BY ROBERT LOONEY

It seemed a routine business deal, though surely a large one by any standard: P&O Group of Britain (including P&O's assets in the United States) was being acquired by Dubai Ports World, the fast-growing Dubai port operator, for $6.8 billion. Overnight, the transaction became Topic A in the U.S. Congress and Fox News. Dubai, the Persian Gulf destination probably best known in America as Michael Jackson's next stop after Neverland, was front-page news.

Self-appointed experts from across the political spectrum painted Dubai as everything from a money-laundering center for Al Qaeda, to a shining beacon of cultural tolerance and free markets. Those in the business community who spend time (and money) there prefer a more succinct description: Dubai Inc.

The actual owner of Dubai Ports World is a low-profile enterprise called simply The Corporate Office, or TCO, a government holding company that controls some of Dubai's most profitable assets. TCO is administered by Sheik Mohammed bin Rashid Al Maktoum – "Sheik Mo" to insiders and "the Boss" to his subjects.

In effect, TCO is a government entity that is run like a private business. And the performance of this state-run enterprise (in contrast to most others) has been impressive. The Dubai airport is the region's busiest. And the Jebel Ali Port and Free Zone, the world's largest man-made port, is buzzing. Emirates Airlines, the Dubai state carrier that is the region's largest and most profitable airline,

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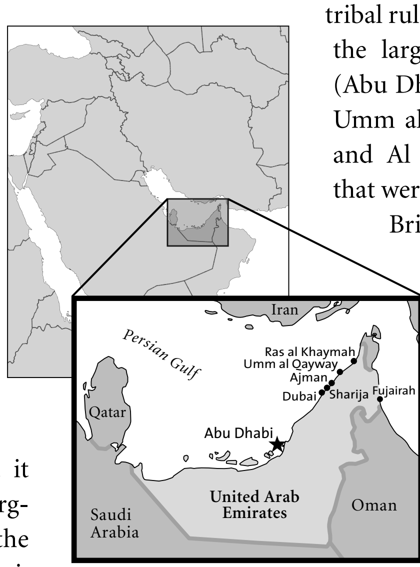
attracted wide attention in the summer of 2006 when it announced it was prepared to buy British Airways.

A relentless marketing campaign painting Dubai as the place to do business (and to unwind) in the Gulf, is supporting an incredible building boom. Indeed, roughly one-quarter of all the cranes used in skyscraper construction in the world are now said to be at work in the tiny country. Dubai is erecting the world's tallest building and already has what it claims to be the world's largest shopping mall. In the showiest project of all, it is dredging some 300 artificial islands just offshore. These ultra-prime properties form the outline of a map of the world and are for sale for $6.85 million and (way) up. Richard Branson, the billionaire owner of Virgin Atlantic Airlines and no slouch himself in the marketing game, has already staked his claim to the Britain-shaped parcel.



Are we simply watching an accidental product of superpower geopolitics riding the crest of the oil boom, or is something more important going on here? Are there lessons applicable to other Arab states seeking to make the leap from perpetual tribal conflict to cosmopolitan capitalism?

BIRTH OF A NATION (CITY… CONGLOMERATE…?)

Dubai Inc. has its roots in its location along the Persian Gulf region's major shipping lanes. The trade routes became increasingly important in the 19th century, leading England to seek control of the ports at the eastern end of the Gulf by imposing a series of agreements on the emir of Dubai and neighboring tribal rulers. These treaties designated the largely Sunni Arab sheikdoms (Abu Dhabi, Dubai, Sharjah, Ajman, Umm al Qaywayn, Ras al Khaymah and Al Fujayrah) as Trucial States that were under the protection of the British Navy. The result was relative security, but isolation from the evolving modernization and nationalism of the region.

Dubai, a bit of a maverick within the group, developed a reputation as a hustling regional entrepôt. It had always possessed one advantage over the other Trucial sheikdoms: a better natural port. And this asset was complemented by its rulers' enthusiasm for foreign trade – especially compared with nearby Abu Dhabi, whose cautious rulers restricted entry even by merchants from other Trucial States.

In the decades before World War II, Dubai also flourished as a center for fishing, pearl diving and gold crafting. Its exports of pearls and gold attracted traders (and smugglers) from around the Gulf. As a result, Dubai developed a reputation for wide-open commerce. Then, in 1968, Britain set a three-year timetable for terminating its protection of the Trucial States as part of a broader move to reduce entanglements in the Middle East. It encouraged the little sheikdoms to form a federation, whose 1971 constitution became the foundation for the United Arab Emirates. Along with designating Abu Dhabi as the capital, the constitution divided responsibilities between individual emirates and the new federal government.

While the UAE's national government has jurisdiction over the currency, foreign policy and defense, the rulers of each emirate retain absolute authority within their borders that gives them wide discretion in development strategies. Specifically, each emirate controls its own oil production and resource development. For example, although Abu Dhabi joined OPEC in 1967 (four years before the UAE was formed), Dubai does not consider itself to be part of OPEC or to be bound by its cartel quota.

The glue holding the UAE together is the vast oil wealth beneath Abu Dhabi, which gives the capital the capacity to underwrite much of the federal budget. Unlike the other emirates, though, Dubai struck out early on its own path, playing the entrepreneur to Abu Dhabi's oil rentier – albeit with consent (and substantial subsidies) from its richer neighbor. Dubai's own oil production now hovers somewhere below 200,000 barrels a day, and its reserves are expected to be exhausted within 10 years.

DUBAI'S ADOPTION OF THE SINGAPORE MODEL

Shortly before Dubai's entry into the federation, the emirate's rulers had begun to build aggressively on its long tradition of open commerce. They focused on developing a base for diversified growth by first investing in major infrastructure. Since oil revenues had not yet begun to flow into the emirate, Dubai's ruler at the time, Sheik Rashid Al Maktoum, borrowed heavily from Kuwait to finance the expansion of the port through the dredging of what is known as Dubai Creek. As a result, larger ships were able to dock in Dubai. To the same general end, he authorized the construction of a modern jetport.

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Early on, then, Dubai's economic strategy was built on: (a) open trade and unrestricted capital outflows, (b) a lightly regulated economy with low taxes, (c) the best infrastructure that government money could buy, and (d) unregulated labor markets. Sheik Rashid plowed the first gush of oil revenue (which began in the 1970s) into expanding Dubai's Port Rashid. He also used oil money to invest in desalinization plants and an aluminum industry (Dubai Aluminum) that could take advantage of natural gas output that might otherwise go to waste.

Rashid's diversification drive continued with Dubai's dramatic entry into tourism in the 1980s. Rashid promoted Emirates Airlines as a luxurious alternative to other airlines' flying sardine tins. "Free zones" were developed, offering a liberal business environment including the right to 100 percent foreign ownership, freedom from corporate tax and zero restrictions on the repatriation of profits. As a result, Dubai became a large re-export hub and an attractive base for finance and technology companies doing business in the Middle East, Africa and South Asia.

After Sheik Rashid's death in 1990, his son, Sheik Mohammed, continued Dubai's go-go development strategy. He raised the promotional ante by establishing sporting events, including the Dubai Desert Classic Golf Tournament (the top prize of $400,000 went to Tiger Woods this year), along with distractions like the Dubai Shopping Festival (the city boasts 25 shopping malls). Additionally, he initiated construction of the "seven-star" Burj Al Arab hotel (rates start at $900 a night), whose sail-shaped silhouette quickly became Dubai's symbol for over-the-top consumerism. All the hype seems to have worked: tourism is the economy's leading growth sector.

Dubai also began to position itself as a regional center for finance. Construction is under way on the Dubai International Financial Center, which its leaders hope will allow Dubai to expand its role in regional banking.

The development model of Singapore has had a great influence on Dubai's leaders. And the appeal is understandable. Like Singapore (and in contrast to Hong Kong and Taiwan), Dubai aspires to state-led capitalism as opposed to pure laissez-faire. Just as Singapore nurtured business champions, including Singapore Airlines and DBS Bank, Dubai's development was led by Emirates Airlines and Dubai Aluminum.

Singapore's ability to integrate and execute policies across multiple agencies by concen-

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trating decision-making in the hands of a few also attracted Dubai Inc.'s bosses. So, too, has Singapore's strategy of luring multinationals with financial incentives, and tackling labor shortages with targeted guest-worker programs. Arguably most important, Dubai's hands-on leaders identify with Singapore's successes in creating competitive advantages

through heavy investment in education and sponsorship of technology clusters.

There are major differences, however, between the two development models. Whereas Singapore's strategy came out of a belief that the city-state could not survive without rapid growth, Dubai's starting point is the need to replace declining oil revenues. Moreover, the reality that Dubai's work force is less skilled has limited the degree to which the Gulf state can emulate Singapore's leap to modernity.

Both Dubai and Singapore draw on key elements of Harvard Business School guru Michael Porter's growth framework, which emphasizes entrepreneurship and innovation as central to the creation of national advantage. For Porter and Dubai Inc., the key to growth is the way in which successful industries cluster in mutually reinforcing ways, both vertically (suppliers and final goods producers) and horizontally (common customers, shared technology, infrastructure). This framework lends itself to strategies that strive to create "virtuous circles" – that is, environments in which activity in one area stimulates investment and production in others.

In Singapore, government-financed infrastructure and open trade zones were used to attract multinationals. After locating there, these companies both stimulated growth in indigenous suppliers and served as a magnet for new foreign businesses that eventually established Singapore as a regional center for commerce.

Dubai has employed a parallel strategy to attract multinationals. In turn, the presence of these companies increased the demand for hotels, restaurants and real estate, while simultaneously raising the emirate's international profile as a good place to work and play. This virtuous circle has been going on for at least a decade and has produced remarkable results by Middle Eastern standards. Since 1995, Dubai's economy has grown by more than 6 percent annually – quite an achievement in a region buffeted by the rise of Al Qaeda, the American invasion of Iraq, the second Palestinian intifada and open conflict between Sunnis and Shiites.

A number of differences between the development strategies in Dubai and Singapore are worth noting. Singapore's approach has been technocratic, while Dubai's leaders have played hunches rather than playing by the book. Private businesses would never have come up with projects as risky and ambitious as dredging the Dubai Creek to create a world-class port or building the world's tallest building on the faith that if it was built, tenants would come.

In fact, Singapore could learn a few lessons from Dubai in calculated risk-taking. The emirate has already overtaken Singapore in a few areas – especially in selling itself to the world as a trendy place to spend money and do business. In fact, Dubai has managed to build a reputation as being open to new ideas, in contrast to Singapore's rigidity.

DUBAI'S SYNERGY WITH ABU DHABI

While Dubai is, for good reasons, bent on economic diversification, the United Arab Emirates' capital has had the luxury of relying on huge energy reserves to ease its way into modernity. But natural resource exploitation can be a trap, albeit one lined in silk. Abu Dhabi's share of the UAE's gross domestic product fell from 61.9 percent in 2000 to 58.5 percent in 2004, even as oil prices went through the roof. By contrast, Dubai's share of the emirates' total GDP increased to 26 percent from 24.2 percent during the same period.

Dubai has been similarly successful in attracting foreign direct investment, a key to enduring growth. It ranks first among the emirates, with 54 percent of all foreign investment in the UAE's non-oil-related manufacturing sector. Abu Dhabi is fourth.

Paradoxically, the differences may serve the emirates' collective interests. Most oil-rich developing countries are underperformers across a wide spectrum of economic, social, political and governance standards. In countries ranging from Iran to Venezuela to Indonesia, following the path of least political resistance has meant stagnation outside the oil economy. The federal nature of the UAE, by contrast, allows for bold entrepreneurship in one city and a (relatively benign) rentier economy in another city just two hours down the road.

Dubai, for its part, will use its reputation as a dependable oasis in an undependable region to build a prosperous entrepôt state.

The whole has proved greater than the sum of the parts. Moreover, there is every indication this synergy will endure. Abu Dhabi is likely to stay the course on its long-term strategy of leveraging the development of heavy industry on rich reserves of oil and gas. Dubai, for its part, will use its reputation as a

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dependable oasis in an undependable region to build a prosperous entrepôt state.

POSSIBLE COMPLICATIONS

What could go wrong? First, as the Dubai Ports World fiasco demonstrated, Dubai carries perceptual baggage that constrains its ability to participate in lucrative international ventures. Many view the emirate as a murky bazaar of money laundering and arms trafficking. And that is not entirely unfair: Dubai has long been a crossroads of trade, barter and informal cash transfers that have been linked to terrorist groups. In recent years, Dubai's traders have earned international ill will by helping expatriates from India bypass that country's ban on gold futures trading. Dubai traders have also helped to launder consumer goods bound for Iran in violation of United States economic sanctions.

The hope is that, with time, the emirate will gain both the will and the ways to control the less savory aspects of its economy. Indeed, there have already been some signs of progress on the governance front. The UAE has improved its World Bank rankings in the key areas of government effectiveness, regulatory quality, rule of law and control of corruption.

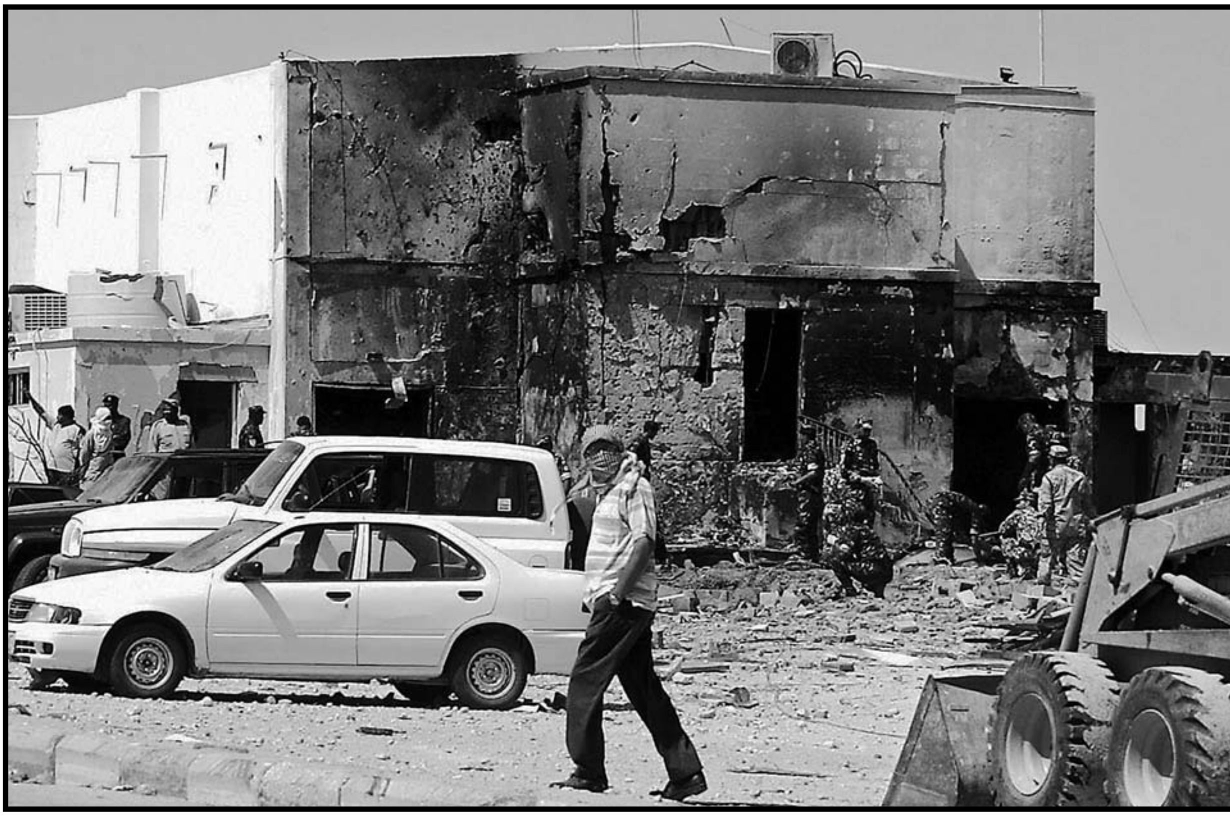
RABIH MOGHRABI/AFP/GETTY IMAGES

Unfortunately, in the key area of "voice and accountability," the UAE still lags far behind its city-state rivals Hong Kong and Singapore.

For some time, the powerful inner circle controlling Dubai Inc. proved to be highly effective and motivated, in contrast to the organized crime syndicates that dominate most of the region's other oil-based economies. As the economy has matured, however, it has become increasingly complex. As a result, it has become ever harder for the ruler and his close allies to anticipate Dubai's needs and deliver remedies.

Conflicts of interest are also appearing that may mean that what is best for Dubai Inc. is no longer best for the population at large. This is illustrated most vividly by the government's approach to the Dubai's transport system.

In recent years, the rising volume of road



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Dubai's increasing dependence on tourism renders it extremely vulnerable to terrorist attacks.

traffic in this city of 1.1 million has led to serious rush-hour snarls. Many analysts fear that the congestion will soon become a drag on growth in Dubai, significantly adding to the cost of doing business. Now, a primary cause of these traffic snarls is the daily influx of labor from the neighboring emirate of Sharjah (population: 700,000), where housing is cheaper. The traffic problem could easily be fixed with more roads. Dubai's authorities have reportedly refused to do the job, however, apparently because easier transit between emirates would raise property values in Sharjah and lower them in Dubai. And the fortunes of Dubai's ruling elite are now closely aligned with the local real estate market.

The population of Dubai is projected to double to 2.1 million in 2010, while visitors are expected to increase to 15 million annually within a decade. The lack of affordable housing is already impeding worker recruitment. And with commercial rents also on the rise, some firms are moving from Dubai or at least considering moves to neighboring Gulf states.

The danger for Dubai is that these bottlenecks are beginning to undermine its business model. Although the model is not based on Dubai's being the cheapest place to do business in the region, rapid rises in costs hardly serve the emirate's long-term goal of becoming another Singapore. And, more insidiously, high costs chip away at Dubai's efforts to differentiate itself through quality of life.

Note, too, that Dubai's increasing dependence on tourism renders it extremely vulnerable to terrorist attacks. And, as violence in Qatar – most notably the suicide bombing of a theater – demonstrated, terrorists are now going after "soft targets" that symbolize Western influence as well as more obvious targets like Americans in Iraq and security forces in Saudi Arabia. Indeed, authorities in Dubai have successfully foiled several terrorism attempts in recent years, including one in which explosives were placed in a popular shopping mall.

If terrorists get luckier or simply more determined, Dubai could lose those deep-pocketed tourists. By the same token, terrorism could cause a capital outflow similar to the outflows suffered by Kuwait and Bahrain in the 1990s – outflows that contributed to Dubai's rise as a regional business center.

the global economy.

A series of extravagant initiatives has enabled Dubai to reinvent itself when necessary to maintain growth. But a close look suggests the emirate has been incredibly lucky as well as smart – hitting hot oil markets at just the right time, while reaping benefits as a safe place to play in an ever more dangerous region. Indeed, the recent Hezbollah-Israel confrontation in Lebanon will no doubt divert many tourists to Dubai.

The new skittishness in the Dubai Stock Exchange – in early 2006 stocks lost half their value from the 2005 peak – suggests more than one investor is having doubts about the impermeability of the emirate's Teflon coating, however. Moreover, as other out-of-the-line-of-fire Gulf countries begin to compete for tourism and foreign business on Dubai's terms, the going is bound to get rougher.

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LAST THOUGHTS

The wealth created by the world-class firms attracted to the emirate proves that Dubai Inc. is much more than a mirage. Whether Dubai Inc. is a paradigm for other Arab countries, though, is another question. While the emirate's history, geographic setting and federation with a major oil supplier set it apart from most other countries in the region (and even from other entrepôt states like Singapore and Hong Kong) some aspects of its economic strategy could be fruitfully adopted by other countries in the region. In particular, policymakers would do well to emulate Dubai's determined effort to integrate with

Dubai may be a home away from home for Michael Jackson, Richard Branson, David Beckham and Michael Schumacher. And it certainly has earned its reputation as a place where celebrities can misbehave without consequences: In July, Senator Orrin G. Hatch of Utah wangled a pardon for the music producer Dallas Austin after he was caught carrying cocaine on his way to visit the supermodel Naomi Campbell. But Dubai's success in playing host to a community that lives and breathes fantasy doesn't, alas, guarantee that it will never come face to face with Middle East realities.