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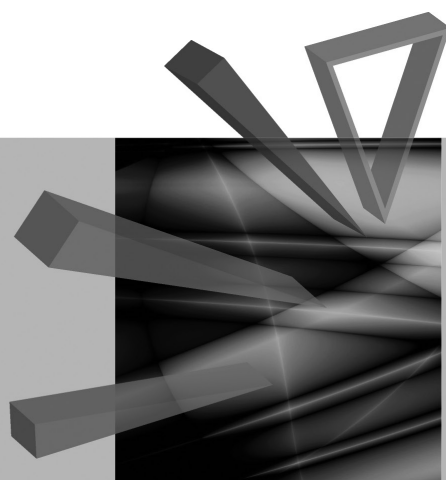
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DUBAI – AN EMERGING AND INNOVATIVE OFFSHORE FINANCIAL CENTRE

Summary: Dubai – a city and region in the United Arab Emirates (UAE) – has recently joined the group of specific economies oriented towards foreign capital, namely has become an emerging offshore financial centre. Thanks to the business-friendly environment, Dubai has attracted a lot of innovative projects financed by foreign capital, which has become a crucial factor in the recent development of the city and region. Consequently, during last decade FDI inflows into the United Arab Emirates have achieved the highest level in the history. FDI boom has resulted in the improvement of the UAE's investment position and in the growth of services' role in export. In result, the economy of the UEA has become more diversified; however, the petroleum sector still plays a significant role. Moreover, the United Arab Emirates has marked their position in the international finance. Dubai participates in competition among Asian OFCs. It can compete in alluring FDI with Hong Kong and Singapore as well as with emerging Pacific OFCs.

Keywords: Dubai, United Arab Emirates, offshore financial centre.

1. Introduction

Offshore financial centres (a contemporary form of tax havens) play a significant role in the world economy. Due to alluring a lot of foreign capital, they are flourishing, belonging to the group of the richest countries of the world. Recently, Dubai – a city and region in the United Arab Emirates – has become an offshore financial centre.

Innovation investments in the real estate, infrastructure and the financial sector in Dubai appear to be an important factor of development and diversification of the United Arab Emirates' economy. Consequently, the aim of this article is to scrutinise changes in the economies of Dubai and the United Arab Emirates during last decade in the light of establishing offshore financial centre in the heart of the Arab world.

2. Offshore financial centres in the world economy

An offshore financial centre (OFC) is a secondary term stemming from a tax haven. Traditionally, a tax haven is a country or territory where certain taxes (especially

direct taxes, such as income taxes or inheritance taxes) are levied completely or at a low. Tax havens allow non-residents to escape higher taxes in their country of residence. Particularly, liberal tax jurisdictions allure foreign affiliates of transnational corporations (TNCs) originating from developed countries, where corporate taxes are much higher.¹

According to the traditional approach, tax havens can be divided into two groups: no-tax havens and low-tax havens. The first group encompasses: Bermuda, the British Virgin Islands, the Turks and Caicos Islands, the Cayman Islands, Montserrat and Nauru. These tax havens impose (or used to impose) nil taxes generally or impose taxes only on domestic incomes. Low tax havens include: Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, Cook Islands, Dominica, Gibraltar, Grenada, Guernsey, Hong Kong (SAR of China), the Isle of Man, Jersey, Liberia, Liechtenstein, Macau (SAR of China), the Maldives, Marshall Islands, Mauritius, Monaco, the Netherland Antilles, Niue, Panama, Samoa, Saint Lucia, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Samoa, the Seychelles, Tonga, US Virgin Islands and Vanuatu.²

However, the traditional approach to a tax haven is not enough. A contemporary name of a tax haven is “offshore financial centre” (OFC), which means jurisdiction that makes its living mainly by attracting foreign capital. They offer foreign business and well-heeled individuals not only low or no taxes, but also economic and political stability, business-friendly laws, well-developed sector of services (especially in finance, banking and insurance), lack of constraints in capital flows and above all discretion.³ OFCs include traditional tax havens but also countries (territories), such as the Canaries (Spain), Costa Rica, Cyprus, Dubai (the United Arab Emirates), Dublin (Ireland), Jamaica, Labuan (Malaysia), Lebanon, Luxembourg, Madera (Portugal), Malta, Singapore, Switzerland, all of which has not been perceived as traditional tax havens.

Naturally, the most obvious use of OFCs is tax avoidance and tax evasion. Many of the world’s richest people and transnational corporations (TNCs) use them legally or illegally to minimise tax liabilities. According to the Tax Justice Network, one third of global incomes are being taxed in OFCs.⁴

TNCs, which are aimed at tax avoidance, establish their foreign affiliates in OFCs, but the role of these affiliates is varied. First of all, TNCs may establish a sale company in OFCs which buys goods or services from a manufacturing plant

¹ A. Beuchamp, *Die Steuerparadiese der Welt*, Piper Verlag, München 1983, p. 36; T. Lipowski, *Raje podatkowe a unikanie opodatkowania*, C.H. Beck, Warszawa 2004, pp. 135–136; A. Starchild, *Tax Havens for International Business*, Palgrave MacMillan, 1994, p. 1.

² List of tax havens are prepared by institutions collecting data concerning international trade and foreign direct investments (for example: OECD, UNCTAD and Eurostat).

³ T. Lipowski, *op. cit.*, pp. 140–142.

⁴ Tax Justice Network, http://www.taxjustice.net/cms/front_content.php?idcat=127&lang=1 (accessed: 20.09.2011).

at low a price and then transfers them at a higher price to a sister division which provides for final consumers. Consequently, via transfer prices⁵ the major share of profit is attributed to OFCs. Secondly, OFCs can be a good location for a consulting company which provides specific services at very high prices in order to enhance artificially the costs of sister companies. Thirdly, there is a possibility to establish subsidiary specialising in giving intra-firm loans, also at transfer prices (interest rates). Therefore, TNCs may move a physical business (e.g., manufacturing plant) to OFCs and then attribute there as much profit as possible. Finally, a subsidiary located in OFCs can become an owner of intangibles (e.g., know-how, logo, brand) and collect money from other affiliates which want to use rights to these intangibles (naturally earnings for intangibles should be enormously high in order to transfer profits to OFCs). However, tax avoidance via transfer pricing is not the only way to use OFCs. Due to liberal regulations (also those concerning banking and insurances), non-financial TNCs (financial TNCs as well, obviously) can establish in OFCs their own banks or insurance companies. Banks are used in order to govern and finance intra-firm transactions. Insurance companies are set up by TNCs to lower insurance bills by covering predictable risks themselves.⁶

Consequently, offshore financial centres are significant host economies for foreign direct investments (FDIs). According to the UNCTAD's data for last two decades, their FDI inward stocks have accounted for 10-odd% of global FDI inward stocks (about 12% in 1990, about 10.5% in 2000 and about 14% in 2010).⁷

3. Dubai – an offshore financial centre at the heart of the Arab world

Dubai is an emirate within the United Arab Emirates. The city (the capital of the emirate) is also named Dubai. The emirate is located south of the Persian Gulf on the Arabian Peninsula. The Emirate of Dubai extends over 3 900 square kilometres and currently has a population of approximately 1 million, 80% of which are expatriates of other Arab nationals, Asians and Europeans. The geographical location halfway between Europe and the Far East makes Dubai a major transit stop. In this context, Dubai International Airport plays a leading role in the region. Dubai is also the third

⁵ Transfer prices differ from market prices in that they do not simply constitute a component of commercial transaction, but they are used in order to transfer income within TNCs in order to pay taxes at the lowest possible level or avoid paying them at all.

⁶ P. Folfas, Przenoszenie działalności gospodarczej do rajów podatkowych jako strategia zarządzania finansami korporacji transnarodowych: motywy, formy, korzyści i zagrożenia, *Bank i Kredyt* 2008, nr 12, pp. 15–30; P. Folfas, Ceny transferowe w korporacjach transnarodowych: korporacja kontra mechanizm rynkowy, korporacja kontra państwo, [in:] G. Wrzeszcz-Kamińska (Ed.), *Zawodność państwa. Zawodność rynku*, Wyższa Szkoła Handlowa, Wrocław 2010, pp. 247–259.

⁷ UNCTAD database, <http://unctadstat.unctad.org> (accessed: 15.04.2012).

largest re-exporter in the world after Hong Kong and Singapore.⁸ Over a few last decades, city of Dubai has faced rapid development from being a small centre of trade to the booming tourist and economic metropolis which it is today. The city is relatively young, historically speaking, originating from a fishing village that was probably founded in the 18th century. There are three major periods in the relatively short history of the city of Dubai. The first one includes the 19th century and the first half of the 20th century, during which Dubai was transformed from a fishing village to a harbour playing an important role in the Middle East.⁹ The next four decades (1960–2000) constituted the petroleum era, during which processes of urbanisation and industrialisation were strictly connected with the development of the petroleum sector. Finally, during the last decade the city of Dubai has become a world metropolis and offshore financial centre.¹⁰

As oil reserves in Dubai were expected to dry out by 2010, at the end of 1990s the government of Dubai prepared the strategic development plan of Dubai for years 2000–2030 aimed at diversification of its economy by supporting non-oil industries and making Dubai an attractive place for FDI.¹¹ The government of Dubai launched much more liberal economic policy than the policy provided by central government of the UAE. It was possible because Dubai and Abu Dhabi are the only two emirates to have veto power over critical matters of national importance in the country's legislature. Consequently, Dubai implemented a free port, free trade zones¹² and low taxes. Dubai's rulers also promoted the immigration of foreign business people and workers, showing tolerance of their foreign cultures and religions. Aside from the rapidly growing tourism industry, the openness has mainly been a boom for the real estate sector.¹³ Since the Emirate of Dubai became the first country in the Gulf region to allow foreigners to own land in 2002, the real estate market has been soaring.¹⁴

Moreover, in 2000 the Dubai Internet City was established, which is a tax-free zone targeting information and communications technology companies and encouraging them to establish regional headquarters in Dubai to serve the wider Arab region, India subcontinent and the countries of the Commonwealth of Independent States (CIS). Additionally, thanks to handsome profits from oil export, the Dubai

⁸ *Urbanization and the Changing Character of the Arab City*, Economic and Social Commission for Western Asia, United Nations, New York 2005, p. 26.

⁹ Dubai became one of the main trading points for pearls, with tradesman from the Indian subcontinent and divers from Africa creating the original nucleus of an international community that still inhibits the city.

¹⁰ H. Schmid, *Economy of Fascination. Dubai and Las Vegas as Themed Urban Landscapes*, Gebrüder Bornträger, Stuttgart 2009, pp. 77–92.

¹¹ *Urbanization and the Changing...*, *op. cit.*, p. 25.

¹² For example, Dubai Internet City, Dubai Media City, Dubai International Finance Centre, Dubai Multi Commodities Centre, and Dubai Healthcare Centre.

¹³ In the real estate sector, the boom came in the form of spectacular projects – for example, artificial islands and the highest buildings in the world: Burj Dubai or Emirates Towers.

¹⁴ H. Schmid, *op. cit.*, p. 86.

International Finance Centre (DIFC) was established to provide services in the areas of asset management, reinsurance and back office operations. DIFC is also a tax-free zone for wholesale financial services. The Centre extends over 446 000 square metres and aims to become the hub for all trade on Islamic finance markets, offering one-stop shopping from stocks to *sukuk* (Islamic) bonds, investment banking and insurance. DIFC is a separate legal, geographical and judicial jurisdiction. All activity within DIFC is governed by the laws of the DIFC, with the exception of the federal criminal law (including anti-money laundering law), which applies within the centre. The DIFC has adopted a full set of laws including the insolvency law, trust law, personal property law and employment law. These have been based largely on UK common law. The DIFC also established a separate court, with both the trial and the appeal level, to hear all matters in the DIFC (others than those related to the criminal law). The investment in DIFC proves the commitment by the government of Dubai to a high value-added economy. Another important step which was taken by the government of Dubai is massive infrastructure expansion. The most significant projects in this area include investment in a state-owned airline and Dubai International Airport, the development of container terminal in the Port of Dubai and building a mass transport railway system.¹⁵

Consequently, alluring FDI and domestic investments created at the heart of the Arab world an offshore financial centre. Innovative projects in Dubai ensured a rapid rise of the city and the emirate, which is similar to the development of Hong Kong (one of the biggest and oldest offshore financial centres in the world) in the 1980s. Dubai has shown, following Singapore's earlier footsteps, that a determined government can build an international financial centre from scratch. In 2007, contribution of financial services to employment and GDP in Dubai equalled 1.9% and 9.3%, respectively. Analogical indicators were 5.9% and 12% for Singapore, and 5.4% and 12.3% for Hong Kong.¹⁶ Key features, such as low taxes, business-friendly environment, innovative projects in real estate, infrastructure, financial sector and media, but also implementing in Dubai International Finance Centre laws based on UK common law, has decided about the success of Dubai as an emerging offshore financial centre. However, there are also some drawbacks of being an OFC, especially at the time of the crisis. Dubai suffered from financial turbulences in 2008 and faced a debt crisis.¹⁷

¹⁵ *Urbanization and the Changing...*, *op. cit.*, pp. 31–32; *United Arab Emirates – Dubai International Financial Centre: Financial Sector Assessment Program – Detailed Assessment of Observance of IOSCO Objectives and Principles of Securities Regulation*, International Monetary Fund, New York 2007, p. 4; Magnets for money. A special report on financial centres, *The Economist*, 15–21 September 2007, p. 14.

¹⁶ Magnets for money..., *op. cit.*, pp. 3–4.

¹⁷ Among all emirates, the crisis hit Dubai hardest, as it was heavily exposed to depressed real estate prices. Dubai lacked sufficient cash to meet its debt obligations, prompting global concern about its solvency. Dubai's debts are heavy amounting to about 80 billion USD including the government and

Despite the debt crisis, it is hardly debatable that many transnational corporations made Dubai their regional headquarters, relocating branch offices from elsewhere in the region to the free trade zones in Dubai. For example, in years 2000–2003, over 470 firms settled in Dubai Internet City alone, including such internationally known companies as Siemens, IBM, HP and Microsoft. Dubai Media City attracted over 620 firms during the same period, including well-known international corporations, such as CNN, Reuters and Al Arabiya. In addition to the “proximity advantages” and the excellent infrastructure at the new location, the companies mainly enjoyed the advantage of not having to pay any taxes or tariffs and being able to freely transfer their capital. Instead of being limited to a maximum hold of 49%, as usually required in the Gulf states, TNCs can maintain full ownership of their regional subsidiaries.¹⁸ The boom of Dubai resulted in intensification of FDI inflows into the UAE during last decade (see Figure 1) and has changed the international position of the United Arab Emirates. Another proof confirming the investment position of Dubai is the fact that among the top 10 West Asian companies¹⁹ there are two from Dubai: Dubai World (the first place in the ranking) and Dubai Holding (the fifth place).²⁰

4. The influence of the offshore financial centre in Dubai on the economy of the United Arab Emirates

According to the UNCTAD country classification, the United Arab Emirates is a developing country, which belongs also to the group of major petroleum and gas exporters. The development of OFCs in Dubai has influenced the economy of the UAE as the country’s economic performance has recently depended more on services and foreign direct investments. Simultaneously, the economy of the UAE has become less vulnerable to changes on the international petroleum market. Consequently, it is worth comparing the international position and economic performance of the UAE with the condition and position of Hong Kong and Singapore – the two biggest and oldest Asian OFCs.

Firstly, the investment position of the UAE during last ten years has strengthened much. Until 2000, the share of the UAE in the global inward direct investment stocks did not outstrip 0.06%. In last decade this share grew rapidly and in 2010 equalled 0.4% (see Table 1).

the conglomerates it controls. Fortunately, Dubai was supported by the National Bank of the UAE (see more in Standing still but still standing, *The Economist*, 28 November – 4 December 2009, p. 81; When sovereign does not mean safe, *The Economist*, 5–11 December 2009, p. 16).

¹⁸ H. Schmid, *op. cit.*, p. 88.

¹⁹ Companies were ranked by the total value of cross-border mergers and acquisitions purchases during 2004–2010.

²⁰ *World Investment Report 2011. Non-Equity Modes of International Production and Development*, UNCTAD, New York/Geneva 2011, p. 57.

Table 1. Inward direct investment stocks in the United Arab Emirates, Hong Kong and Singapore, 1980–2010

| Country | Measure | 1980 | 1985 | 1990 | 1995 | 2000 | 2005 | 2010 |
|----------------------|---|--------|--------|--------|--------|--------|--------|--------|
| United Arab Emirates | Percent of total world FDI inward stock | 0.06 | 0.05 | 0.04 | 0.05 | 0.01 | 0.24 | 0.40 |
| Hong Kong | Percent of total world FDI inward stock | 25.43 | 18.55 | 9.69 | 6.71 | 6.12 | 4.53 | 5.73 |
| Singapore | Percent of total world FDI inward stock | 0.77 | 1.08 | 1.46 | 1.93 | 1.49 | 1.69 | 2.45 |
| United Arab Emirates | Percent of GDP | 1.38 | 1.78 | 2.22 | 4.13 | 1.52 | 19.93 | 27.40 |
| Hong Kong | Percent of GDP | 616.82 | 515.64 | 262.26 | 157.76 | 269.32 | 294.32 | 484.64 |
| Singapore | Percent of GDP | 45.66 | 60.03 | 82.57 | 78.21 | 119.26 | 160.48 | 218.38 |

Source: author’s own study based on UNCTAD database, <http://unctadstat.unctad.org> (accessed: 15.04.2012).

Consequently, currently the share of the UEA in the global inward direct investment stocks is about 6 and 14 times lower than the analogical share of Singapore and Hong Kong, respectively. In 2000, the share of Hong Kong was 612 times higher and the share of Singapore 149 times higher. These figures illustrate the change of the UAE position in global FDI. This change is a result of the rapid increase of FDI inflows into the United Arab Emirates during the period between 2003 and 2007. Despite the large fall caused by the economic crisis in 2008–2010, the current value of FDI inflows to the UAE is more than 10 times higher than the average values in 1980s and 1990s (see Figure 1).

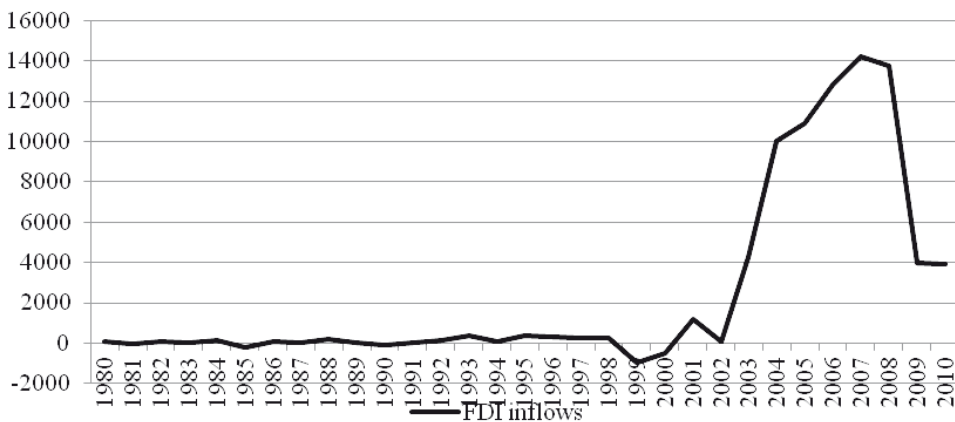


Figure 1. Foreign direct investment inflows into the United Arab Emirates (USD million), 1980–2010

Source: author’s own study based on UNCTAD database, <http://unctadstat.unctad.org> (accessed: 15.04.2012).

It is very likely that this FDI boom is rather the result of alluring foreign capital by the OFC in Dubai than the consequence of investments in the petroleum sector. Rapid and disproportional, to the size of the economy, FDI inflow growths are typical for offshore financial centres. Due to intensive inflows of foreign direct capital, also the share of FDI inward stocks in GDP of the UAE increased during last decade (27.40% in 2010 compare to merely 1.52% in 2000 – see Table 1). Consequently, the economy of the UAE is now much more vulnerable to fluctuations in FDI, but still not so much as the economies of Hong Kong and Singapore.

Table 2. The share of fuels and services in United Arab Emirates' export, 1995–2010

| | 1995 | 2000 | 2005 | 2010 |
|--|------|------|------|------|
| Export of fuels in total export of goods and services (%) | 69.5 | 69.8 | 59.4 | 52.5 |
| Export of services in total export of goods and services (%) | 4.0 | 4.2 | 4.0 | 5.5 |

Source: author's own study based on UNCTAD database, <http://unctadstat.unctad.org> (accessed: 15.04.2012).

Secondly, the improvement of the investment position means changes in the export structure of the United Arab Emirates. On the one hand, changes in export are not as noticeable as in the case of FDI. The share of services in total export increased during last decade by 37.5%, but still is almost 10 times lower than the share of fuels (see Table 2). On the other hand, since 2003 the value of the export of services has been rapidly growing, even at the time of the crisis (see Figure 2).

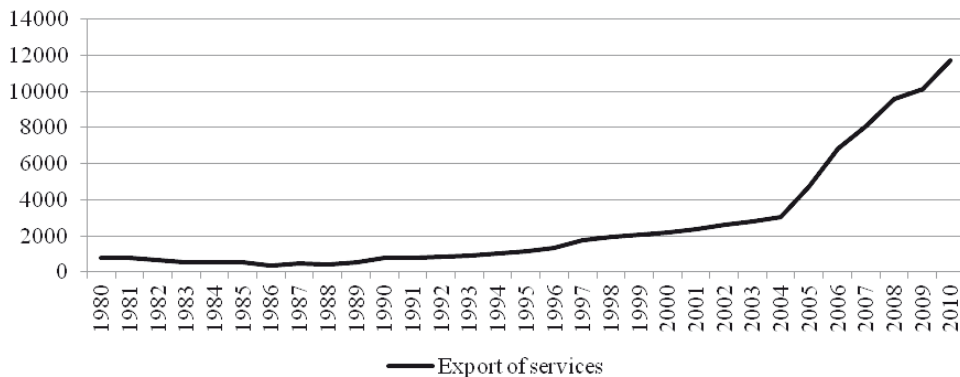


Figure 2. Export of services from the United Arab Emirates (USD in millions), 1980–2010

Source: author's own study based on UNCTAD database, <http://unctadstat.unctad.org> (accessed: 15.04.2012).

This suggests that intensive development of OFCs in Dubai has been maintaining trade in services, especially export of financial services. However, the share of tertiary sector in the UAE's GDP remains quite stable (about 46% in 2000 and 2010)

and much lower than share of services in Hong Kong's (almost 93% in 2010) and Singapore's (almost 72% in 2010) GDPs.²¹

5. Conclusions

The emerging and innovative offshore financial centre in Dubai is important for the structure and condition of the UAE's economy. Thanks to the intensive FDI inflows and export of financial services, the economy of the UEA has become more diversified; however, the petroleum sector still plays a significant role.

Key features, such as low taxes, business-friendly environment, innovative projects in real estate, infrastructure, the financial sector and media but also implementing in Dubai International Finance Centre laws based on UK common law, has decided about the success of Dubai as an emerging offshore financial centre. Dubai is a good example of the development driven by innovation. Consequently, Dubai and the United Arab Emirates have marked their position in the international finance. Dubai participates in competition among Asian OFCs. It can compete with Hong Kong and Singapore as well as with emerging Pacific OFCs.

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DUBAJ – WSCHODZĄCE I INNOWACYJNE CENTRUM FINANSOWE

Streszczenie: Dubaj – miasto i region w Zjednoczonych Emiratach Arabskich (ZEA) – dołączył ostatnio do grona specyficznych gospodarek zorientowanych na przyciąganie zagranicznego kapitału, czyli stał się tzw. zamorskim centrum finansowym (współczesnym rajem podatkowym). Dzięki probiznesowemu klimatowi Dubaj przyciągnął innowacyjne projekty finansowane kapitałem zagranicznym, które okazały się kluczowym czynnikiem obecnego rozwoju miasta i regionu. W konsekwencji w ostatniej dekadzie napływy bezpośrednich inwestycji zagranicznych (BIZ) do ZEA osiągnęły najwyższy poziom w historii. Boom BIZ zaowocował poprawą pozycji inwestycyjnej ZEA oraz wzrostem znaczenia usług w eksporcie tego państwa. W rezultacie gospodarka ZEA stała się bardziej zróżnicowana, aczkolwiek sektor paliwowy wciąż odgrywa istotną rolę. Ponadto ZEA zaznaczyły swoje miejsce w finansach międzynarodowych. Dubaj uczestniczy w konkurencji między azjatyckimi centrami finansowymi. Może skutecznie rywalizować w przyciąganiu BIZ z Hongkongiem i Singapurem, jak również ze wschodzącymi centrami finansowymi w Oceanii.

Słowa kluczowe: Dubaj, Zjednoczone Emiraty Arabskie, zamorskie centra finansowe, raje podatkowe.