Macroeconomic Report Series

UAE Macroeconomic Report

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ملخص تنفيذي

إن مراجعة تقرير التنمية الاقتصادية الكلي للمؤشرات على ويركز إلى الإمارات الاقتصادية سلامة مدى فيها هذا.

هي الرئيسي للمؤشرات التالية:

• الإجمالي المحلي تج: المحلي الناتج الإجمالي قيمة وزيدت ثابتة نمو الإمارات الاقتصاديةسجل الأثري العقود خلال ضعف أكثر.

• المحرك النفطي غير الإجمالي المحلي الناتج أصبح النفط، حصة انخفاض مع الإمارات الاقتصادية لنمو الرئيسي). مثل 73٪ عام في 2005.

• القطاع الاقتصادي غير الرئيسي: التصالح والتجارة والتخزين، البناء العقارية، التجارة، التوريد، الصناعات المالية.

• المال ورأس العمال الإنتاجية: أو بالنفط سواء كبرى بفارق العمال الإنتاجية تمتد دونه مثلاً القطاع في الإنتاجية أكثر من العمال في الإنتاجية يتعلق فيما العقار، المالية، النفط، التوريد، التصدير، تداول.


• التجارة الميزانية: العالم دول بقية مع التجارة الفائض حالة في الإمارات التجارة الميزانية يصبح النفط ضم عند الماضي الأعوام خلال عام في 2004 الفائض كان 19٪ بقية وذل ذلك الإجمالي المحلي الناتج منها 63.0٪ في 2004 ذهب إلى إعادة استخدام يورب.
تبلغ نسبة زيادة الطلب على النفط في منطقة وكل ذلك، لأن الرغبة مع حال في التجارة المتزامنة 
.2004 إلى زيادة الطلب بنسبة 12% في زيادة الناتج المحلي ونسبة 5.2% في 2004. 
• الدعم الرياضي: 
• المشاركة القوية: 

.2004 إلى زيادة الطلب بنسبة 12% في زيادة الناتج المحلي ونسبة 5.2% في 2004. 
• الدعم الرياضي: 
• المشاركة القوية: 
Executive Summary

The present report examines the healthiness of the UAE economy, focusing throughout on selected macroeconomic indicators. The main indicators are as follows:

- **GDP:** During the last decade the UAE economy has shown steady growth and the value of total GDP has more than doubled. Whilst oil’s share has declined, non-oil GDP has been the major driver behind the UAE’s economic growth (representing 73% in 2005). The major non-oil sectors in the UAE economy are: manufacturing; trade; real estate; construction; transport, storage & communication; and finance. Abu Dhabi and Dubai contribute the most to the country’s GDP (59% and 28.9% respectively). However, the latter is primarily responsible for the remarkable growth witnessed in the majority of non-oil sectors.

- **Labor and Capital Productivity:** The UAE’s capital productivity significantly exceeds its labor productivity both with and without oil. With regards to the labor productivity by sector, labor is most productive in the oil, finance, real estate, transport and manufacturing sectors.

- **Government Budget:** Government revenue surpassed expenditure significantly between 2004 and 2005 thus aiding the government to convert a budget deficit, witnessed between 2001 and 2003, into a surplus. In 2005 the government budget recorded a surplus of AED 56,773 million.

- **Trade Balance:** The UAE balance of trade when including oil has been in trade surplus with the rest of the world over the last few years. In 2004 the surplus was 19% of GDP with a value of AED 63 billion. However, the trade balance excluding oil is in trade deficit. Nonetheless, since 2000 the deficit has been decreasing; in 1999 and 2000 the deficit was at a maximum 26% of GDP, whereas in 2004 it stood at only 8% of GDP.
**FDI:** In 2005 the UAE attracted AED 68 billion of FDI, a substantial improvement on previous years. The UAE has predominantly been a net receiver of FDI inflows over the past decade; the main investors into the UAE being the USA and the UK. Business and financial services are currently receiving the highest concentration of projects, receiving 22% of all UAE FDI projects, thus indicating the future expansion of this sector.

**Inflation:** For the past five years the UAE has been experiencing creeping inflation (6.2% in 2005). In some sectors, such as the housing sector, inflation is becoming more of a problem and may start to impede on economic growth if the creeping persists. Therefore, authorities must take measures to prevent any further increases in inflation and curtail the potentially detrimental economic consequences that it may produce.

**Labor Force:** In 2004 the UAE labor force accounted for 2,731 thousand of the total population (4,320 thousand), representing a total of 63.2%. The unique structure of the UAE’s labor force, with its dependency on foreign workers, has meant that unemployment levels in the UAE are notably low; 3% in 2004.

In general, the UAE’s macroeconomic indicators signal a healthy, booming economy experiencing steady growth.
1. Introduction

The UAE is comprised of 7 Emirates: Abu Dhabi; Dubai; Sharjah; Ajman; Umm Al Quwain; Ras Al Khaimah and Fujeirah. The UAE is one of the world’s primary oil producers and has thus benefited accordingly from recent increases in world oil prices. The UAE economy is, however, not as reliant on the oil market as may be presumed.

The UAE has been following a largely successful, stringent diversification strategy away from oil dependency and has been equally committed to its outward-orientated growth policy. The UAE’s vision to define itself as a regional financial centre and international trading hub is gradually being realized and as a result both because, and irrespective of oil, the UAE economy has been booming. High capital productivity has filtered into high levels of gross domestic product (GDP) and sustained remarkable growth rates over the past decade. Composite economic performance indicators simply substantiate the success and prosperity of the current UAE economy.

The main objective of this report is to examine the health of the UAE economy by focusing on its main macroeconomic indicators. These economic indicators comprise the GDP growth, FDI development, employment, inflation, and other variables that are of economic relevance.
2. Objective

This report aims to analyze the following macroeconomic indicators:

1. UAE GDP and its structure over the last decade.
2. Labor and capital productivity.
3. Public finance (represented by government revenues and expenditures).
4. Foreign trade (i.e. exports, import, & re-exports).
5. Foreign direct investment.
6. Inflation.
7. Labor force.

Examining several aspects of the UAE economy at the macroeconomic level facilitates an understanding of the contemporary economy and offers a clear indication of its buoyancy and overall prosperity.
3. Data and Methodology

The UAE macroeconomic data is mainly collected and compiled by the UAE Ministry of Economy. However, several local and international reliable sources are also used, for example from the UAE Central Bank, the IMF and UNCTAD. The data used in this report is the most recently available; which in general is either 2004 or 2005. Based on availability and consistency data from earlier years is also presented for comparative purposes.

The methodological approach employed is descriptive and analytical, aiming to expose the raison d’être behind the absolute levels and observed trends of the presented macroeconomic indicators.
4. UAE GDP Structure

It is well known that the UAE is one of the world’s major oil producers. Therefore, it is not surprising that a considerable part of UAE GDP is comprised of oil. Oil’s share in UAE GDP is, however, small compared with other GCC countries. In what follows, we will present the UAE’s GDP structure, its growth rates, the main contributors to UAE GDP by Emirate, and the major non-oil sectors.

4.1. Oil and Non-oil GDP

Over the past 10 years the UAE has more than doubled its GDP, totaling AED 358 billion in 2005 (see Figure 4.1). Conversely, oil’s share in GDP has been diminishing during this period; non-oil GDP has been the main driver of the UAE economy – its share of total GDP was 73% in 2005.

Figure 4.1. UAE GDP at Basic Prices 1994-2005

The fact that oil’s share in GDP has decreased over time can be attributed to the strategic plan pursued by the UAE government to diversify its economy away from oil dependency.
Figure 4.2 presents the growth of overall GDP as well as both oil and non-oil growth. In the last two years the UAE’s overall GDP growth has ranged between 8% and 10%. This growth has been mainly driven by non-oil GDP, where growth rates exceeded 10%, as oil GDP growth failed to exceed 3% in the same period.\(^1\) In sum, non-oil contributions to UAE GDP surpass that of oil in both its absolute value and growth rates.

![Figure 4.2. UAE GDP Growth 1994-2005](image)

**Figure 4.2. UAE GDP Growth 1994-2005**


Source: UAE Ministry of Economy

### 4.2. GDP by Emirate

Abu Dhabi and Dubai were the primary contributors to total GDP in 2005 at 59% and 29% respectively. The remaining 12% was distributed over the other 5 Emirates, as shown in Figure 4.3. It is worth mentioning here that although Abu Dhabi was the main contributor to total UAE GDP, almost 56% of the Emirate’s GDP is derived from oil. In contrast, oil only contributes to around 5% of Dubai’s GDP; reflective of its diversity. A similar structure applies for the rest of Emirates; specifically, oil represents 12% and 9% of the GDP of Sharjah and Ras Al-Khaimah, whilst in the rest of Emirates oil does not exceed 2% of GDP for each.

\(^1\) The high growth of the oil sector in 2001 was mainly driven by a jump in world oil prices in that year.
4.3. Major Non-oil Sectors

Given that non-oil GDP is the dominant driver behind UAE GDP growth, it is important to identify the economic sectors responsible for this. Data from 2005 reveals that the main non-oil sectors in the UAE economy are manufacturing and trade, representing 20% and 17% respectively (see Table 4.1). Real estate and construction are also important, representing 12% and 11% of non-oil GDP respectively, followed by transport, storage & communication at 10% and financial at 9%. Note that the government services sector also makes an integral contribution to the UAE’s non-oil GDP (11%).

With regards to manufacturing, figures reveal that the primary producer is Abu Dhabi as it represents almost half of the UAE manufacturing sector, followed closely by Dubai with a share of 33% and Sharjah with 11%. The UAE manufacturing sector in 2005 had almost doubled its value since 2001, with a compounded annual growth rate (CAGR) of 11.8% over the last five years.
In order to maximize benefits from the forthcoming free trade agreements (FTAs) UAE manufacturers must continue to perform well in order to boost UAE industrial exports.²

Unlike the manufacturing sector, which is led by Abu Dhabi, UAE trade is mainly conducted by Dubai; in 2005 Dubai’s share of total UAE trade stood at 60%, almost triple that of Abu Dhabi (22%). Sharjah’s trading share was 8% of the UAE total, whilst the remaining 10% was distributed over the other four Emirates. The UAE’s trade sector has grown by 140% compared with its value in 2001 at a CAGR of 18.8%. This remarkable growth has been mainly spurred by an increase in both local demand and re-exports in Dubai.

Similarly, the real estate and construction sectors in Dubai are significantly larger than in Abu Dhabi. Real estate and construction in Dubai, 2005, represented 40% and 48% of the total for the UAE respectively; whilst Abu Dhabi’s share was about 36% for each sector; and Sharjah’s was 15% and 8% respectively. The UAE’s real estate sector has grown by 85% since 2001 with a CAGR of 13%. The UAE construction sector has doubled its 2001 value, growing at

Table 4.1. GDP at Basic Prices by Emirate 2005 (Million AED)*

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Fujeirah</th>
<th>Ras Al-Khaimah</th>
<th>Umm Al-Qwain</th>
<th>Ajman</th>
<th>Sharjah</th>
<th>Dubai</th>
<th>Abu Dhabi</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Non Financial Corporations Sector</td>
<td>4,643</td>
<td>7,305</td>
<td>1,663</td>
<td>5,173</td>
<td>30,227</td>
<td>120,270</td>
<td>254,832</td>
<td>427,364</td>
</tr>
<tr>
<td>- Agriculture, Live Stock &amp; Fishing</td>
<td>615</td>
<td>1,020</td>
<td>209</td>
<td>203</td>
<td>1,112</td>
<td>974</td>
<td>7,783</td>
<td>11,028</td>
</tr>
<tr>
<td>- Mining &amp; Quarrying:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Crude Oil &amp; Natural Gas</td>
<td>78</td>
<td>791</td>
<td>38</td>
<td>53</td>
<td>4,226</td>
<td>7,577</td>
<td>161,406</td>
<td>174,114</td>
</tr>
<tr>
<td>* Quarrying</td>
<td>78</td>
<td>433</td>
<td>38</td>
<td>53</td>
<td>103</td>
<td>108</td>
<td>162</td>
<td>919</td>
</tr>
<tr>
<td>- Manufacturing Industries</td>
<td>765</td>
<td>868</td>
<td>217</td>
<td>1,400</td>
<td>6,494</td>
<td>19,967</td>
<td>29,596</td>
<td>61,194</td>
</tr>
<tr>
<td>- Electricity, Gas &amp; Water</td>
<td>188</td>
<td>415</td>
<td>97</td>
<td>212</td>
<td>1,074</td>
<td>1,938</td>
<td>4,013</td>
<td>7,935</td>
</tr>
<tr>
<td>- Construction</td>
<td>613</td>
<td>815</td>
<td>284</td>
<td>729</td>
<td>2,807</td>
<td>16,640</td>
<td>12,415</td>
<td>34,980</td>
</tr>
<tr>
<td>- Wholesale Retail Trade &amp; Repairing Services</td>
<td>825</td>
<td>1,336</td>
<td>301</td>
<td>840</td>
<td>4,529</td>
<td>31,977</td>
<td>11,724</td>
<td>52,998</td>
</tr>
<tr>
<td>- Restaurants &amp; Hotels</td>
<td>154</td>
<td>189</td>
<td>70</td>
<td>174</td>
<td>1,041</td>
<td>4,987</td>
<td>2,088</td>
<td>8,946</td>
</tr>
<tr>
<td>- Transport, Storage &amp; Communication</td>
<td>777</td>
<td>736</td>
<td>159</td>
<td>517</td>
<td>2,573</td>
<td>18,035</td>
<td>9,517</td>
<td>32,642</td>
</tr>
<tr>
<td>- Real Estate &amp; Business Services</td>
<td>474</td>
<td>935</td>
<td>249</td>
<td>851</td>
<td>5,465</td>
<td>14,526</td>
<td>13,016</td>
<td>35,920</td>
</tr>
<tr>
<td>- Social &amp; Personal Services</td>
<td>155</td>
<td>201</td>
<td>38</td>
<td>194</td>
<td>907</td>
<td>3,649</td>
<td>3,275</td>
<td>7,607</td>
</tr>
<tr>
<td>The Financial Corporations Sector</td>
<td>569</td>
<td>597</td>
<td>85</td>
<td>199</td>
<td>2,473</td>
<td>13,474</td>
<td>11,029</td>
<td>28,426</td>
</tr>
<tr>
<td>Government Services Sector</td>
<td>696</td>
<td>1,408</td>
<td>276</td>
<td>557</td>
<td>3,389</td>
<td>9,413</td>
<td>22,613</td>
<td>34,735</td>
</tr>
<tr>
<td>- Domestic Services of Households</td>
<td>79</td>
<td>133</td>
<td>37</td>
<td>103</td>
<td>411</td>
<td>733</td>
<td>1,015</td>
<td>2,382</td>
</tr>
<tr>
<td>Less: Imputed Bank Services</td>
<td>190</td>
<td>191</td>
<td>29</td>
<td>65</td>
<td>782</td>
<td>3,691</td>
<td>2,944</td>
<td>7,395</td>
</tr>
<tr>
<td>TOTAL</td>
<td>5,797</td>
<td>9,252</td>
<td>2,033</td>
<td>5,967</td>
<td>35,718</td>
<td>140,200</td>
<td>286,545</td>
<td>485,513</td>
</tr>
</tbody>
</table>

* Preliminary
Source: UAE Ministry of Economy

² The UAE is currently negotiating several FTAs with the following countries: USA, European Union, Japan, China, India, Pakistan, Singapore, Malaysia, Turkey, and Australia.
a CAGR of 15%. The notable growth observed in the UAE real estate and construction sectors has been mainly driven by the infrastructural and building boom witnessed in the three major Emirates (Abu Dhabi, Dubai, and Sharjah) during recent years.

Additionally, the high performance of the transport, storage & communication sector in the UAE can be mainly attributed to Dubai. Its composite share exceeds 55%; whereas Abu Dhabi’s represents 30%; and Sharjah’s 8%. The overall sector has grown by 78% compared with its value five years ago (2001), growing at a CAGR of almost 12.3%. The UAE’s initiation of a new railway project and remarkable growth in the telecommunications base means that transport, storage and communication is considered one of the most promising sectors in the UAE.

Although the financial sector’s share in UAE GDP is relatively small, the UAE financial sector is one of the most profitable and developed financial sectors in the region. The UAE’s financial sector has grown by more than 70% since 2001, with a CAGR of 11.3%. Most of this growth can be attributed to Dubai and Abu Dhabi, as their financial sectors represent the majority of the UAE’s at 47% and 39% respectively. It follows that the only two financial markets in the UAE, namely the Dubai Financial market (DFM) and the Abu Dhabi Securities Market (ADSM), are located in these Emirates. The financial sector of Sharjah represents only 9% of the UAE. Interesting changes are expected to be observed in the UAE financial sector if major reforms are implemented in response to liberalization petitions which have been submitted to the UAE by countries engaged in FTAs negotiations, such as the USA. For the potential impact of the UAE’s financial sector liberalization, see Rettab et al. (2005) and Rettab and Bakheet (2005).

Throughout this section it has been reported that over the last decade the UAE economy had shown steady growth; the value of total GDP has more than doubled. Oil’s share has declined whilst non-oil GDP has been the major driver behind economic growth (accounting for 73% of GDP in 2005). The major non-oil sectors in the UAE economy are: manufacturing (20%); trade (17%); real estate (12%); construction (11%); transport, storage & communication (10%); and finance (9%). The government services sector also contributes considerably to UAE GDP; at 11% of GDP in 2005. Although Abu Dhabi and Dubai are both major contributors to
domestic GDP (59% and 29% respectively), the latter is primarily responsible for the remarkable growth which has been witnessed in the majority of non-oil sectors.
5. Labor and Capital Productivity

Productivity measures the efficiency with which an economy creates output from a given input. In other words, productivity measures the economic performance of an economy. High productivity levels signify that an economy is competitive and efficient in its production of goods and services, thereby suggesting high levels of economic growth. Ideally, to measure the productivity of an economy various inputs such as land, labor, capital, knowledge or a combination of these should be used. However, in this report productivity is measured using solely labor and capital as inputs.

In this report, due to data restrictions, labor and capital productivity are examined for the latest year available (2004). Labor productivity is calculated as the ratio of GDP to the total number of workers and is available by both Emirate and sector. Capital productivity is, similarly, calculated as the ratio of GDP to the stock of capital. Unfortunately, however, stock of capital by sector is not available for the UAE except for Dubai in 2001 (calculated in a study by Rettab and Kwaak, 2004). Therefore, an extrapolation technique, based on the GDP share of each Emirate in 2001 and the gross fixed capital formation (GFCF) by Emirate for each of the subsequent years, was employed to produce estimates for the capital productivity of the UAE.

5.1. Overall Productivity

As shown in Figure 5.1 Abu Dhabi, Dubai and Sharjah have, respectively, both the highest labor and capital productivities for oil and non-oil sectors, in 2004. Specifically, one unit of labor in Abu Dhabi produces AED 236 thousand units of output; almost double the labor productivity of Dubai (AED 121 thousand) which should be viewed in light of the oil sector. The opposite will be shown for the non-oil sector in the following section. Labor productivity in the remaining four Emirates is not significantly different from Sharjah’s (AED 93 thousand); Ajman has the least productive labor force of the Emirates, at AED 61 thousand. Labor is most productive in the oil, finance, real estate, transport and manufacturing sectors, where one unit of labor produces AED 826 thousand, AED 400 thousand, AED 184 thousand, and AED 155 thousand worth of output respectively.
Capital productivity in Abu Dhabi, Dubai and Sharjah far exceeds that of the other Emirates. The capital productivity of these three Emirates is fairly uniform, as shown in the Figure above. Overall, capital productivity is substantially higher than labor productivity in the UAE; one unit of capital produces AED 2,850 thousand units of output compared with one unit of labor that produces AED 711 thousand units of output. The reason behind such a disparity is, essentially, the presence of oil. Therefore, in what follows we will deduct the oil share (from both GDP and labor and capital stock respectively) in orders to compare non-oil labor and capital productivity.

5.2. Non-oil Productivity

When considering non-oil labor and capital productivity, a rather different picture emerges with regards to Abu Dhabi. Hitherto, Abu Dhabi was the most productive Emirate in terms of both labor and capital; however, with the deduction of oil from calculations Abu Dhabi’s labor productivity is almost halved, placing it on a par with Dubai (see Figure 2) and similarly, Dubai becomes the most capitally productive Emirate followed by Sharjah, Ras Al-
Khaimah and Fujairah. Dubai’s non-oil capital productivity was AED 676 thousand per unit in 2004, whilst Abu Dhabi’s was AED 565 thousand. It therefore follows that Abu Dhabi’s impressive capital and labor productivity rates were purely a reflection of the productiveness of the oil sector.

As shown in Figure 5.2 total non-oil labor productivity in the UAE was valued at AED 567 thousand units of output in 2004 whereas total non-oil capital productivity was valued at AED 4,409 thousand units of output; therefore, capital is nearly eight times more productive than labor in the non-oil sectors of the UAE. This finding indicates that the UAE should either focus on capital intensive growth strategies or, alternatively, on improving the productivity of labor in order to maximize output.

In sum, the UAE’s capital productivity significantly exceeds labor productivity with regards to both with and without oil. Without oil, labor productivity in Abu Dhabi is almost halved and capital productivity is driven from first place to fifth among the other Emirates, thus demonstrating the importance of oil to Abu Dhabi’s productivity levels and economic growth.
6. Public Finance

Government operations have an economic impact on the economy through revenue collections and expenditure policies. Government revenues impact the supply side of the economy through taxable and non-taxable revenues. In the UAE, taxable revenues are generated from customs (trade and port operations) and incomes (foreign banks and oil companies) whereas the non-taxable revenues are generated from the profits of public enterprises and other sources\(^3\). Conversely, government expenditures impact the demand side of the economy through government consumption, investment spending, and subsidies and transfers. Table 6.1 shows the UAE government revenues and expenditures for the period 2000 to 2005.

Over the last five years government expenditures have generally been increasing; although they did fall marginally in 2002. Between 2004 and 2005 government expenditure grew by 15%, vastly exceeding the 2% growth in the previous year. From 2000 to 2002 government revenues declined and as a result the government ran a budget deficit from 2001 to 2003. A decline in oil revenues combined with simultaneous increases in government expenditures, on subsidies, transfers and real estate developments, meant that the gap between revenues and expenditures widened. However, more recently, from 2003 to 2005, the government’s revenues have actually been increasing, and as a result the government has been in budget surplus. A discussion later on offers a more detailed analysis of the budgetary position.

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\(^3\) There is no direct corporate income tax except for companies involved in oil production and branches of foreign banks. Foreign banks are taxed at 20% and oil companies are taxed at 55% in UAE. There is a 15-year tax exemption for companies established in the Free Zones. There is no personal income tax and no restrictions on repatriation of capital and profits (BMI, 2005).
Table 6.1: UAE Government Operations, 2000-2005 (Millions AED)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total revenue</strong></td>
<td>89,691</td>
<td>78,440</td>
<td>66,086</td>
<td>84,079</td>
<td>110,574</td>
<td>163,955</td>
</tr>
<tr>
<td><strong>Non tax revenues</strong></td>
<td>87,746</td>
<td>76,388</td>
<td>64,188</td>
<td>81,320</td>
<td>107,214</td>
<td>159,689</td>
</tr>
<tr>
<td>Oil and gas 1/</td>
<td>59,978</td>
<td>51,648</td>
<td>40,926</td>
<td>56,898</td>
<td>73,322</td>
<td>111,277</td>
</tr>
<tr>
<td>Enterprise profits</td>
<td>3,938</td>
<td>3,384</td>
<td>3,357</td>
<td>2,935</td>
<td>3,313</td>
<td>4,089</td>
</tr>
<tr>
<td>Fees and Charges</td>
<td>4,173</td>
<td>5,120</td>
<td>6,429</td>
<td>6,479</td>
<td>6,327</td>
<td>8,145</td>
</tr>
<tr>
<td>Investment Income 2/</td>
<td>15,065</td>
<td>11,576</td>
<td>8,869</td>
<td>9,881</td>
<td>16,863</td>
<td>27,669</td>
</tr>
<tr>
<td>Other</td>
<td>4,592</td>
<td>4,660</td>
<td>4,607</td>
<td>5,127</td>
<td>7,389</td>
<td>8,509</td>
</tr>
<tr>
<td><strong>Tax revenue</strong></td>
<td>1,945</td>
<td>2,052</td>
<td>1,898</td>
<td>2,759</td>
<td>3,360</td>
<td>4,266</td>
</tr>
<tr>
<td>Customs</td>
<td>1,779</td>
<td>1,846</td>
<td>1,663</td>
<td>2,458</td>
<td>3,040</td>
<td>3,846</td>
</tr>
<tr>
<td>Income tax 3/</td>
<td>166</td>
<td>206</td>
<td>235</td>
<td>301</td>
<td>320</td>
<td>420</td>
</tr>
<tr>
<td><strong>Total expenditures</strong></td>
<td>82,542</td>
<td>95,558</td>
<td>86,798</td>
<td>91,563</td>
<td>93,384</td>
<td>107,182</td>
</tr>
<tr>
<td>Current expenditure</td>
<td>69,441</td>
<td>76,732</td>
<td>72,608</td>
<td>74,255</td>
<td>79,536</td>
<td>88,147</td>
</tr>
<tr>
<td>Wages and salaries 4/ 5/</td>
<td>13,965</td>
<td>14,383</td>
<td>15,313</td>
<td>15,764</td>
<td>15,892</td>
<td>15,654</td>
</tr>
<tr>
<td>Goods and services 5/</td>
<td>21,287</td>
<td>22,491</td>
<td>23,745</td>
<td>26,519</td>
<td>27,172</td>
<td>30,537</td>
</tr>
<tr>
<td>Abu Dhabi federal services 6/</td>
<td>19,440</td>
<td>19,082</td>
<td>17,045</td>
<td>19,198</td>
<td>23,533</td>
<td>22,431</td>
</tr>
<tr>
<td>Subsidies and transfers</td>
<td>14,237</td>
<td>20,128</td>
<td>16,108</td>
<td>11,372</td>
<td>12,346</td>
<td>18,981</td>
</tr>
<tr>
<td>Other</td>
<td>512</td>
<td>648</td>
<td>397</td>
<td>1402</td>
<td>593</td>
<td>544</td>
</tr>
<tr>
<td>Development</td>
<td>11,230</td>
<td>13,358</td>
<td>12,470</td>
<td>16,028</td>
<td>15,515</td>
<td>13,509</td>
</tr>
<tr>
<td>Loans and equity (net)</td>
<td>652</td>
<td>4,507</td>
<td>760</td>
<td>16</td>
<td>-2,308</td>
<td>4,499</td>
</tr>
<tr>
<td>Domestic</td>
<td>714</td>
<td>903</td>
<td>592</td>
<td>-810</td>
<td>1,654</td>
<td>5,106</td>
</tr>
<tr>
<td>Foreign</td>
<td>-62</td>
<td>3,604</td>
<td>168</td>
<td>826</td>
<td>-3962</td>
<td>-607</td>
</tr>
<tr>
<td>Foreign Grants 7/</td>
<td>1,219</td>
<td>961</td>
<td>960</td>
<td>1,264</td>
<td>641</td>
<td>1,027</td>
</tr>
<tr>
<td><strong>Overall balance</strong></td>
<td>7,149</td>
<td>-17,118</td>
<td>-20,712</td>
<td>-7,484</td>
<td>17,190</td>
<td>56,773</td>
</tr>
</tbody>
</table>

1/ Includes royalties and taxes on oil and gas companies
2/ Fund staff estimates, based on fiscal accounts and other sources
3/ Taxes on profit of foreign banks
4/ Excludes military wages and salaries, which are in goods and services
5/ Water and electricity expenditure is allocated 25 percent to wages and salaries
6/ Mainly military and internal security outlays paid by Abu Dhabi, but not in federal accounts
7/ Intergovernmental grant’s are netted out in consolidated accounts

Source: IMF Country Report No. 06/257, July 2006

6.1. Government Revenues

During the period 2000 to 2005 the share of non-tax revenues in total government revenues was on average 97%. Non-tax revenues were predominantly comprised of 66% oil and gas, 17% investment income, 5% fees and charges, 5% profits of public enterprises. The share of the taxable revenues in total government revenues was only 3%, which included 2.5% from customs and 0.5% from income tax.
As shown in Figure 6.1 oil and gas revenue has been the primary contributor to the government’s revenues and as a result any changes in this sector are directly reflected in government revenues and indirectly reflected in overall government budgetary operations. For example, the increase in oil prices, as a result of OPEC cut backs on oil production following September 11th and the political unrest in the Middle East, meant that oil and gas revenues declined in both 2001 and 2002 (see the trend line in Figure 1) and as a result the UAE government ran a budget deficit between 2001 and 2003.

![Figure 6.1. Structure of UAE Government Revenues (2000-2005)](image)

**Figure 6.1. Structure of UAE Government Revenues (2000-2005)**


### 6.2. Government Expenditures

The rise in government expenditures from 2000 to 2001 also played a key role in accentuating the budget deficit. During the period 2000 to 2005 the average share of current expenditure in total expenditures was 83%; composed of included goods and services at 27%, Abu Dhabi federal services at 22%, subsidies and transfers at 17%, wages and salaries at 16% and other expenditures at 1%. Development expenditure represented 15% of total expenditures, whereas the contributions to federal government and loans and equity represented 1% each.
As mentioned earlier, increases in government spending on subsidies and transfers and real estate development added further to the government budget deficit in 2001 and 2002. The increased spending on subsidies and transfers from 2000 to 2002 (see Figure 6.2) was mainly the result of the government’s initiation of the Emiratization plan to increase work opportunities and provide greater compensation to UAE nationals. The increase in development expenditure from 2000 to 2001 was the result of government initiations to further develop the country’s infrastructure by creating real estate opportunities, especially in the Emirate of Dubai.

By 2003 the budget deficit had been considerably reduced and converted into a budget surplus as a direct result of substantially higher revenues between 2002 and 2005. The staggeringly high growth of total revenues can be attributed to the increase in revenues from the oil and gas sectors in 2003 to 2005, when OPEC increased its production due to an increase in world demand.
In conclusion, the increase in the world demand for oil between 2003 and 2005 has enabled the government to convert its budget deficit, witnessed between 2001 and 2003, into a surplus. In 2005 the government reported a budget surplus of AED 56,773 million, which is more than three times the surplus reported in 2004. This hereby reveals that although the UAE’s government operations currently produce a budget surplus, the budgetary position is still very much reliant and vulnerable to changes and price movements in the oil sector.
7. Foreign Trade

Generally, richer countries are engaged in more foreign trade. The existence of a positive relationship between foreign trade and high GDP is well established (e.g., Dollar, 1992; Levine and Renelt, 1992; and Edwards, 1993). In what follows, the composite components of UAE foreign trade will be presented and measured as shares of total GDP.

Over the past decade total foreign trade in the UAE has increased substantially, more than doubling from AED 221 billion in 1994 to AED 463 billion in 2004 (see Figure 7.1). Since 2000 foreign trade has been growing at a CAGR of 11%.

In 2004, the value of foreign trade excluding oil accounted for roughly 80% of total foreign trade (see Figure 7.1), composed of 54% imports, 20% exports and 26% re-exports. Figure 7.2 shows the UAE’s foreign trade patterns between 1994 and 2004.
The relative share of each of the components of foreign trade has remained fairly stable over the past decade; imports share has fallen by 5%, whereas both exports and re-exports share has increased by a marginal 3% and 2% respectively.

Figure 7.3 displays the annual change in each component of non-oil foreign trade. Each constituent component shall be discussed separately later on.
7.1. Trade Balance

Over the past decade the UAE balance of trade, including oil, has been in trade surplus with the rest of the world, with the exception of the year 2000 (see Figure 7.4). In 2004 the surplus fell from 23% to 19% of GDP, however, remained at an impressive surplus value of AED 63 billion.

![Figure 7.4. Total Trade Balance including Oil (1994-2004)]

Source: Calculations based on UAE Ministry of Economy

The trade balance excluding oil in the UAE is, however, in trade deficit and has been throughout the last decade (see Figure 7.5). However, since 2000 the deficit has been decreasing; in 1999 and 2000 the deficit was at a maximum 26% of GDP, whereas in 2004 it stood at only 8% of GDP. This fall in the deficit can be attributed to the success of diversification strategies within the UAE and the subsequent increase in non-oil exports and re-exports.

Unsurprisingly, Dubai is the main Emirate responsible for the trade deficit; in 2004 it ran a deficit of AED 82 billion, 21% of UAE GDP. All other Emirates, with the exception of Ajman, also ran a trade deficit with the rest of the world. Unfortunately, Ajman’s contributions to trade
are negligible within the UAE. The UAE holds the largest trade deficits with China and Japan; where in 2004 the value of the trade deficits were AED 18 billion and AED 15 billion respectively. The largest trade surplus that the UAE had in 2004 was with Iran, at AED 9 billion.

In sum, foreign trade is an integral component of the UAE economy. Over recent years strategies to diversify away from oil dependency have been implemented and now the UAE is realizing the benefits. In the last five years exports and re-exports have both experienced high growth, over 17%, whilst imports have remained fairly stable; thus the historic trade deficit is being reduced. A trade deficit of 8% of GDP is a huge achievement for the UAE especially given foreign trade’s importance to GDP growth.
8. Foreign Direct Investment

Foreign direct investment (FDI) is defined as an investment that involves a long-term relationship, reflecting lasting interest and control, by a resident entity in one economy in an enterprise resident in an economy other than that of the foreign direct investor. The importance of FDI in the economy goes beyond the benefits of money flows to the host country; through knowledge spillovers, as a source of human capital augmentation, as a source of technological change and by value-added from production. In 2005 the UAE attracted $19 billion of FDI, a substantial improvement on previous years. In this section three areas of FDI will be examined for the UAE; FDI indices, followed by FDI flows and stock, and finally FDI projects.

8.1. Indicators

This sub-section analyses FDI performance and potential in the UAE and examines how the UAE fairs in attracting foreign investment.

The UAE scores consistently poorly on the Inward FDI Performance Index and consequently receives low rankings (see Table 8.1). In 2004 the UAE ranked 104th out of a total 140 countries. The Index reflects the FDI received in the UAE relative to its economic size measured by GDP. In 2002-2004 the UAE scored a value of 0.55, thus indicating that the UAE’s received FDI is around half, relative to its economic size. In the period 1997-2001 the UAE scored negative values reflecting a period where foreign investors decided to actually disinvest. As a result rankings in these years were among the lowest in the world.

The UAE’s outward FDI performance is significantly better than its inward performance. In 2004 the UAE ranked 63rd out of a plausible 128 countries. The Index calculates the ratio of a country’s outward FDI in the world FDI as a ratio of its share in world GDP. In 2001-2003 the UAE scored 0.10 revealing that in this period the UAE invested far below its relative economic size. Recent years have, however, seen a marked improvement on scores from the early 1990s where negative scores reflected domestic investors disinvesting in international markets.
Table 8.1. UAE FDI Inward and Outward Performance Indices

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inward</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td>0.05</td>
<td>0.64</td>
<td>0.49</td>
<td>0.32</td>
<td>-0.14</td>
<td>-0.22</td>
<td>-0.05</td>
<td>0.55</td>
</tr>
<tr>
<td>Rank (/140)</td>
<td>124</td>
<td>93</td>
<td>111</td>
<td>119</td>
<td>137</td>
<td>136</td>
<td>134</td>
<td>104</td>
</tr>
<tr>
<td><strong>Outward</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td>-0.04</td>
<td>-0.02</td>
<td>0.16</td>
<td>0.11</td>
<td>0.08</td>
<td>0.39</td>
<td>0.43</td>
<td>0.10</td>
</tr>
<tr>
<td>Rank (/128)</td>
<td>102</td>
<td>110</td>
<td>62</td>
<td>68</td>
<td>70</td>
<td>31</td>
<td>32</td>
<td>63</td>
</tr>
</tbody>
</table>

* The scores are the average of the three year time period to offset annual fluctuations in the data

Source: UNCTAD

Furthermore, the Inward FDI Potential Index (see Table 8.2) captures several factors which are expected to affect an economy’s attractiveness to foreign investors. The UAE scores consistently highly on this index, maintaining a score around 0.33 during 2002-2004 and thus is awarded an international ranking around 27. Given the poor performance of FDI in the UAE and the expected attractiveness of the UAE market for investors it is clear that the UAE is currently performing below potential. Overcoming this may be realized through pragmatic policies such as opening up economic sectors that are currently off limits to foreign investment and/or by amending its ownership and commercial laws that currently restrict competition to a certain extent.

Table 8.2. UAE Inward FDI Potential Index

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>0.31</td>
<td>0.31</td>
<td>0.36</td>
<td>0.37</td>
<td>0.37</td>
<td>0.39</td>
<td>0.39</td>
<td>0.37</td>
<td>0.33</td>
</tr>
<tr>
<td>Rank (/140)</td>
<td>24</td>
<td>23</td>
<td>20</td>
<td>20</td>
<td>24</td>
<td>19</td>
<td>17</td>
<td>22</td>
<td>27</td>
</tr>
</tbody>
</table>

* The scores are the average of the three year time period to offset annual fluctuations in the data

Source: UNCTAD

8.2. Flows and Stocks

The following sub-section examines FDI flows and stocks and how they relate to major economic aggregates such as gross fixed capital formation and gross domestic product within the UAE.
8.2.1. Inward FDI flows and gross fixed capital formation

Figure 8.1 shows inward FDI flows as a percentage of gross fixed capital formation (GFCF) in the UAE for the period 1994-2004. As shown in the figure there is no discernable trend. This result, however, is more likely to be attributed to data problems given that not much is known about inward FDI flows into the UAE. During the period 1994-2004 FDI constituted on average about 2% of UAE GFCF. In the years 1999 and 2000 inward FDI flows, as a percentage of GFCF, was negative meaning that there was reverse investment or disinvestment by foreign investors. The subsequent two years 2001 and 2002 saw the highest FDI inward flows during the last decade, representing about 8% and 9% of GFCF respectively. Overall, since 1994 the UAE has experience a rising trend in FDI inward flows.

![Figure 8.1. Inward FDI Flows as % of Gross Fixed Capital Formation (1994-2004)](image)

Source: Own calculation based on World Investment Reports

8.2.2. Net inward FDI flows

Net inward FDI flows are defined as inward FDI flows minus outward FDI flows. Net inward FDI flows reveals overall how much foreign investment enters the economy in a
particular time period. On average, annual net inward FDI flows to the UAE, for the period 1994-2004, was around US$ 126 million. In the years 1999, 2000 and 2003 the UAE witnessed negative net inward FDI flows; disinvestment by foreign investors (see Figure 8.2).

![Figure 8.2. Net Inward FDI Flows (1994-2004)](image)

Source: Own calculation based on World Investment Reports

8.2.3. Inward FDI stock and gross domestic product

FDI stock represents the direct investment position of a country on a historical cost basis; it is the amount of direct investment already accumulated in a host country in a given year. Figure 8.3 shows inward FDI stock as a percentage of GDP for the UAE for the period 1994-2004. Overall, inward FDI stock displays a positive trend, with the exception of years 1999 and 2000. The poor performance of those two years may be a result of data problems rather than real performance. On average inward FDI stock amounted to around US$ 2.5 billion, 4% of UAE GDP. The inward FDI stock as a percentage of GDP increased from 3.6% in 1994 to 4.6% in 2004.
8.2.4. Net inward FDI stock

Net inward FDI stock is measured as the amount of inward stock minus the amount of outward stock from a country in a given year. During the period 1994 to 2004 the UAE’s inward FDI stock averaged around US$ 2.5 billion. In 2004 FDI inward stock stood at US$ 4.5 billion. Conversely, the UAE’s FDI outward stock averaged US$ 641 million 1994-2004. In 2004, outward FDI stock was around US$ 1.5 billion. Therefore, the UAE’s net inward FDI stock was around US $3 billion in 2004. On average, during the period 1994-2004, the UAE net inward FDI stock was about US$ 1.8 billion. Figure 8.4 reveals that the UAE is a net receiver of FDI.
8.3. Projects

In what follows, we will present FDI by capital investment, number of projects, transnational companies and source countries, clusters of industry and key business functions.

8.3.1. FDI capital investment and projects

Table 8.3 shows FDI capital investment and the number of projects invested in, for the period 2003-2005. During that period, FDI capital investment averaged US$ 8 billion with an average 172 projects. UAE FDI capital investment recorded its highest growth in 2005 and similarly the highest number of FDI projects.

<table>
<thead>
<tr>
<th>Table 8.3. UAE FDI Capital Investment and Number of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Capital investment (billion US$)*</td>
</tr>
<tr>
<td>Number of projects</td>
</tr>
</tbody>
</table>

* Capital investment data does not capture all FDI projects in UAE

Source: LOCO monitor database
8.3.2. FDI projects by industry cluster

An industry cluster is defined as a group of related sectors. The top 5 industry clusters containing the highest number of the FDI projects, in the UAE, are: business & financial services with 137 FDI projects; information & communication technology (ICT) with 100 projects; property, tourism & leisure 75 projects; heavy industry; and light industry (see Figure 8.5). These five industry clusters contain 70 per cent of all FDI projects in UAE.

![Figure 8.5. FDI Projects by Industry Cluster since 2002](image)

8.3.3. FDI projects by business function

The business function of a project is defined as the main activity of the new operation. A business function is not sector-specific. The predominant business functions invested in in the UAE are: sales, marketing and support; business services; and retail, each accounting for 151, 137 and 104 projects respectively (see Figure 8.6). These indicators highlight the importance of the trading sector within the UAE economy.
8.3.4. FDI transnational companies and their source countries

Transnational companies which have been recently investing in the UAE are from the areas of: logistics (DHL Express – 5 projects); financial services (HSBC – 5 projects); automobiles (General Motors); hotels (Marriott); and electronics (Nokia).

The USA is the top investor in the UAE, with 116 projects in total, and the UK is the second largest, with 96 projects. It is interesting to note that India is the third top investor in UAE with 67 projects (see Figure 8.7).
FDI indices reveal that the UAE is currently performing below its full potential, as both inward and outward investments are small relative to the UAE’s economic size (inward FDI stock accounted for an average of 4% of GDP from 1994-2004). Although the UAE has, at times, suffered from periods of disinvestment, recent years have been much more promising; net inward FDI stock has been continually increasing since 2000. Ardent measures to curtail the gap between the potential and actual performance of FDI in the UAE are beginning to be realized.
9. Inflation

The analysis of price change is central to any analysis of macroeconomic conditions. Inflation is defined as an overall rise in the level of prices and is representative of a decline in the purchasing power of money.

Although the responsiveness of GDP growth to inflation produces a striking variety of conclusions within the theoretical literature (e.g., Tobin, 1965; Sidrauski, 1967; Ireland, 1994; and Stockman, 1981)\(^4\), the empirical literature, however, is more unanimous in its recognition of a robust, cross-country, negative correlation between high per capita output growth and inflation. More specifically, countries which experience higher than average inflation in general experience slower than average output growth (e.g., Stockman, 1981). Overall, the empirical literature suggests that when initial levels of inflation are low (i.e. under 10%), inflation does not necessarily hurt an economy, whereas when initial levels are high inflation will retard economic growth, making the average person less well-off (e.g., Judson and Orphanides, 1998).

The Consumer Price Index (CPI) is a useful indicator which attempts to capture inflationary trends by approximating the true changes in the cost-of-living. The CPI approximates an average person’s inter-temporal utility function, reflecting both the goods and services demanded and their respective relative prices. According to the UAE Ministry of Economy, CPI has been increasing continuously (creeping inflation) since 2001 at an average annual growth rate of 3.9% over the past 5 years, rising from 2.2% in 2001 to 6.2% in 2005 (see Figure 9.1). That is, the cost of living has increased, for the average person, by an average of 3.9% per annum; prices are 20.1% higher than in 2001.

\(^4\) These studies present diverse theories on the inflation-growth effect. Differences stem from the theoretical framework employed and the role that money plays within the economy.
Some empirical literature suggests that for developed nations the negative effects of inflation start when inflation rises above 1%, whereas the threshold for developing economies is 11% (Gillman, Harris and Matyas, 2002). Given that the UAE is an emerging economy its threshold is likely to fall within this range, therefore one can infer that the UAE’s inflation rate is not currently at an overly concerning level.

9.1. Inflation by Emirate

Available data shows that Abu Dhabi, Dubai and Sharjah have all witnessed a continuous increase in the cost of living (CPI) over the past five years (see Table 9.1). For example, in 2001 Dubai’s CPI increased by 2.9%, this figure has incrementally increased to reach an inflation rate of 6.48% in 2005. Similar increases have been experienced in Sharjah. Conversely, Abu Dhabi has witnessed a fluctuating CPI; for example the inflation rate fell from 2004-2005. Only Dubai has a CPI growth rate higher than the overall UAE CPI thus revealing that Dubai is positively skewing, and therefore primarily responsible for, the UAE’s 2005 inflation rate.
Table 9.1. CPI Annual Growth Rate (%) by Major Emirate (2001-2005)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Price Index</td>
<td>2.75</td>
<td>2.93</td>
<td>3.19</td>
<td>5.02</td>
<td>6.21</td>
</tr>
<tr>
<td>- Abu Dhabi</td>
<td>3.10</td>
<td>3.09</td>
<td>3.03</td>
<td>6.22</td>
<td>5.05</td>
</tr>
<tr>
<td>- Dubai</td>
<td>2.90</td>
<td>2.94</td>
<td>3.45</td>
<td>5.09</td>
<td>6.48</td>
</tr>
<tr>
<td>- Sharjah</td>
<td>2.30</td>
<td>2.92</td>
<td>3.12</td>
<td>4.82</td>
<td>6.10</td>
</tr>
</tbody>
</table>

Source: UAE Ministry of Economy

9.2. Inflation by Expenditure Group

The composite manner in which the CPI is calculated means that it is possible to identify which sectors of the economy are responsible for the inflationary pressures within the UAE. Table 9.2 reveals that all of the major expenditure groups have experienced annual increases in nominal price since 2001.

Table 9.2. Annual Change in CPI (%) by Major Expenditure Groups (2001-2005)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Price Index</td>
<td>2.2</td>
<td>2.9</td>
<td>3.2</td>
<td>5.0</td>
<td>6.2</td>
</tr>
<tr>
<td>- Food, Beverages &amp; tobacco</td>
<td>0.2</td>
<td>1.4</td>
<td>2.3</td>
<td>7.0</td>
<td>4.5</td>
</tr>
<tr>
<td>- Clothes, Textiles &amp; Footwear</td>
<td>0.4</td>
<td>0.8</td>
<td>1.7</td>
<td>5.0</td>
<td>2.5</td>
</tr>
<tr>
<td>- House Rent &amp; Related House Items</td>
<td>2.1</td>
<td>4.3</td>
<td>5.3</td>
<td>5.5</td>
<td>9.4</td>
</tr>
<tr>
<td>- Furniture &amp; Related Items</td>
<td>0.3</td>
<td>1.8</td>
<td>1.6</td>
<td>2.4</td>
<td>3.4</td>
</tr>
<tr>
<td>- Medical Care &amp; Health services</td>
<td>3.4</td>
<td>7.3</td>
<td>2.5</td>
<td>1.5</td>
<td>5.4</td>
</tr>
<tr>
<td>- Transportation &amp; Communication</td>
<td>2.1</td>
<td>1.8</td>
<td>2.7</td>
<td>4.7</td>
<td>4.6</td>
</tr>
<tr>
<td>- Recreational, Education &amp; Cultural Services</td>
<td>8.5</td>
<td>4.5</td>
<td>1.3</td>
<td>2.2</td>
<td>3.9</td>
</tr>
<tr>
<td>- Other Goods &amp; Services</td>
<td>0.6</td>
<td>1.3</td>
<td>1.6</td>
<td>7.0</td>
<td>6.0</td>
</tr>
</tbody>
</table>

Source: UAE Ministry of Economy

House rent, and related house items are currently allocated the most weight within the UAE CPI calculations accounting for 36% of CPI. This expenditure group, is similarly, the one which has witnessed the most dramatic increases in prices over the last year; in 2005 house rents and related house items rose by 9.4%. Food, beverages and tobacco, weighted 14% of the CPI, saw the second highest price increases, 6.2% higher in 2005 than in 2004, followed by medical care and health services, rising by 5.4% over the same period. Transportation and
communication, allocated 15% of the CPI, has also experienced high inflation, prices are 9.3% higher in 2005 than in 2003.

9.3. Potential Problems with Compilation of CPI

There is some speculation that the CPI currently underestimates the true inflation rate within the UAE. The IMF in their UAE country report (2006) states that this may be caused by a variety of methodological reasons associated with CPI compilation within the UAE (such as outdated weights not reflecting the geographical region, an outdated basket where replacement products are not adjusted for quality, lack of imputations for missing data and a discrepancy between the base year for prices and expenditure as they refer to different periods). The IMF reports an 8% increase in consumer prices for 2005 (compared with 6.2% announced by the UAE Ministry of Economy) arguing that this figure may also be understated. Some economists believe that the disparity may be fairly more significant.

Intuitively, it follows that as oil prices have increased over the past five years (2001-2005) the UAE has received an increasing value of oil revenues resulting in an injection of liquidity into the domestic market. The inflationary pressure that a money supply shock causes is usually nullified by changes in the exchange rate. However, given that the UAE dirham is pegged to the US$ the UAE does not vantage this economic tool. Therefore, perpetual windfall profits from oil will have inevitably inflated domestic prices. The UAE authorities therefore must implement price ceilings on goods and services to restrain domestic price hikes. Similarly, financial institutions must take measures to limit the high growth levels of credit supplied to the private market to reduce money supply.

5 Dubai for example currently has a 15% cap on rental prices until the end of 2006.
10. Labor Force

The importance of the labor market is irrefutable. A country’s economic performance relies to a significant extent on the functioning of the labor market; production, economic growth, and prices are all intimately linked to it (see, for example, Restrepo and Tokman, 2005). The impact that the labor market has on economic growth and other performance indicators is dependent on the labor productivity of the labor force.

A labor force is defined in the UAE as those persons between the ages of 15 and 60 either employed or actively seeking work. In 2004, the UAE labor force accounted for 2,731 thousand of the total population of 4,320 thousand. As a result of a small national population the UAE domestic economy has become heavily reliant upon expatriate contractual labor; currently comprising 80% of the total population. Given that such a high proportion of the labor force is only permitted to be resident in the UAE given they are employed, it follows that UAE unemployment levels are extremely low. In 2004 only 3% of the population were considered unemployed.

Historically women’s contribution to the labor force has been minor. In 1995 (the latest year available by the UAE Ministry of Economy) women comprised only 11.7% of the labor force, a substantial increase from the 1975 levels where women’s participation was at a negligible 3.3%. Given this observed rising trend it can be assumed that women’s participation has and will continue to increase.

10.1. Labor Force Composition

The UAE labor force participation rate (LFPR) was 63.2% in 2004, having increased from 59.6% in 2001. Overall, it is evident from Table 10.1 that an increasing proportion of the population has been entering the labor force. The economically active share of the population has grown by 3% over the past four years. In absolute terms the UAE labor force rose by 652 thousand from 2001 to 2004.

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Non-Labor Force</td>
<td>40.4%</td>
<td>39.6%</td>
<td>38.5%</td>
<td>36.8%</td>
</tr>
<tr>
<td>Total Labor Force</td>
<td>59.6%</td>
<td>60.4%</td>
<td>61.5%</td>
<td>63.2%</td>
</tr>
<tr>
<td>- Active labor force</td>
<td>57.2%</td>
<td>57.9%</td>
<td>58.8%</td>
<td>60.2%</td>
</tr>
<tr>
<td>- Inactive labor force (Unemployment)</td>
<td>2.4%</td>
<td>2.6%</td>
<td>2.7%</td>
<td>3%</td>
</tr>
<tr>
<td>Total Population*</td>
<td>3,488</td>
<td>3,754</td>
<td>4,041</td>
<td>4,320</td>
</tr>
</tbody>
</table>

*Figures are in thousands
Source: UAE Ministry of Economy

As shown in the table above, unemployment has remained fairly low over the past four years ranging between 2.4% in 2001 and 3% in 2004, which is considered small by international standards.

During the same time frame, the non-labor force (comprised of children under the age of 15, housewives, students, those unwilling or unable to work and elders over the age of 60) has been steadily decreasing which means a favorable economic dependency rate. In 2004 the non-labor force population accounted for 36.8% of the UAE population, down from 40.4% in 2001.

10.2. Labor Force by Emirate

Over the past four years the composition of the labor force by Emirate has changed markedly. In 2001 Abu Dhabi was the largest employer of workers within the UAE, employing 40% of the labor force, whereas Dubai employed 33%. Since 2001 the share of the labor force between Abu Dhabi and Dubai has equalized; Abu Dhabi’s labor force share fell by 3% whilst Dubai’s increased by 4%. Both Emirates currently employ 37% of the total labor force (see Figure 10.1). The remaining Emirates (i.e., Sharjah, Ajman, Umm Al-Quwain, Ras Al Khaimah, and Fujairah) employ a much smaller proportion of the UAE labor force, in total summing to just 26% in 2004.
Figure 10.1. Composition of the UAE Active Labor Force by Emirate (2004)

Whilst Dubai’s labor force share has increased, all the other Emirates have experienced a decrease in their shares between 2001 and 2004. The smallest employer of the labor force is Umm Al-Quwain, at 1% of the total labor force. This is primarily a reflection of both the small geographical size and population of the Emirate.

10.3. Labor Force by Economic Sector

The construction sector employs the largest share of the labor force within the UAE, in 2004 accounting for 20.2% (see Table 10.2). In 2001 the share was 15.8%, however in 2002 as a result of government initiated infrastructural development and the building boom the share of the labor force employed in construction jumped to 19.3%, an annual increase of 22%.

In 2001 the trade sector was the largest employer of the domestic labor force, employing 19.2%. Over the past four years, the share of the labor force in this sector has remained fairly uniform, in 2004 accounting for 19.5%. Therefore, it is now the second largest employer of the UAE labor force. The third largest employer of the labor force is the manufacturing sector; its
employment share has similarly remained fairly stable over the same period, in 2001 comprising 12.8% and in 2004, only marginally more, at 13%.

**Table 10.2. UAE Active Labor Force by Economic Sector (2001-2004)**

<table>
<thead>
<tr>
<th>Economic Sector</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>8%</td>
<td>7.5%</td>
<td>7.1%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>1.6%</td>
<td>1.5%</td>
<td>1.4%</td>
<td>1.4%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>12.8%</td>
<td>12.7%</td>
<td>12.8%</td>
<td>13%</td>
</tr>
<tr>
<td>Electricity, Gas and Water</td>
<td>1.6%</td>
<td>1.2%</td>
<td>1.2%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Construction</td>
<td>15.8%</td>
<td>19.3%</td>
<td>20.3%</td>
<td>20.2%</td>
</tr>
<tr>
<td>Trade</td>
<td>19.2%</td>
<td>19.1%</td>
<td>19.3%</td>
<td>19.5%</td>
</tr>
<tr>
<td>Hotels</td>
<td>4.4%</td>
<td>4.4%</td>
<td>4.2%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Transports</td>
<td>6.6%</td>
<td>6%</td>
<td>6.1%</td>
<td>6%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>2.9%</td>
<td>2.9%</td>
<td>2.9%</td>
<td>3%</td>
</tr>
<tr>
<td>Social Services</td>
<td>4.7%</td>
<td>4.2%</td>
<td>4.3%</td>
<td>4.3%</td>
</tr>
<tr>
<td>Finance</td>
<td>1.3%</td>
<td>1.2%</td>
<td>1.1%</td>
<td>1.1%</td>
</tr>
<tr>
<td>Government Services</td>
<td>11.1%</td>
<td>10.9%</td>
<td>10.7%</td>
<td>10.8%</td>
</tr>
<tr>
<td>Domestic Services</td>
<td>10%</td>
<td>9.1%</td>
<td>8.6%</td>
<td>8.1%</td>
</tr>
<tr>
<td><strong>Total Active Labor Force</strong>*</td>
<td>1,929</td>
<td>2,176</td>
<td>2,334</td>
<td>2,649</td>
</tr>
</tbody>
</table>

*Figures are in thousands  
Source: UAE Ministry of Economy

Both the agricultural and domestic services sectors have experienced a fall in their share of the labor force between 2001 and 2004 (1.1% and 1.9% respectively). Lastly, the shares of active labor force for the rest of UAE economic sectors remained almost stable during 2001-2004.

In general, the UAE labor force indicators are fairly positive, with low unemployment and an increasing labor force participation rate.
11. Summary and Conclusions

This report has examined the wellbeing of the UAE economy, focusing throughout on selected macroeconomic indicators for the latest years available. Below is a summary of the main findings.

During the last decade the UAE economy has shown steady growth and the value of total GDP has more than doubled. Oil’s share in GDP has declined, whilst non-oil GDP has been the major driver behind the UAE’s economic growth (accounting for 73% of GDP in 2005). The major non-oil sectors in the UAE economy are: manufacturing (20%); trade (17%); real estate (12%); construction (11%); transport, storage & communication (10%); and finance (9%). Furthermore, although Abu Dhabi and Dubai both contribute highly to the country’s GDP (59% and 29% respectively), the latter is actually more responsible for the remarkable growth witnessed in the majority of non-oil sectors.

The UAE’s capital productivity significantly exceeds labor productivity both when including and excluding oil from calculations. When omitting oil, labor productivity in Abu Dhabi is almost halved and capital productivity drops to fifth place amongst the Emirates, thus demonstrating the importance of oil to both labor and capital productivity levels in Abu Dhabi and ultimately the UAE’s overall economic growth.

Over the last five years government expenditure has generally been increasing; although it did fall marginally in 2002. Between 2004 and 2005 government expenditure grew by 14.8%, vastly exceeding the 2% growth in the previous year. Similarly, from 2003 to 2005 government revenue has also been increasing. In 2005 the government reported a budget surplus of AED 56,773 million which was more than three times the surplus reported in 2004. Government operations currently produce a budget surplus, however, this has not always been the case, as figures reveal the overall budgetary position of the UAE government is heavily dependent and vulnerable to fluctuations and price movements in the oil sector.
Total foreign trade in the UAE has increased substantially over the past decade, more
than doubling from AED 221 billion in 1994 to AED 463 billion in 2004. Non-oil trade
accounted for 80% of total UAE trade in 2004, comprising 54% imports, 20% exports and 26%
re-exports. The UAE trade balance with the inclusion of oil has been in trade surplus with the
rest of the world over the past decade (with the exception of the year 2000). In 2004 the surplus
fell, however, remained at an impressive surplus value of AED 63 billion. The trade balance
excluding oil is, however, in deficit and has been throughout the last decade. Nonetheless, since
2000 the deficit has been decreasing; in 1999 and 2000 the deficit was at a maximum 26% of
GDP whereas in 2004 it comprised only 8% of GDP. The reduction in the deficit can be mainly
attributed to successful diversification strategies within the UAE culminating in an increase in
non-oil exports and re-exports (both have experienced growth rates exceeding 17% over the last
five years).

The UAE has predominantly been a net receiver of FDI inflows over the past decade; the
main investors being the USA and the UK. Business and financial services are currently
receiving the highest concentration of projects, receiving 22% of all UAE FDI projects and thus
indicating the future expansion of this sector. In 2005 the UAE attracted AED 68 billion of FDI,
a substantial improvement on previous years.

For the past five years the UAE has been experiencing creeping inflation. In 2005 the
inflation rate based on the CPI measured 6.2%; a healthy rate given the high economic growth
the UAE has experienced as an emerging economy (especially in the Emirate of Dubai). In some
sectors, however, such as the housing sector where inflation reached 9.4% in 2005 and is
becoming more of a concern as creeping inflation could potentially start to impede economic
growth if allowed to persist. Dubai is the main contributor to inflation within the UAE; the cost
of living went up by 6.5% in 2005 alone. Given the UAE’s exchange rate policy and the possible
underestimation of UAE CPI it is imperative that the authorities take measures to prevent further
increases in inflation to avoid any potentially detrimental economic consequences.

In 2004 the UAE labor force accounted for 2,731 thousand out of a total population of
4,320 thousand, representing a labor force participation rate of 63.2%. The unique structure of
the UAE’s labor force, with its dependency on foreign workers, has meant that unemployment levels in the UAE are notably low; 3% in 2004. Whereas the share of the unemployed has remained fairly stable over the past four years, the labor force participation rate has been steadily increasing. Dubai’s share of the total labor force has been similarly increasing over the last four years, whereas all the remaining Emirates have witnessed a fall. In 2004 Dubai and Abu Dhabi were the main employers of the labor force, both employing 37%. The construction sector employs the most workers (20.2%) followed by the trade and manufacturing sectors at 19.5% and 13% respectively.

Overall, the economic indicators examined suggest that the UAE economy is booming; benefiting from high oil prices but more significantly from the government’s ardent commitments to diversification. Capital productivity is high, both including and excluding oil, and subsequently the UAE appears an increasingly attractive option for foreign investment. The UAE is beginning to realize itself as an international trading hub and regional financial centre and thus, provided inflationary pressures are constrained, economic prospects for the UAE are good.
References


