dollars, together with borrowings from Abu Dhabi, one of the few possible sources of finance (Dubai has little oil) and therefore a drug of addiction from which Dubai could not possibly be weaned.

With each successive financial crisis through the 1990s (Argentina, Mexico, Asia, Russia) the policy response of the US Federal Reserve was to push interest rates even lower, ramping up global liquidity. Dubai naturally over-borrowed. Reports at the time of the emergence of the crisis last week suggested a total government-related debt of $80 billion, but according to investor services firm Moody's, the figure is likely to be more than $100 billion, i.e., greater than Dubai's annual GDP. Meanwhile, a large proportion of the assets purchased with the cheap funds, especially property assets, have seen their values halved. In this way, Dubai is just a different face of the same global process that produced the subprime housing bubble in the US itself.

Despite the claims of US policy makers, including Federal Reserve Chairman, Ben Bernanke, that the mistakes of the Greenspan era have been digested and eliminated, the US response to the crash of 2007-2008 has been no more than Greenspan's policy taken to its logical conclusion—near-zero interest rates into the foreseeable future plus the generation of additional liquidity. As Australian Reserve Bank board member, economist Warwick McKibbin put it in a speech earlier this week, in circumstances where there has been a relative decline in the value of the US dollar, "the monetary policy of the developing countries is US monetary policy." McKibbin went on to say that the asset and price bubbles that have been created in East Asia, especially China, by the zero interest rate policy (a Dubai-style cheap-dollar bubble writ large), could set off a second stage of the financial crisis. Dubai's repayments crisis has caused such alarm because overleveraged markets are hyper-sensitive to even a whisper of default. Moreover, bubbles are burst in precisely such moments of panic.

The banking and real estate profits that have, in Dubai, funded the lavish lifestyles of European and US finance sector expatriates were not, however, simply the product of US monetary policy and a zero-tax regime. They were, in a more direct sense, the product of a partnership between global banks and the brutal regime of the ruling Al-Makhtoum family and of virtual slave labour imported from poor countries. Nearly 80 percent of Dubai's 1.5 million residents have come to the country from elsewhere, and about 85 percent of that number are from East and South Asia, especially India, Bangladesh, Pakistan and the Philippines. Before the crash there were an estimated 500,000 construction workers in Dubai, many of whom, typically, left their families in their home country. The UAE has an estimated 300,000 foreign housemaids.

Working and living conditions in Dubai are among the worst in the world. Unions are banned, while internal security forces punish dissent and violation of racial segregation rules with violence or deportation. Until recently, workers were paid on average $150 per month, meaning millions in remittances to poor families. Reports from various human rights and labour organisations indicate that thousands of workers in the construction industry have not been paid for months.

Together with the various cheap labor platforms of South East Asia, Dubai demonstrates that a major source of capitalist profitability, including its less industrial and more "financialised" forms, is the compact between finance and feudal, dictatorial, regimes, whose primary service is the suppression of the working class.