

# The Dubai Tourism Cluster

## From the Desert to the Dream



Microeconomics of Competitiveness  
6 May 2011

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# **1. The United Arab Emirates Competitiveness Analysis**

## **1.1. Profile of the United Arab Emirates (“UAE”)**

### **1.1.1. History and Endowments**

The UAE is a federation of seven emirates located in the southeast of the Arabian Peninsula on the Persian Gulf. With a population of 4.6 million and land area of approximately 30,000 square miles, UAE’s seven states (called emirates) include: Abu Dhabi (the capital emirate), Ajman, Dubai, Fujairah, Ras al-Khaimah, Sharjah and Umm al-Quwain.<sup>1</sup> The nation borders Oman and Saudi Arabia and shares sea borders with Iran, Iraq, Kuwait, Bahrain, and Qatar. Compared to its neighbors, UAE is small in land mass and population.

The country’s landscape shifted dramatically in the early 1960s, when oil was discovered in Abu Dhabi. By 1962, it became the first emirate to export oil, and these natural resources virtually transformed the nature of the region’s economy and society. By 1971, the emirates established independence from Britain and formed a federation of six states known as the United Arab Emirates. In early 1972, Ras al-Khaimah joined the nationhood.

After declaring independence and establishing nationhood, the UAE developed a constitution to frame its legal and political framework. The country’s constitution separated state powers into executive, legislative, and judicial branches. Furthermore, executive and legislative powers were broken down on both the federal and emirate levels. Although “elected” by the Supreme Council, the role of president and prime minister are hereditary: the emir of Abu Dhabi holds the presidency and the emir of Dubai fills the prime minister role.

Since the early 1970s, the UAE’s unprecedented growth was fuelled by the discovery and exploitation of oil onshore and offshore. Currently, the UAE holds 97.8 billion barrels of oil, which contribute to 7% of global oil reserves. Based on current oil production of 2.9 million barrels per day,

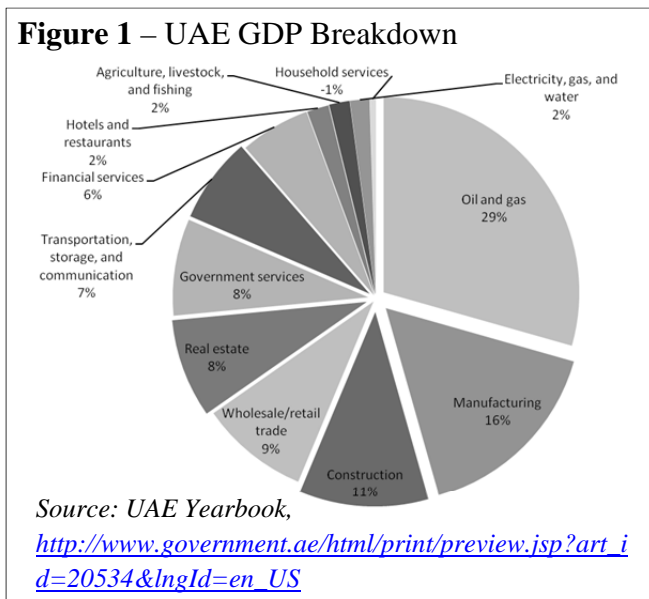
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<sup>1</sup> Background Note: United Arab Emirates, <http://www.state.gov/r/pa/ei/bgn/5444.htm>

projections estimated that oil reserves in the UAE will last for more than 93 years. In addition to oil, the UAE is estimated to hold natural gas reserves equal to over 3.3% of the available global gas supply.<sup>2</sup>

### 1.1.2. Economic Performance

The UAE government recognized the threat of the resource curse and committed early to economic diversification. Since the oil shocks of the 1970s, the UAE has spent billions of US Dollars on infrastructure and accounts for 37 percent of total infrastructure project value within the construction, oil and gas, petrochemicals, power and water and waste sectors in the region.<sup>3</sup> Investments have also been made in real estate, tourism and leisure. The fruits of these investments are particularly evident in the larger emirates of Abu Dhabi and Dubai. Due to these diversification efforts, oil and gas only contribute to 29 percent of the nation’s gross domestic product (“GDP”) (see **Figure 1**).



and gas, petrochemicals, power and water and waste sectors in the region.<sup>3</sup> Investments have also been made in real estate, tourism and leisure. The fruits of these investments are particularly evident in the larger emirates of Abu Dhabi and Dubai. Due to these diversification efforts, oil and gas only contribute to 29 percent of the nation’s gross domestic product (“GDP”) (see **Figure 1**).

Despite fluctuations in oil prices, the

country has experienced a 9% GDP compound annual growth rate (“CAGR”) since 1980. The country has generated higher PPP-adjusted GDP per capita than other oil-exporting and Arab nations (**Figure 2**).

However, the country has experienced -0.22% GDP per capita CAGR between 2005 and 2010.<sup>4</sup>

### 1.1.3. Labor Policies

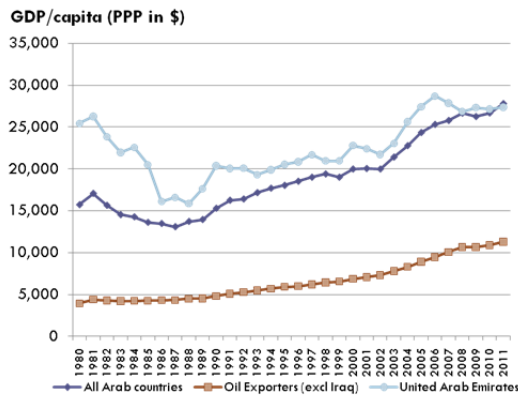
The unemployment rate in the UAE is relatively low at 4 percent, which can be attributed to its high workforce turnover. This turnover is wholly attributed to the demographic breakdown of labor:

<sup>2</sup> “The World’s 15 Biggest Oil Producers.” CNBC. Web. 04 May 2011. [http://www.cnbc.com/id/41887743/The\\_World\\_s\\_15\\_Biggest\\_Oil\\_Producers](http://www.cnbc.com/id/41887743/The_World_s_15_Biggest_Oil_Producers).

<sup>3</sup> Investor Relations, The European Business Review: <http://www.europeanbusinessreview.com/?p=746>.

<sup>4</sup> Source: Economic Intelligence Unit Country Data, United Arab Emirates, 2011

**Figure 2 – GDP Per Capita**



Source: Economic Intelligence Unit, 2011

approximately 85 percent of the UAE labor workforce consists of expatriates from South Asia and other Arab Countries.<sup>5</sup>

Despite low unemployment rates, only 77% of UAE's total population is being utilized.<sup>6</sup> This is due to multiple reasons. First, despite the UAE's overall ranking of 25<sup>th</sup>, the UAE ranks 125 out of 139 in female participation in the labor force,

behind Kuwait and Qatar in the 2011 World Economic Forum Global Competitiveness Report ("GCR" or "GCI"). Its female labor force participation is only 39 percent compared to 92 percent for men, indicating a significant gender gap in the workforce (Assaad, 2008). Furthermore, the workforce is skewed toward low-skilled labor. The UAE has fewer employees with secondary and tertiary education in comparison to other OECD countries.<sup>7</sup> In 2010, the New Global Competitiveness Index ("New GCI") ranked the UAE very low in primary enrollment (83<sup>rd</sup>) and tertiary enrollment (82<sup>nd</sup>).<sup>8</sup> Last, the government sponsors an "Emiratization" program to employ its citizens in the workforce. This program provides preferential hiring treatment to UAE citizens in the private sector. Consequently, non-UAE citizens who are more qualified or skilled for a particular role may be excluded from senior roles.

## 1.2. Macroeconomic Competitiveness

### 1.2.1. Fiscal and Monetary Policy

With regards to *fiscal policy*, the UAE remains fiscally sound. The UAE government has been conscious about driving a balanced budget by aligning spending with revenues. Because 70% of

<sup>5</sup> Source: United Arab Emirates", CIA: The World Factbook: <https://www.cia.gov/library/publications/the-world-factbook/geos/ae.html>

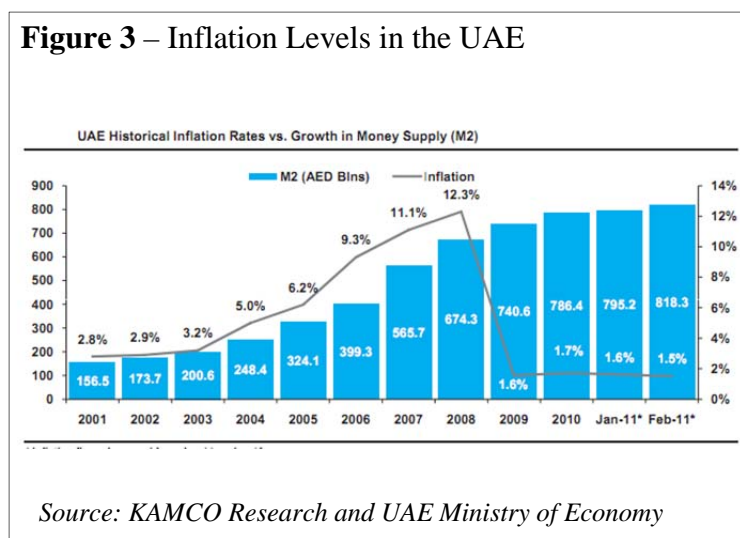
<sup>6</sup> Source: Economic Intelligence Unit Country Data, United Arab Emirates, 2011

<sup>7</sup> Source: World Bank Country Data, 2011

<sup>8</sup> New Global Competitiveness Index 2010, Institute for Strategy and Competitiveness, Harvard Business School.

revenues are generated from oil and gas receipts, any major fluctuations in oil prices directly impact revenue streams. The rise in world oil prices since 2003 has fostered the growth of a budget surplus. However, this surplus dropped from 14.2% in 2008 to 2.2% in 2010. In 2010, total public debt (including state-owned enterprises (“SOEs”)) stood at 45.7% of GDP.<sup>9</sup>

The country’s *monetary policy* is centralized and controlled by the Central Bank of the UAE. However, the UAE Dirham is pegged to the US Dollar, as this fixed exchange rate reduces volatility in export revenues. Since the UAE is a resource-based exporter, currency stability is closely related to economic health. The pegged-exchange rate mechanism limits the power of the Central Bank, as it



minimizes options to curb inflation and manage money supply.

The challenge of managing the dollar-peg is evidenced in the fluctuation of inflation rates over the last decade. Money supply growth is directly influenced by U.S. interest rates and U.S. dollar value. Between 2001 and 2008, inflation rates rose from

2.8% to 12.3%. However, due to the economic downturn and the appreciation of the U.S. dollar, inflation rates plummeted to 1.56% in 2009 and have remained at steady levels ever since (**Figure 3**). Although inflation appears to be at manageable levels, the UAE was still ranked 83<sup>rd</sup> for inflation policy in the New GCI.

### 1.2.2. Social Infrastructure and Political Institutions (“SIPI”)

Since independence in 1971, the country has experienced political stability, despite being in a neighborhood of instability. Additionally, the country is a member of several different regional and

<sup>9</sup> Source: Economic Intelligence Unit Country Data, United Arab Emirates, 2011

global associations (including the Arab League, World Trade Organization, and United Nations) and sustains healthy relationships with Western democratic countries. The government has instituted a strong rule of law, including property rights and due process.

The country's strong social, political, and economic infrastructure has positively influenced its economic growth. The high revenues generated from natural resources have been invested in social and economic infrastructure, including basic health services, education, and training. UAE has a relatively strong record for human rights, which further contributes to the retention of political and social stability. The country's stability coupled with open trade policies further enhance the appeal of the country for foreign investors. However, on top of the education and female labor participation issues discussed above, the UAE ranks 111<sup>th</sup> for voice and accountability, 94<sup>th</sup> for freedom of the press and 50<sup>th</sup> for rule of law in the New GCI, reflecting the government's control over key institutions.

### **1.3. Microeconomic Competitiveness**

#### **1.3.1. Quality of the Business Environment**

**Figure 4** sets out the UAE's competitiveness diamond. As outlined below, the country has made significant investments to diversify beyond oil production and enhance the quality of its business environment.

*Factor Conditions:* Because of its significant investments in physical and transportation infrastructure, the country has grown into a global logistics and financial hub. The access to capital and inexpensive labor further elevate it as an attractive place to do business. However, the country still ranks low in innovation in terms of patents (45<sup>th</sup>) and scientific research institutions (51<sup>st</sup>) in the New GCI. Additionally, low-quality of education and training contributes to the scarcity of high-skilled workers. Overall, the New GCI ranked factor conditions 24<sup>th</sup>.

*Demand Conditions:* The New GCI rates the quality of the UAE’s local demand conditions at 21<sup>st</sup> globally. The sophistication of UAE citizens pushed the passage of certain standards, including safety, environmental, and consumer protection laws.

**Figure 4 – UAE Country Competitiveness Diamond**

Factor Conditions	Context for Strategy and Rivalry	Related and Supporting Industries	Demand Conditions
(+) Rich resources of oil and gas	(+) High political and social stability relative to the rest of region	(+) SOEs have driven development of the UAE’s non-oil sectors by attracting FDI	(+) High penetration of new technologies (#14)
(+) Favourable location as a global hub	(+) Local availability of specialized research and training facilities (#27)	(+) Highly efficient capital markets (#6)	(+) New consumer protection law
(+) Abundance of cheap immigrant labor	(-) Low market disruption for SOE’s (#71)	(+) Venture capital availability (#16)	(+) Strict quality, safety and environmental standards
(+) High quality of air, road and port infrastructure (#11)	(-) Low transparency and accountability in government (#43)	(-) Oil and gas still dominate the structure of GDP	
(+) Ease of access to local financing	(-) Low rank on protecting investors	(-) There is little collaboration between the Emirates and major companies in each cluster	
(-) Low quality of higher education system	(-) Not attractive to FDI (#49) because of restrictions on foreign ownership		
(-) Very few females in workforce (#125)	(-) Dirham pegged to the \$, which is a limitation on monetary policy		
(-) Low innovation in terms of patents and research institutions (#38)			
(-) Low labor productivity			

*Source: Team Analysis*

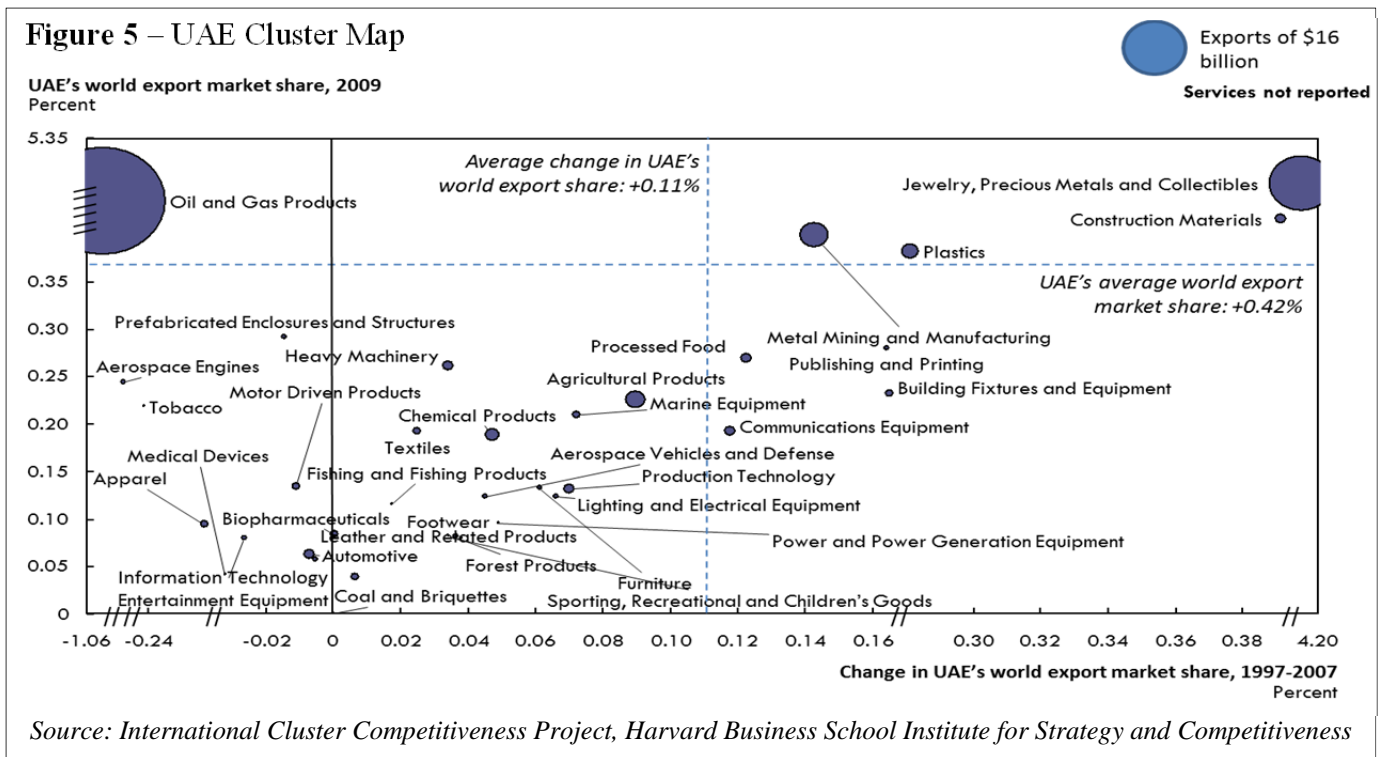
*Related and Supporting Industries (“RSIs”):* Due to efforts by SOEs, the UAE has attracted foreign direct investment (“FDI”) for non-oil sectors. Between 2003 and 2010, the UAE received ~\$73 billion in foreign capital inflows, second only to Saudi Arabia in the region. Furthermore, the access to capital markets and venture capital has fostered the growth of businesses in the country. However, a lack of collaboration between each emirate and the UAE government has limited overall cluster growth. The RSI and clusters category was ranked 25<sup>th</sup> globally in the New GCI.

*Context for Strategy and Rivalry (“CSR”):* Due to the presence and involvement of SOEs, there is little opportunity for competition from private players. Furthermore, there is little transparency into government actions and accountability for SOE business decisions. Restrictions on foreign ownership limited protection for investors, and high inflation risk (due to the US Dollar peg) further limit the competitive environment. The UAE is ranked 72<sup>nd</sup> in the New GCI for prevalence of foreign ownership, while CSR overall is ranked 28<sup>th</sup>.



### 1.3.2. Cluster Development Efforts

Despite efforts to diversify its economy away from oil, the country has not achieved outstanding success developing non-service related clusters outside of its natural resources (See **Figure 5**). Naturally, the oil and gas products cluster is the largest, followed by precious metals, metal mining, and plastics. Much of this limited success can be attributed to the decentralization of cluster development efforts to each emirate, and the lack of cooperation with the UAE government. Furthermore, the depth of the clusters is quite low, because of the lack of local supplier quality (ranked 50<sup>th</sup>) and availability of specialized research and training (ranked 28<sup>th</sup>) in the New GCI.



However, the government has made a concerted effort toward cluster development as a diversification strategy. They have established the Emirates Competitiveness Council (“ECC”), which is composed of eighteen representatives from the seven emirates. Currently, the country ranks 15<sup>th</sup> in the world in extent of cluster policy in the New GCI and the country has made more progress in cluster-based diversification compared to any other oil-producing nation. (Porter, 2010)

## **2. Dubai Competitiveness Analysis**

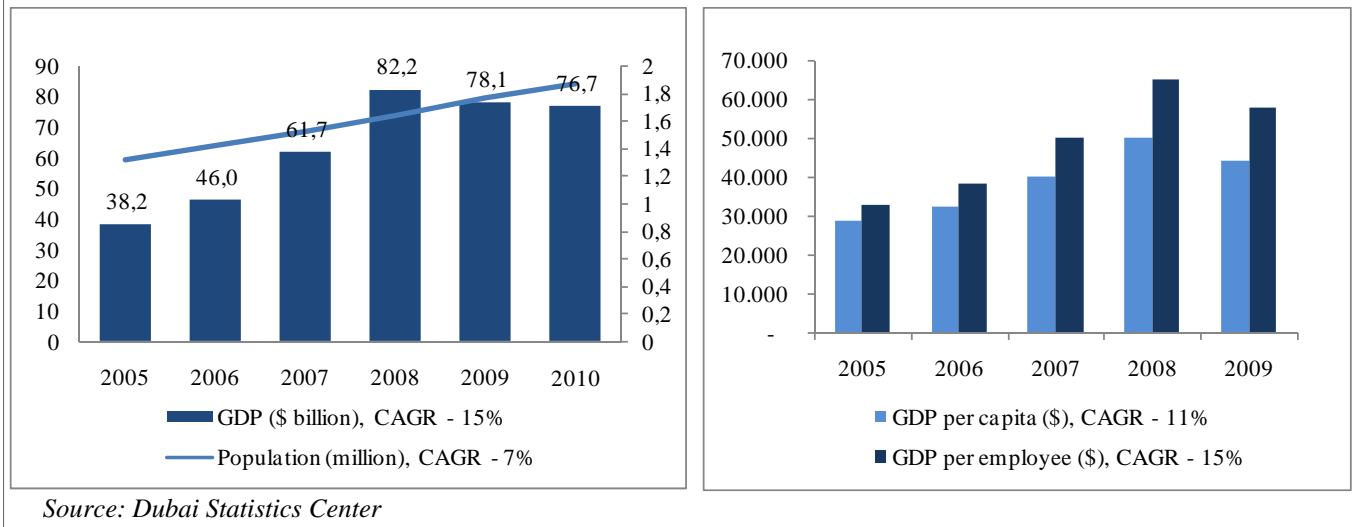
### **2.1. History and Endowments**

Natural endowments and location have been significant factors in defining Dubai's growth. In 1966, the Dubai Petroleum Company ("DPC") discovered four offshore fields. Oil production peaked in 1991 at 410,000 barrels per day and by 2010, the contribution of oil and gas in the economy decreased to 2.5% of GDP from more than 60% in 1976. Already in the 1970s, Sheikh Mohammed from the ruling Al Maktoum family realized that Dubai could not remain independent of Abu Dhabi's political and economic control if its economy relied on diminishing oil reserves. He therefore created a "futuristic vision for Dubai as an international hub that keeps a delicate balance between modernity and the city's Arab and Islamic identity" (Davidson, 2008) and deliberately redirected the oil revenues in a series of ventures designed to strengthen Dubai's position as a regional trading center. Taking advantage of the excellent location as a trans-shipment point between Asia and Europe, the government built its national airport in 1960, port Rashid in 1971, port Jebel Ali in 1977, Jebel Ali Free Zone in 1985, and Dubai International Financial Centre in 2002. Furthermore, the neighborhood of oil rich countries provided opportunities to attract capital for investments in the non-oil sectors.

### **2.2. Economic Performance**

Dubai's GDP in 2010 was roughly \$76 billion, with GDP per capita at \$41,000. GDP per capita and GDP per employee grew at 11% and 15% respectively from 2005 to 2009, which is a positive trend compared to a decline of UAE GDP per capita in the same period (**Figure 6**). However, the growth of nominal GDP per capita is misleading, as it fails to take substantial inflation into account. Furthermore, only a small share of GDP per capita growth can be explained by an increase in labor productivity, as the population grew at a 7% CAGR from 2005-2010. Ninety percent of the population growth came

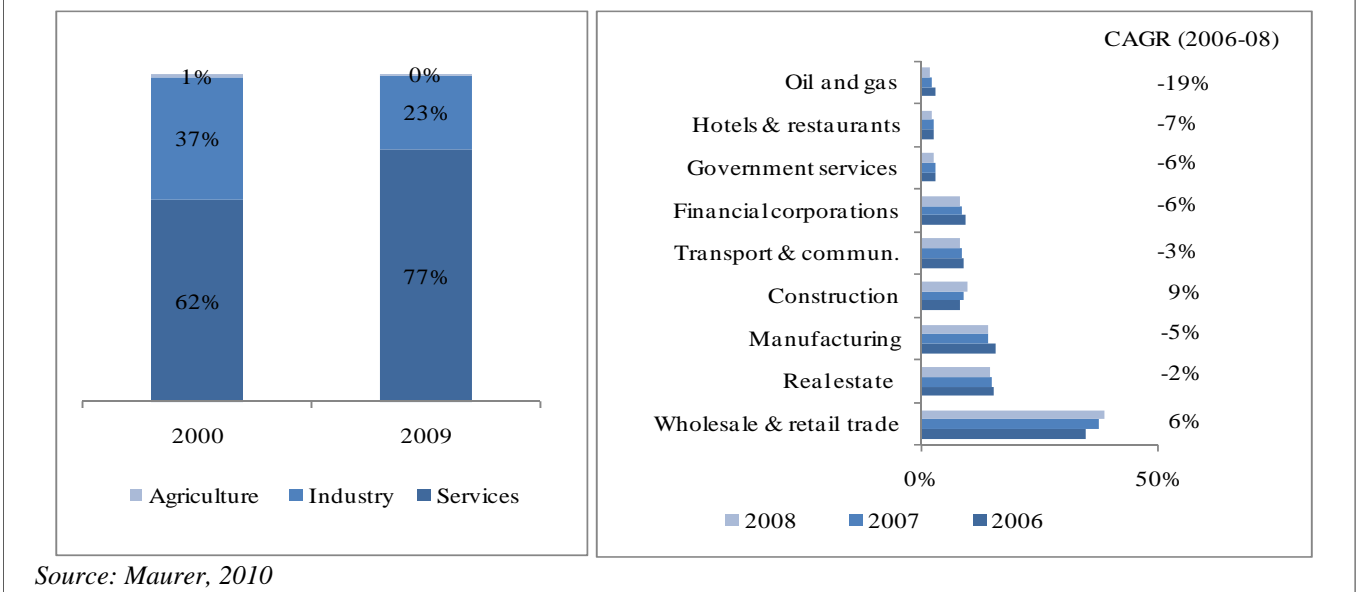
**Figure 6 – Dubai’s nominal GDP, GDP per capita, GDP per employee and population from 2005-2010**



from an inflow of expatriates, especially construction workers who immigrated without their families. That is one of the primary reasons why males account for 77.3% of the Dubai population.

Dubai has a very high labor mobilization rate at 86.8% and only 0.8% unemployment rate.<sup>10</sup> The main driver of the high labor mobilization rate is the high share of expatriates in the economy who

**Figure 7 – Dubai GDP by Sector**



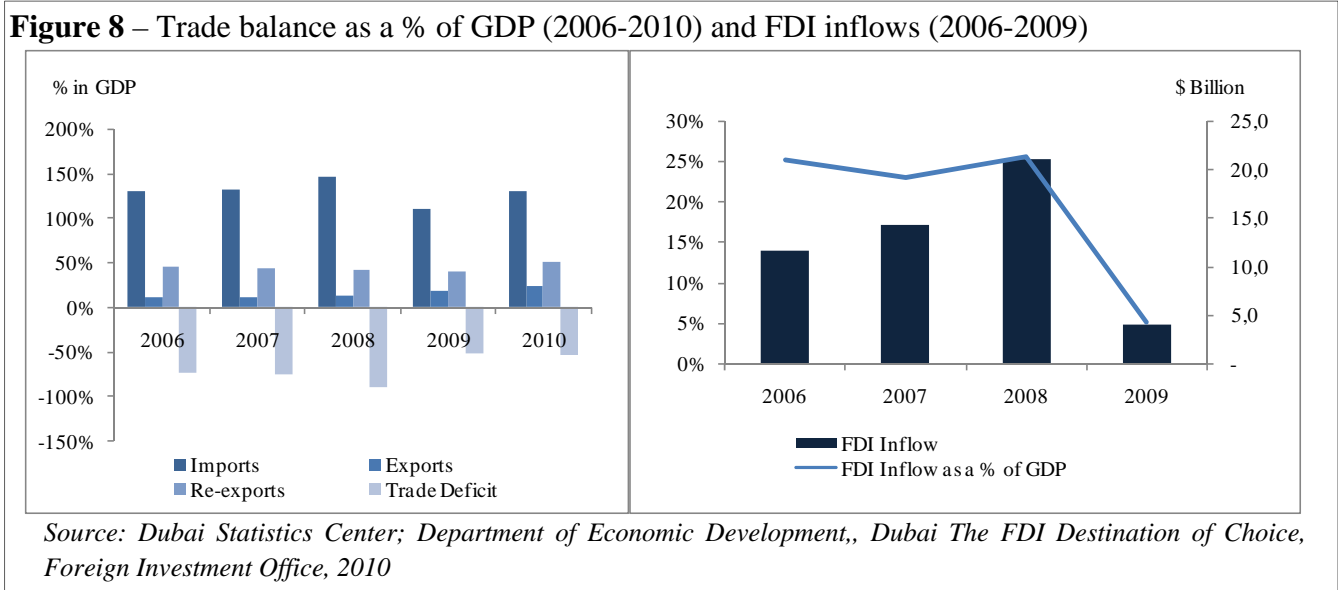
<sup>10</sup> Data Dubai: [http://www.datadubai.com/directory/uae\\_labor\\_statistics.html](http://www.datadubai.com/directory/uae_labor_statistics.html)

account for 97% of all employees. As of 2005, 41% of the labor force worked in construction, 9% in transportation, 8% in personal and domestic service and 5% in manufacturing, hotels and real estate.

The deliberate strategy of diversifying the economy proved successful: the service sector today accounts for 77% of GDP (up from 61.8% in 2000), with the biggest sectors being wholesale and retail trade, real estate and manufacturing in 2008 (Figure 7). The only two sectors that grew from 2006 and 2008 were construction and wholesale and retail trade, but these clusters were hit severely during the crisis when many projects were cancelled or curtailed.

**2.2.1. Trade and FDI**

Dubai is the main entry port to serve the markets of the other emirates in the UAE and that of neighboring countries. Re-exports continue to dominate Dubai’s export portfolio. Direct exports (i.e. products where some value added in addition to the logistical service is provided in Dubai) remain limited to pearls and precious stones, base metals, minerals, and some food products. Consequently, the



country has incurred a huge trade deficit (Figure 8), which is both a macroeconomic worry and a sign that Dubai’s capacity as a trading hub is to a large degree serving the needs of its own economy, and not winning business from others (Ketels, 2010). Dubai has attracted a sizeable amount of FDI. In 2008, the

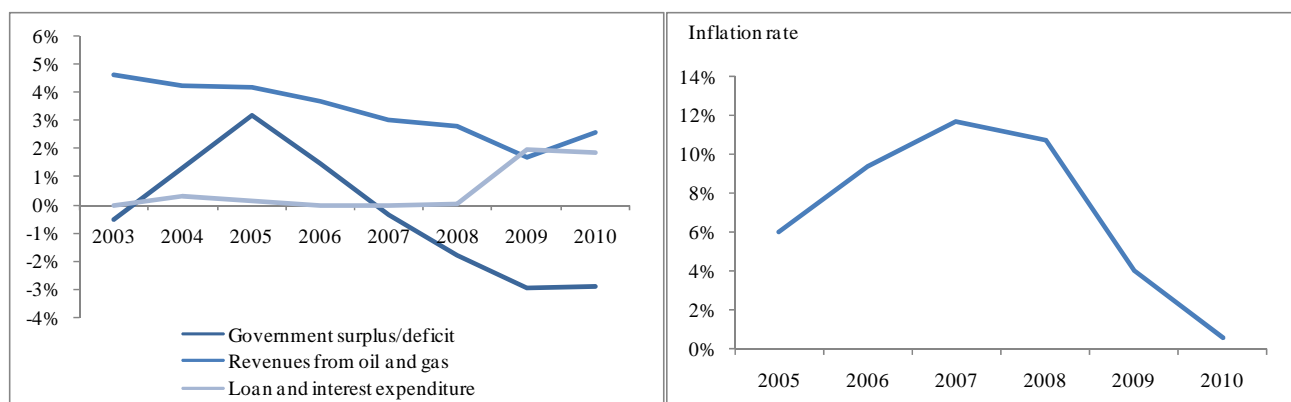
inward FDI stock accounted for 26% of GDP but then dropped to 5% in 2009 (**Figure 8**). In spite of the crisis, Dubai ranked as the 11<sup>th</sup> most-cited investment location globally for the next 3 years and is the top destination in the Middle East based on A.T. Kearney’s 2010 FDI Investment Confidence Index.

### 2.3. Macroeconomic Competitiveness

#### 2.3.1. Monetary and Fiscal Policy

For the Dubai economy, the diminishing role of oil revenues (both directly and indirectly through the correlation of oil prices with overall economic activity) has reduced the benefits of the fixed parity with the US Dollar. Furthermore, the weakening of the US Dollar in the run-up to the global economic crisis fuelled inflation by increasing the price of imports from outside the U.S. (**Figure 9**).

**Figure 9** – Selected Revenue and Expense Items and Government Budget as a % of GDP, Inflation Rate



Source: Adapted from Maurer, 2010.

Dubai’s budget was in surplus until 2007, when it turned into deficit due to high investments in infrastructure to support the growth of non-oil sectors and increasing the level of social welfare.

As of December 2009, Dubai’s sovereign debt was estimated to be \$108 billion and loan and interest repayments equalled 1.9% of GDP in 2009. Most of the debt was used to finance investments of SOEs. The majority (69%) of the debt is foreign owned (**Figure 10**). During the credit crisis, the Dubai government could not repay immediate debt obligations of its companies and asked the government of Abu Dhabi for a bailout (\$10 billion) and a voluntary debt restructuring going forward.

The lack of transparency regarding the repayment process and government role in guaranteeing the debt repayment created significant uncertainty

**Figure 10 – Estimated Gross Outstanding Dubai Public-entity Debt and Ownership as of December 2009**

<b>Total Est. Liabilities (million dollars)</b>		<b>Owners of Dubai's Debt</b>	
Dubai World	\$34.085	International banks	44%
Dubai Holding	\$19.617	Foreign currency bonds	25%
ICD	\$33.930	UAE banks	13%
Dubai government	\$18.700	Regional banks	9%
Other Entities	\$1.885	Domestic currency bonds	7%
<b>Total</b>	<b>\$108.217</b>	Other	2%

*Source: Adapted from Mussachio, Goodman and Qureshi, 2010.*

about Dubai’s macroeconomic management capacity to avoid macroeconomic imbalances, which has shaken the confidence of foreign lenders.

### 2.3.2. Social Infrastructure and Political Institutions

Dubai registers the highest life expectancy rates in the region, 75.8 years for females and 75.7 years for males in 2007. Its infant (8 per 1,000) and child mortality rates (8.8 per 1,000) are the lowest in the region.<sup>11</sup> Dubai’s adult literacy rate is at 96.3%, compared to 90% for the UAE total. Approximately 10% of the population has university or postgraduate degrees.<sup>12</sup> A sizeable number of foreign accredited universities have been set up in the city over the last ten years. Dubai has very low crime rates, but there are still doubts on the fairness and efficiency of judicial system and the lack of a personal bankruptcy regime attracted journalists’ attention during the economic crisis.<sup>13</sup>

## 2.4. Microeconomic Competitiveness

### 2.4.1. State of Cluster Development and Key Clusters

The Dubai government is the primary driver of the emirate’s development strategy and comprises three State Owned Holding Companies (“SOHCs”) (**Figure 11**).

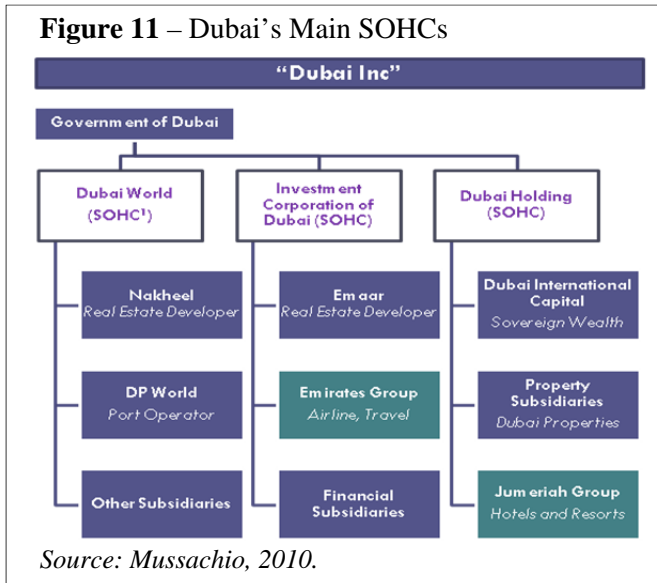
<sup>11</sup> Analytical Report on Economic And Social Dimensions in the UAE, [uaestatistics.gov.ae](http://uaestatistics.gov.ae)

<sup>12</sup> Dubai Statistics Center, <http://www.dsc.gov.ae/EN/Themes/Pages/Reports.aspx>, accessed April 2011

<sup>13</sup> [http://findarticles.com/p/articles/mi\\_qn4188/is\\_20070611/ai\\_n19291850/](http://findarticles.com/p/articles/mi_qn4188/is_20070611/ai_n19291850/)

The real estate cluster is dominated by two SOHCs, Emmar and Nakheel, that invested more than \$500B in building new projects. The oil cluster is also dominated by the Emirates National Oil

Company. The government used oil revenues to make significant investments in infrastructure. Oil reserves are expected to be depleted in 20 years. The development of the Dubai International Financial Centre into the financial hub in the region has encouraged the influx of business tourism. The travel cluster is led by Emirates Group, but Dubai has adopted an open skies policy that enabled open access for other airlines as well.



### 2.4.2. Quality of Business Environment

Dubai’s rulers have been consistently pro-business and growth oriented. The government created an environment in which foreign and domestic companies competed on roughly equal terms. SOEs spearheaded its economic development, but Dubai’s leadership strives to intervene little except defining

**Figure 12 – Dubai Competitiveness Diamond**

Factor Conditions	Context for Strategy and Rivalry	Related and Supporting Industries	Demand Conditions
(+) Higher concentration of education institutions relative to other emirates	(+) Department of Economic Development is a one-stop shop for licenses and permits	(+) Oil and gas industry allows for cheap inputs for infrastructure development	(+) High share of expatriates, which is manifested into more Westernized culture
(+) Reliance on foreign specialists and low cost labor from South Asia	(+) Department of ED has SME promotion campaign to support and develop SMEs	(+) Regional and international investors rank Dubai high as FDI destination	(+) Government’s proactive approach in formation and positioning of Dubai as an upscale destination
(+) Strong infrastructure (airports, ports, metro system)	(+) Open to foreign competition (100% foreign ownership in Free Trade Zones)	(-) Major companies are all government-owned and subject to cross-default	(+) Increase in regional income fosters more consumption
(+) Favorable location	(+) Rules and regulation encourage investments	(-) Investor confidence was shaken by recent crisis which might result in more expensive borrowing	(+) As of 2006, foreigners can own land
(-) UAE citizens preferred for senior positions	(-) Dominance of SOHCs in main sectors	(-) Little collaboration in the private sector	(-) Two classes of citizens, locals and non-locals, and preferential treatment for locals with regards to senior positions, especially in government owned entities
(-) Weak labor protection laws	(-) Time consuming and bureaucratic permitting procedures		
(-) High fluctuation of skilled workers			
(-) Low investments in R&D and innovation			

Source: Team Analysis

aggressive growth ambitions. Dubai compensated for the lack of manpower and skills by allowing the immigration of workers, especially those of lower skill levels. However, it also created living conditions that made it attractive for skilled expatriates to relocate to Dubai. Through tax free zones, it created a competitive environment to attract foreign companies (see the full Dubai diamond at **Figure 12**).

The 2008 economic crisis revealed many weaknesses in the system, especially related to governance, risk management and oversight over the financing of this growth. The government was not transparent in the decision making process. The private sector has not been involved in defining strategy going forward and there are no institutions that encourage public-private collaboration. Furthermore, despite the recent growth in the education system and the clear focus of the government on skill development, the Emirati population remains insufficiently skilled to compete globally. There is also the question of a growing cultural divide between the two classes of citizens: Emiratis and immigrants.

### **3. Issues and Recommendations for the Competitiveness of the UAE and Dubai**

As discussed above, specific issues inhibit the UAE's and Dubai's competitiveness. Recommendations at both the UAE and Dubai levels will begin to solve the deficiencies, and recommendations suggested below have been split into three stages by priority.

#### **3.1. Macroeconomic Competitiveness**

**Macro policy:** In terms of *fiscal policy*, the UAE remains fiscally sound but Dubai is running budget deficits and, as at 2009, total public and SOE debt was estimated at around 116% of GDP (Jaber and Batori, 2009). Despite such precarious finances, Dubai continues to spend with 23% of the 2011 budget earmarked for infrastructure spending (Bitar, 2011). The Dubai government let its SOEs run up foreign debt without much accountability or governance and, despite the \$10bn bail-out by Abu Dhabi, Dubai remains under a large debt cloud. However, information about the size of this debt does not appear in any reliable form, and market analysts are forced to estimate and project the size of SOE debt



(Economist, 2010). In the first stage, Dubai needs to slow its spending on infrastructure projects (such as the new port and airport, further high-end hotels and real estate projects) and begin to focus on repayment of debt. Dubai should wait until there is sufficient demand to warrant these investments. It seems that both government and SOEs invest in new infrastructure without a profit focus, merely to ensure that Dubai has the most advanced infrastructure in the region. Dubai should instead collaborate with the UAE and other emirates (particularly Abu Dhabi) to ensure that infrastructure spending is coordinated and repetitive investments are not made, resulting in overspending at the country level. The lack of data, accountability and governance should be altered, and Dubai in the first stage should prepare public accounts for SOEs and an aggregate statement of SOE debt.

In terms of *monetary policy*, the UAE Dirham's peg to the US Dollar resulted in both the UAE and Dubai suffering from significant inflation from 2006-2008. The UAE should have raised interest rates further in the boom time in 2005 and should not have cut its rate so quickly in 2007. Although achieving this will be unlikely, the UAE should consider removing the currency peg. The UAE will have to balance Dubai's interests for a free currency with Abu Dhabi's (oil-driven) interests for a peg. The Gulf Cooperation Council ("GCC")<sup>14</sup> monetary union would be an unwise choice for the UAE as, despite the ability to boost regional trade and demand, the union is unlikely to ever remove a US Dollar peg.

**SIPI:** As a first priority, the UAE needs to increase its spending on education and healthcare. Particularly, programs for vocational training of the Emirati and foreign population would significantly increase productivity. It seems, however, that the problem is not the quality of education or the number of schools, but the demand for education – the government must undertake a marketing campaign targeted at altering the UAE's culture to one that values skills and education. This change of culture and focus will also improve the UAE's poor innovation record.

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<sup>14</sup> Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE comprise the GCC.

### 3.2. Quality of the business environment

**Factor conditions:** The *administrative infrastructure* of both the UAE and Dubai is cumbersome. Entrepreneurs in Dubai complain about the price and number of licences required to operate by the “one stop shop” Department of Economic Development. Dubai is aware of this, and initiated a fee freeze in 2009 (Hartley, 2009). Further, in 2009 the Dubai government launched Dubai SME<sup>15</sup>, headed by HH Sheikh Mohammed, which is dedicated to improving the business environment for small- and medium-sized enterprises (“SMEs”), which includes access to finance, support services, minimization of licences and a fee waiver for the first three years of business (Byrne, 2011). Similar licence and fee reviews should be undertaken as a first priority for all companies, not just SMEs.

**CSR:** Firstly, the *preferential treatment towards Emirati citizens* is also hampering productivity, as the Emiratisation policies almost force private sector companies to employ Emirati citizens, despite their relatively low skills and qualifications. The UAE should curtail this programme in the second stage, instead investing in education and training to bring the UAE workforce up to the level of expatriates and allowing Emiratis to compete for jobs on merit.

Secondly, productivity is severely hampered by the *lack of women* in the workforce. This is mainly due to the low female labor participation rate. A first stage action should be for the UAE to provide incentives for companies to employ women, to institute policies such as flexible working hours and to open day care facilities to allow women to work. As with education, this necessitates a cultural change, so a marketing campaign discussing the value of women in the workplace is necessary. The government can actively recruit women into government roles to stimulate this cultural change.

Thirdly, *FDI* at the UAE and Dubai levels remains weak after the crisis. Restrictions on foreign ownership should be relaxed and the UAE should allow 100% foreign ownership of companies in all areas, not just tax free zones. This is a second stage policy as tax free zones already provide a middle

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<sup>15</sup> Mohammed Bin Rashid Establishment for SME Development : <http://www.sme.ae/english/index.html>.

ground. At the first stage, the UAE should begin to harmonize laws across the emirates, so that foreign multinational companies (“MNCs”) do not have to learn each emirate’s policies. Attraction of MNCs will bring research and development (“R&D) centres and other high level functions to the UAE, improving innovation and productivity.

### **3.3. Company Sophistication and Cluster Development**

*SOEs* dominate the UAE and particularly Dubai’s private sector. While this has allowed Dubai to develop quickly by using the national balance sheet (by virtue of the implicit government guarantee which these companies enjoy), these companies do not have proper governance and many do not report annual results. *SOEs* should be spun off into the private sector either through trade sales or IPOs, so that they can endure the scrutiny of the public markets. This will make such companies more profit-focused and stop them from overinvesting in unnecessary infrastructure.

A key struggling cluster is the Dubai *real estate cluster*. Demand for real estate has not reappeared, particularly as speculative development occurred in the hope for international buyers. The UAE and Dubai should institute rules that limit speculative purchasing of development sites and limit trading of pre-construction options. China implemented similar policies which were successful to calm the overheated Shanghai real estate market.

There is very little *collaboration between the UAE and individual emirates*. There is a national strategy (Vision 2021) and emirate strategies (Dubai’s Strategic Plan 2015 and Abu Dhabi’s Economic Vision 2030) which set out aspirations for the respective economies. It does not, however, seem that there is much coordination between these visions and no actions to back up the aspirations at any level. Further, the national Economic Competitiveness Council and the Dubai Competitiveness Centre both attempt to foster and develop cluster initiatives, but neither body seems to coordinate with the other. As a first priority, discussions and round-table sessions between the executives of these bodies are required.

At the second stage, it is recommended that only one cluster body should exist at the national level to co-ordinate cluster initiatives across the UAE. Particularly at the Dubai level, it does not seem that the *private sector* is involved in shaping the national vision or improving the cluster environment. Efforts should be made to involve the private sector in cluster initiatives and to have the private sector entities in key clusters (particularly finance, logistics and tourism), set up institutes for collaboration (“IFCs”) to allow for coordination in the private sector and for private sector views to be heard at government level.

#### **4. The Dubai Tourism Cluster Analysis**

##### **4.1. History and Development**

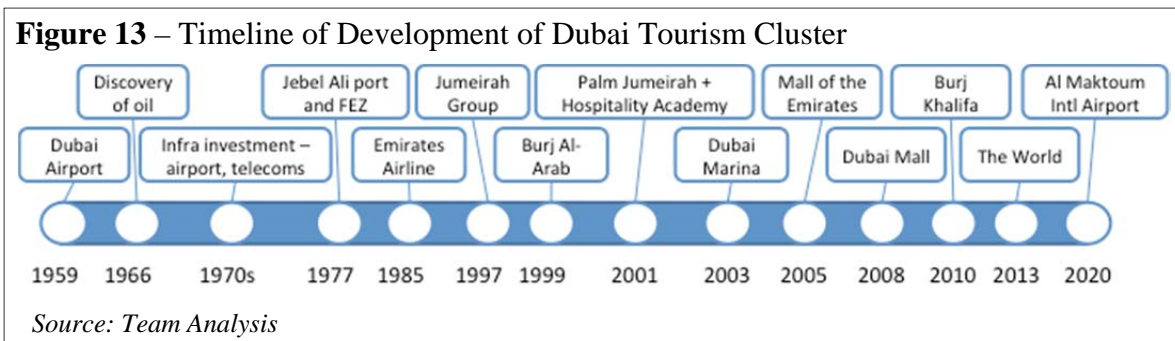
The tourism industry in Dubai, and in the entire Gulf region, is relatively young. Until the late 1950s, there weren't even hotels in Dubai; visitors had no choice but to stay with their hosts or colleagues (Davidson, 1998).

The following two decades saw Dubai develop the basic facilities for travellers. The international airport was opened in 1959. Spurred by the discovery of oil in 1966, a number of small hotels began to open to serve the needs of Dubai's growing economy.

The mid-1980s saw the start of the creation of the key institutions that came to drive the development of the Dubai tourism cluster. In 1985, the government founded Emirates Airlines, using Dubai airport as its main hub. In 1989, the Dubai Tourism Board was created. Transformed into the Department of Tourism and Commerce Marketing (“DTCM”) in 1997, it concentrated on international promotions and positioning Dubai as not just a commercial hub, but also as a resort destination (Davidson, 1998). The DTCM, along with the help of other key companies and institutions of the cluster, held the first annual Dubai shopping festival in 1996. In 1997, Jumeirah Group was established as a hotel management company. The company today has a portfolio of high-end hotels all around the world. These institutions catalyzed the growth of the cluster, and by 2000, 3.4 million tourists were

coming to Dubai each year (Davidson, 1998).

At the turn of the millennium, Dubai’s tourism cluster began growing at an even faster pace. Never-seen-before real estate projects brought Dubai global attention. The Burj-Al-Arab, which opened in 1999, was the first 7 star hotel in the world (Davidson, 1998). The Palm Island projects, started in 2002, were the first of its kind. Foreign money poured into Dubai as wealthy tourists came to stay at its fancy hotels, or to purchase some of its valuable waterfront properties. Between 2006 and 2010, the number of hotel beds grew at an annual rate of close to 10%. Increasing supply led to hotel occupancy plunging from 82.2% in 2007 to 66.8% in 2009 (Ayoub & Choufany, 2010). The capacity of Dubai’s International Airport was extended in this period as well.



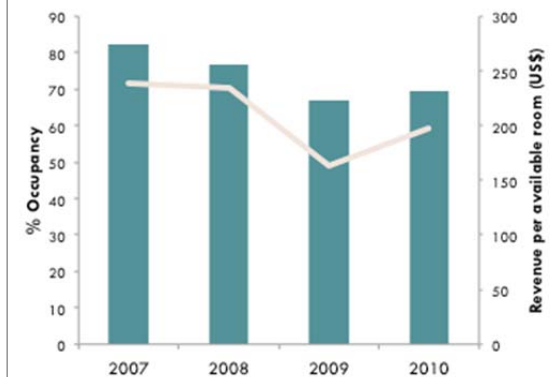
#### 4.2. Recent Cluster Performance

The 2007-2009 financial crisis was particularly hard on Dubai’s tourism cluster, as its focus on high-end foreign tourists left it exposed when global consumption dropped. As shown in **Figure 14**, occupancy was down 19% from 2007-2009 and revenue per available room dropped from \$235 in 2007 per night to \$163 per night in 2009. In 2010, however, the cluster began to recover: occupancy jumped 3% and revenue per available room was up by \$35 per night (Ayoub and Choufany, 2010). Real GDP growth for the Travel & Tourism economy was -17.8% in 2010 (Baumgarten and Kent, 2010). Despite the recent adjustments, the current project pipeline will see Dubai growing its hotel room capacity by more than any other city in the world.

### 4.3. Current Cluster Profile and Key Statistics

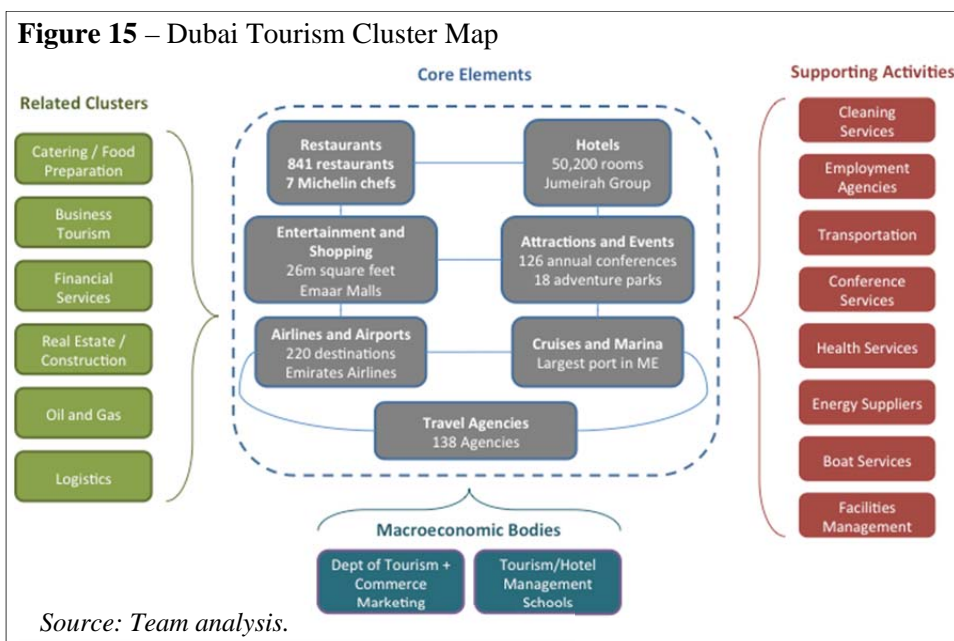
In 2010, 6.5 million visitors stayed in Dubai hotels (the highest number in the region), bringing \$3bn hotel revenues.<sup>16</sup> Tourism comprised 16.6% of the UAE's GDP (Baumgarten and Kent, 2010). Tourism is growing, with an 8.1% growth in GDP contribution since 2001 (at the UAE level) (Baumgarten and Kent, 2010). The UAE cluster ranks 30<sup>th</sup> in the world and first in the region in the 2011 World Economic Forum Travel and Tourism Report (Blanke and Chiesa, 2011).

**Figure 14 – Dubai Hotel Performance During the Financial Crisis**



Source: Hotel News Now, STR Global Dubai Market Snapshot

As shown in the cluster map in **Figure 15**, the cluster is very deep. The cluster is performing



Source: Team analysis.

well as evidenced by high hotel and restaurant prices. In 2010, Dubai's hotels had the highest revenue per available room in the world at \$198 and Dubai was ranked 10<sup>th</sup> in the world in terms of occupancy (78.6%) (Ayoub and

Choufany, 2010). In 2008, Dubai was rated the most expensive city in the world for restaurants.<sup>17</sup>

<sup>16</sup> Government of Dubai press release: <http://pr.dubaitourism.ae/2011/02/28/dubai%E2%80%99s-hotel-establishments-serve-8684387-million-tourists-in-2010/>

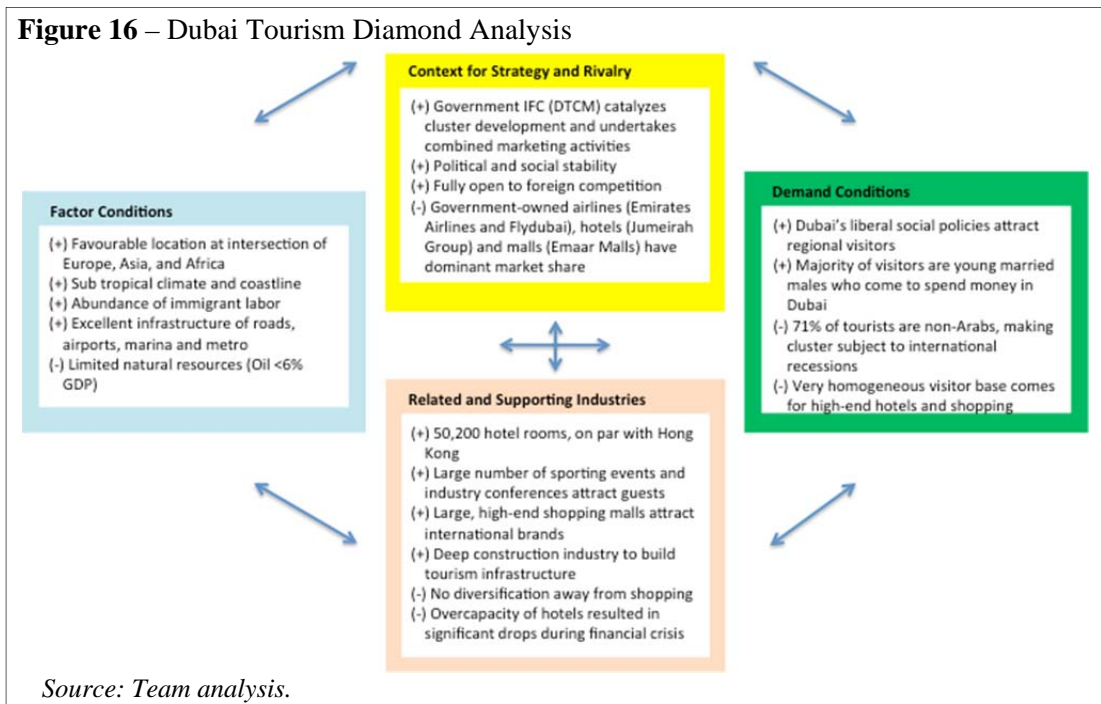
<sup>17</sup> Xpatulator 2008 Survey: <http://www.articlesbase.com/international-business-articles/expatriate-pay-dubai-most-expensive-place-in-world-for-restaurants-meals-out-and-hotels-367735.html>.

#### 4.4. Endowments

Dubai is located between Asia and Europe and is within a non-stop flight from almost all major cities in the world. Close proximity to European and Asian countries has attracted many tourists looking for sun and shopping. Dubai’s central location on the world map has also helped attract transit passengers, many of whom are en route between Europe and Asia.

Dubai is blessed with good weather for 6 months of the year. With almost no rainfall, and temperatures rarely falling below 20 degrees Celsius<sup>18</sup>, Dubai is an easy and close destination for many Europeans and Asian tourists looking for some winter sunshine. A potential disadvantage of Dubai’s weather is that it gets too hot in the summer months, a period when Europeans like to take their annual vacation. Dubai

lacks the cultural heritage of the likes of its neighbors such as Morocco, Oman, Egypt or Jordan. The quality of its beaches trails



behind those in Indonesia, Thailand or the Maldives.

#### 4.5. Quality of the Cluster Business Environment

**Figure 16** sets out the diamond analysis of for the Dubai tourism cluster.

<sup>18</sup> Dubai Meteorological Service, <http://www.dia.ae/Dubaimet/MET/Climate.aspx>.

#### 4.5.1. Factor Conditions

The most important factor conditions that have benefited Dubai's tourism cluster have been its excellent physical infrastructure, and abundance of immigrant labor.

The physical infrastructure, in particular the fast growing airport, has provided Dubai's tourism cluster with the tools to leverage its geographic location; 130 airlines operate out of Dubai International Airport, flying to 220 destinations in 6 continents.<sup>19</sup> As a result of continued investments in Dubai's airport, the UAE has consistently ranked in the top 5 of the GCR for airport infrastructure. It was also recognized as the 'Best Worldwide Airport in 2010'<sup>20</sup>. It is the 15<sup>th</sup> busiest airport in the world by passenger traffic. There have also been strong investments to aggressively improve the local transportation infrastructure through new roads and a metro system. The UAE has been climbing up the GCR for quality of road infrastructure and currently stands at 5.

Dubai's attractiveness to low-skilled foreign workers is particularly critical for a service sector like tourism. At the same time, the lack of higher skilled workers has resulted in a lack of managers in the industry. There is also a lack of participation of local citizens in the tourism workforce at all levels; with some estimates suggesting that only 1% of the employees in the tourism cluster are UAE nationals. Efforts have been made to improve the situation, like the Jumeirah Group's 'Emirates Academy of Hospitality Management', but not much progress has been made. The financial attractiveness of a career in tourism is not appealing for many locals given the low wages, especially when other higher paying jobs are available. Another factor that deters locals from this sector is its perceived low status in society.

The lack of participation of foreigners in higher skilled jobs can be explained by the fact that these firms are run by Emiratis, who seek to fill these positions only with their fellow Emiratis. Emirates Airlines is one exception, which hires several high skilled foreigners, and is in fact run by foreigners as

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<sup>19</sup> Dubai Airports, <http://www.dubaiairport.com/en/media-centre/facts-figures/Pages/factsheets-reports-statistics.aspx?id=9>.

<sup>20</sup> Business Travel Awards: <http://www.businesstravelawards.com/Winners2010.asp>

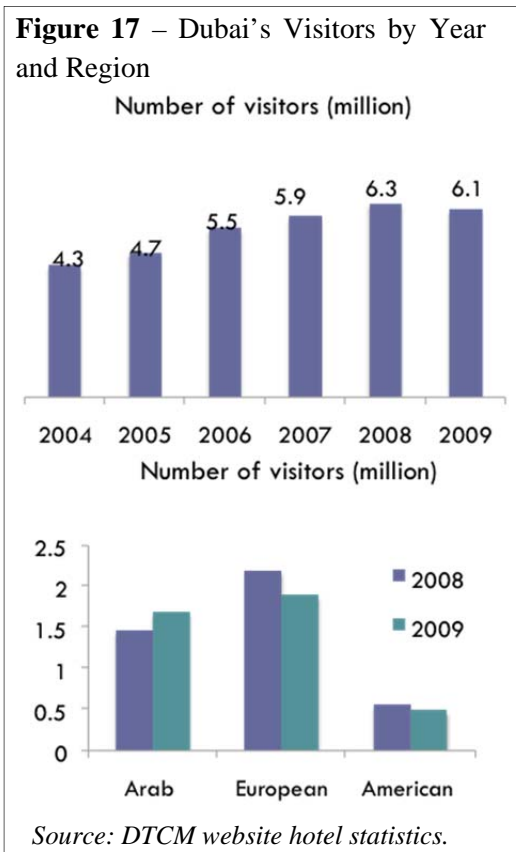


well. The strong, high paying financial cluster in Dubai also creates competition for high skilled local talent.

Dubai’s tourism cluster benefits from the state’s strong balance sheet, and its powerful financial cluster. The companies in the cluster are able to leverage these sources to finance their investments.

#### 4.5.2. Demand Conditions

Dubai’s demand has showed consistent growth from 4.3 million tourists in 2004 to 6.3 million tourists in 2008. The recent economic crisis slowed down this growth. This decline has come primarily from European and American tourists, which declined from 2.8 million to 2.4 million visitors (see



**Figure 17**). In contrast, demand from neighboring Arab countries increased during the same period from 1.5 to 1.7 million.<sup>21</sup>

As stated previously in the endowments and factor conditions, Dubai does not have as many endowments of cultural heritage sites as Morocco, Jordan, Oman, or Egypt and thus tourism has grown largely as a result of investment in infrastructure as shown in **Figure 18** (Bingeli et al, 2010). Instead, Dubai’s lavish shopping and high-end hotel industries largely drove demand from high-end tourists (**Figure 19**). As with Singapore, Dubai has built a base investment of airports, ports, and shopping infrastructure that

is sufficient to drive future demand without the need to constantly build megaprojects. Another important driver to Dubai’s demand was the tourism resulting from its foreign transit passengers. Thus, when the economic crisis hit, these foreign tourists cut their spending on leisure and the number of

<sup>21</sup> Dubai Statistics Center: <http://www.dsc.gov.ae/EN/Themes/Pages/Reports.aspx?TopicId=10>

flights going through Dubai Airport experienced a slight decline, resulting in a decline to the number of Europeans and Americans visiting Dubai.

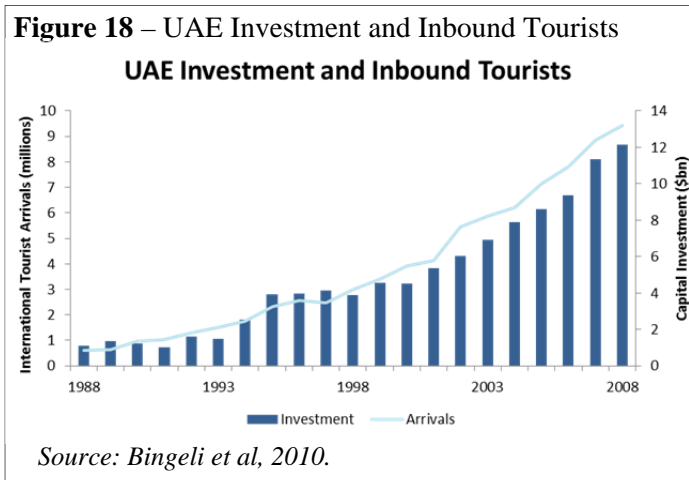
GCC tourists, on the other hand, come not just for malls and hotels. Dubai's relatively liberal policies, as demonstrated by having the

highest alcohol consumption per capita in the region, compared to its neighbors has attracted visitors from its more conservative Arab neighbors. It would take other GCC states a long time to replicate Dubai's liberal policies without causing political turmoil, giving Dubai a temporary lead in this segment of tourism.

### 4.5.3. Related and Supporting Industries

Despite little natural demand for tourism, Dubai's strategic location and forward looking policies fostered the development of four clusters that were most influential to the development of the tourism cluster: the transportation, retail, real estate, and finance clusters.

In the transportation cluster, the airline industry provided the most important boost for tourism. Dubai's airline industry started with the development of the Dubai International Airport in 1965. Since then the airport has developed to be the busiest airport in the middle-east and the 15<sup>th</sup> busiest airport in the world by passenger traffic with over 4 million passengers handled in March 2010 (Fuchs, 2011). The airport serves over 130 airlines and 220 destinations in six continents. Much of the passenger traffic goes through Emirates Airlines, which is the world's largest airline, flying to 106 destinations with 142 aircrafts and serving 27.5m passengers in 2010. Emirates Airlines has also played an important role in marketing Dubai as an international tourist destination. In 2010 Al Maktoum International Airport was

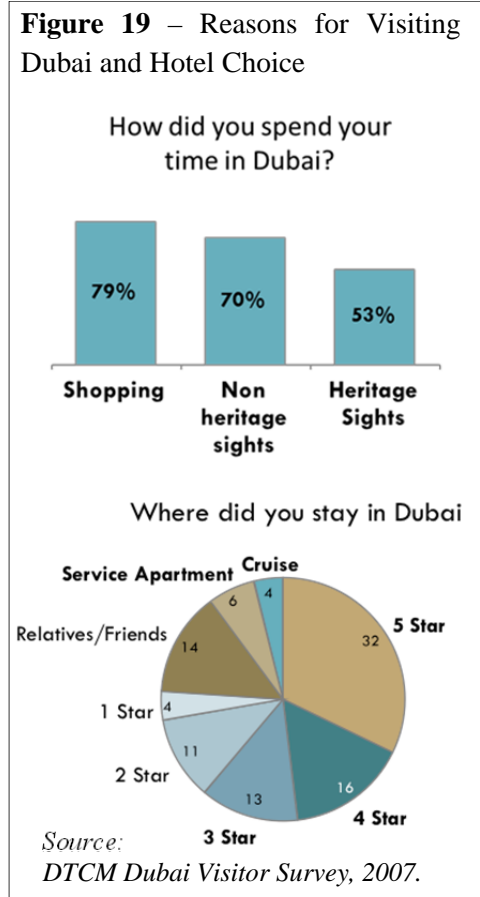


opened and will become the world’s largest airport with a capacity to handle 160 million daily passengers when it is fully operational, which means that the airline industry will continue to be a strong driver for Dubai’s tourism cluster. Beyond airline transportation, Dubai has also built ports that host cruise ships from around the world, and was recently awarded as the Middle East’s leading cruise port in 2010.

As over 80% of visitors visit Dubai to shop (see Demand section), Dubai’s retail industry has been a key driver to the development of the cluster. To satisfy the needs of these shoppers, Dubai has built more retail space than any other GCC country and has the most retail space under development. These spaces are occupied by prominent global brands. In fact, in 2010,

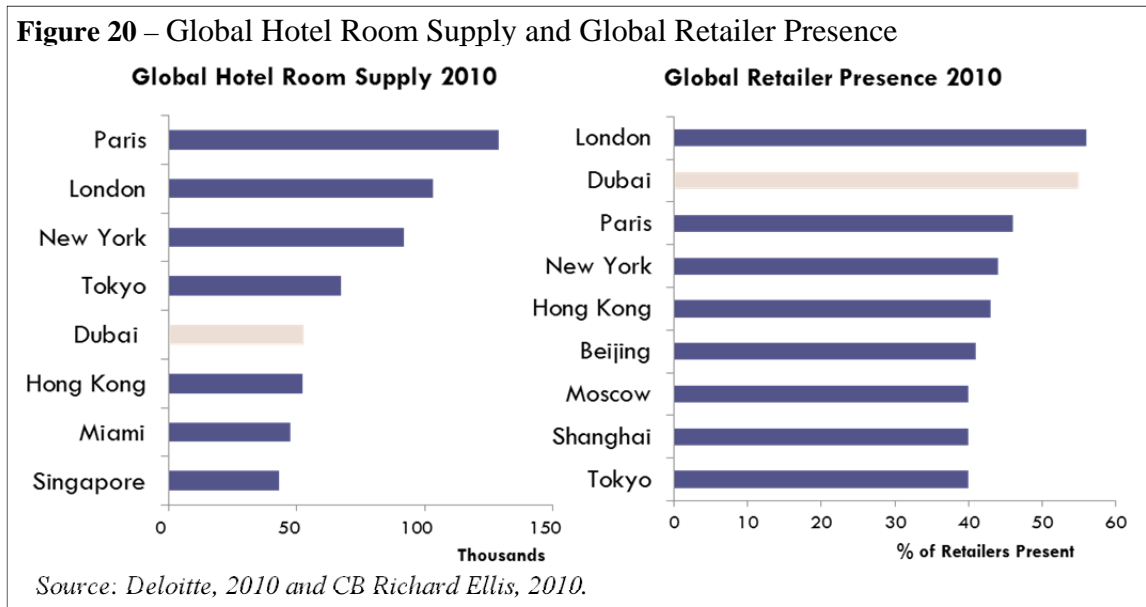
Dubai has more global retailer presence than any other city with the exception of London (**Figure 20**) (CB Richard Ellis, 2010). These retail centers or malls have also built extravagant facilities that include an indoor black diamond ski slope, aquariums, and indoor skydiving.

The real estate cluster has been the primary driver for the development of hotels, with help from the finance clusters to finance the projects. Jumeirah Group played an important role in developing the Burj al Arab, which serves as an important landmark for Dubai. Dubai, with over 52,000 rooms, is ranked as the fifth largest number of available rooms in the world’s cities (**Figure 20**). These hotel rooms are primarily high-end, as Dubai’s rooms generate more revenue than any other city in the world.



#### 4.5.4. Context and Strategic Rivalry

Dubai’s openness to foreign investment, secular policies with regard to issues such as alcohol, and diversification away from oil has led to an environment that is conducive to the development of the tourism cluster. Dubai’s Government also promotes the growth of the clusters directly through government owned companies and through the government-run DTCM, as discussed below.



The Government promotes open competition in most sectors despite having large state-owned companies that compete directly in each sector in the tourism cluster. For example, despite having its own national carrier, Emirates, Dubai’s open skies policy promotes open competition between airlines and ensures that there is sufficient competition in the logistics cluster. Qatar and Abu Dhabi are also appearing as competitors through Qatar Airlines and Etihad respectively.

Despite the promotion of competition, competition in sub-clusters within tourism, especially tourism and shopping is still very low. Emirates Airlines and Flydubai, both government owned, still control 62% of Dubai Airport.<sup>22</sup> Emaar Malls, another government owned entity controls, 49% of the

<sup>22</sup> Authors’ analysis from data compiled from Dubai Airports ([www.dubaiairport.com](http://www.dubaiairport.com)), Emirates Airlines ([www.emirates.com](http://www.emirates.com)), Flydubai ([www.flydubai.com](http://www.flydubai.com)) and DTCM.

retail space in Dubai.<sup>23</sup> Only the hotel sub cluster is competitive, with 47 international brands present despite the Jumeirah Group's prominence.

The DTCM is the leading IFC responsible for marketing the tourism cluster globally. So far, the DTCM has led the international efforts to promote Dubai's tourism sector. However, little has been done by the DTCM to promote broad based collaboration by the players in the tourism cluster. Amongst the efforts that the DTCM engaged in to promote tourism domestically were the Dubai Shopping Festival in 1996, the Summer Surprises in 2001, the Keep Discovering Dubai campaign in 2009, and most recently the Definitely Dubai campaign in 2010. The earlier campaigns did little to demonstrate the need for collaboration amongst the players as the demand was growing, but the drop in demand during the world economic crisis has increased the necessity to work together (Ketels, 2009).

#### **4.6. Competing Clusters**

Dubai is facing intense competition from its neighbors. Abu Dhabi and Qatar are replicating Dubai's formula for success in driving demand for tourism through investment in infrastructure and events. Abu Dhabi hosts a Formula One grand prix and is building the largest museum complex in the world. Qatar became famous after winning the 2022 Soccer World Cup bid and is also building hotel capacity. As both Abu Dhabi and Qatar are financing development with oil money, it will be difficult for Dubai to keep up in the race to build mega projects. Dubai openness to foreigners and its positioning as a hub for the Middle-East is unique in the region, which could enable it to serve transit tourists as Singapore has done for Malaysia, Thailand, Vietnam, and Indonesia. The countries with a more rich cultural heritage such as Egypt, Oman, and Morocco are facing civil unrest in 2011 and will unlikely be able to invest in infrastructure and attract foreign tourists. It is not yet clear how the Middle East uprising will impact Dubai's perception as a safe destination in the region. Dubai's liberal policies and

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<sup>23</sup> Authors' analysis from data compiled from websites of Emaar Malls, Majid Al Futtaim, and Nakheel Retail.

wealth should isolate it from the region's instability, but perception, especially from foreigners, could still suffer.

## **5. Issues for the Dubai Tourism Cluster**

As highlighted in the discussion above, the Dubai tourism cluster has various issues which inhibit its competitiveness. Dubai's focus on attracting Europeans and Americans for high-end tourism and shopping has left it exposed to international recessions. As consumption dips, tourists have no alternative choice other than 4- or 5-star hotels and choose to go elsewhere. As there are no cultural, natural or historic attractions, the demand is very cyclical, as the 2008-2009 crisis showed. With the singular focus on having the newest and best hotels, there is now significant hotel overcapacity. This seems to be a result of the cluster's dominance by government-owned entities which do not have a profit focus or proper corporate governance and are inhibiting competition. To the extent there is a private sector, it does not seem to be involved in shaping the cluster, as the DTCM does not seem to be functioning well. Perhaps during the economic boom from 2002-2007, there was no need for collaboration, but now the lack of collaboration seems to be inhibiting policies to diversify the economy.

Another major issue with the Dubai tourism cluster is the regional competition. Abu Dhabi, Qatar and Oman have better endowments in terms of historic attractions. All three destinations are making significant investments in infrastructure, hotels and cultural attractions. Each is searching for a way to differentiate and Dubai must work quickly to stay ahead of these competitors.

## **6. Recommendations for the Dubai Tourism Cluster**

### **6.1. Better Governance of SOEs and Eventual Spin-off**

As a first priority, SOEs such as Jumeirah Group need to adopt better governance through publication of annual accounts and hiring of professional management. This will ensure that these companies adopt profit-seeking policies and only make investments when profitable to do so and not at

the whim of the rulers of Dubai. It seems that cluster companies are continuing to invest in new hotels (Dubai has second largest hotel pipeline in the world) despite the leveling off of demand. Attracting new types of tourist as discussed below will allow natural demand to begin to lead supply. In the second stage, Dubai should look at spinning off state-owned companies either to the private sector or to public markets to ensure proper governance and private sector competition.

## **6.2. FDI and SMEs to Create Rivalry**

In order to allow foreign private sector companies to invest and import knowledge into the cluster, the UAE's FDI rules must be changed to allow 100% foreign ownership. Further, the DTCM should conduct a marketing campaign to get foreign tour operators to invest in setting up local operations in Dubai, allowing cluster companies to have a direct, local insight into customer preferences. Dubai's SME policy should be targeted at the tourism cluster to increase rivalry.

## **6.3. Private Sector Engagement in New IFCs**

The DTCM, despite being effective to create initial demand such as the Dubai Shopping Festival, has declined in importance and is not functioning properly. New IFCs at the sub-cluster level for hotels, shopping and restaurants need to be created to involve the private sector in cluster initiatives. This information can feed back up to the DTCM which has high-level government attention. This is a second priority recommendation.

## **6.4. Repurpose Existing Infrastructure Towards Family Tourism**

Tatweer, a Dubai SOE, is investing \$63bn in Dubailand, a family-focused entertainment complex with sports grounds and a Six Flags theme park among others in an attempt to attract a new type of less cyclical demand.<sup>24</sup> Rather than building new hotels, Dubai should repurpose existing hotels to focus on family tourism, boosting occupancy. This can be done with marketing and by creating car and bus connections to Dubailand, as Orlando hotels do with Walt Disney World. The private sector should be

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<sup>24</sup> Dubailand Website: [Http://www.dubailand.ae/news\\_details1.html](http://www.dubailand.ae/news_details1.html)

encouraged to invest in Dubailand, perhaps by making the entire area a tax-free zone allowing 100% FDI. Even if family tourists spend less than shopping tourists, they will stay in Dubai for longer.

#### **6.5. Regional Partnership to Become Gateway to UAE**

The above recommendations will help to stabilize and diversify Dubai's demand. But regional competitors will continue to challenge Dubai and divert tourists. Dubai has the most advanced airport in the region which connects the most international cities. Dubai should leverage this to become the regional tourist hub. Dubai should partner with Abu Dhabi, Qatar and Oman to create a regional tour similar to the Mayan region tours of Central America. Dubai should lead collective marketing for the region to boost overall demand (similar to Scandinavia's marketing under the Go Scandinavia slogan). Since Dubai's endowments are the weakest of its neighbours, Dubai should utilize its infrastructure investments as its competitive advantage. As tourists arrive in Dubai for connections, Dubai should offer 5- and 12- hour tours similar to Singapore's Changi Airport's tours, potentially offering discounted hotel rates for tourists staying for 24 hours. This would position Dubai as the hub for regional tours and slow regional competitors' investments in air infrastructure, cementing Dubai's position as the regional leader.



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## **Required Disclosures**

1. No team members are nationals of the UAE or have resided for an extended period of time in the UAE.
2. No special or non-public information about the UAE or the tourism cluster was used.
3. Sheela Subramanian travelled to Dubai on March 9-10, 2011 for personal reasons. Otherwise, no team member travelled to the UAE during the project period.