Macroeconomic policy of the united arab emirates economics essay

ASSIGN
BUSTER

The UAE economy is based on solid macroeconomic fundamentals and sound policies stressing in infrastructure and competitive advantage. Its successful diversification from hydrocarbon into higher value-added, export-oriented manufacturing and services makes it an attractive strategic partner for other developing countries beside its inherent attractiveness in hydrocarbons.

After entering the WTO, the next mighty things coming out of the UAE economy are the vast projects of economic cities, which are going to have a permanent impact on the macro-economic policies and on the fundamental structure of the UAE economy. UAE economy is doing exceptionally well in the last few years led by oil-driven growth. UAE's nominal Gross Domestic Product (GDP) is estimated to have grown by 2. 4% in 2009 to contact US $ $230 billion while real GDP is estimated to have grown by 1. 2% to US $ 186. 8 billion. Despite strong growth in surplus, the government is judiciously spending on both oil as well as non-oil sectors which can be seen in 6% increase in the oil sector GDP in 2009 while the increase in industrial activity saw the non-oil industrial sector grow by -5. 6% in the same period. Besides the government, economy saw increased interest from private and foreign players who have increased investments in the country. Although dominated by the oil sector, the government intends to diversify the economy and use it as a base for job creation.

On the other hand, Since 1980s recent macroeconomic policies emerged in UAE to cover the money as well as any other upcoming crisis. These new policies emphasized structural adjustment programs and policy reforms. Additionally, building a healthy competitive environment is considered the

crucial factor to achieve production efficiency, while the government's role focuses on the regulatory role and capacity building.

The modem economic development of the United Arab Emirates depended largely on the petroleum industry. Knowing that oil is depleting and taking serious note of the economic ramifications of random fluctuations in oil prices, the government of the UAE has, since early 1980s, embarked on solid economic diversification strategies. Economic diversification away from crude oil is inevitable for achieving sustainable future economic growth beyond the oil era. Both public sector and private domestic investments have grown remarkably in the 1990s. Nevertheless, as evidence suggests private investment rather than public funding is associated with higher growth rates.

United Arab Emirates as well as other neighborhood Countries in Arabian Gulf region are actively moving towards greater participation in the global economy. While most of GCC countries are now members of the World Trade Organization (WTO), some countries either have signed or are finalizing trade agreements with the European Union (EU). The increasing trend towards regional and international globalization is presenting at UAE as well as the area with different monetary and fiscal challenges. Consequently, greater macroeconomic policy coordination and cooperation could be involved in terms of preparing for enhanced economic integration. Since, they are opting for increased regional economic integration in the future. An important part of economic integration is the increase in cross-border trade through the lifting of trade barriers as provided for within the frameworks of the Gulf Cooperation Council (GCC)

Discussion:

Over the past two decades, an unstable macroeconomic environment has plagued the area with negative implications for regional integration efforts. UAE as well as the region countries have experienced several episodes of monetary instability that have hindered efforts aimed at integrating their economies. On the monetary side, exchange rates have generally been fixed to the United States dollar; and the success of the policy of ostensible pegged regimes to the dollar has not been uniform across the region.

1. Exchange rate policies:

UAE as well as the region countries has experienced episodes of high domestic inflation, coupled with a loose expansion of the supply of money. Consequently, this has resulted in a steady appreciation of the real exchange rates in some of the region countries.

By pegging the currency to a relatively low-inflation currency, particularly the United States dollar, and by relying on high interest rate policies to protect the exchange rate, UAE has attempted to incorporate and go back inflationary pressures. While this policy has helped it reduce inflation substantially, it has also generated continuous real exchange appreciations; losses in international competitiveness; fluctuations in GDP growth rates; and powerful trade and sometimes budget deficits. On the other hand, a fixed nominal exchange rate regime combined with careful anti-inflation policies have led to aggregate real exchange rate overvaluation.

The UAE exchange rate arrangements are rigid and fixed to the United States dollar with surprisingly limited exchange rate bands. The United Arab Emirates have been pegged to the dollar since 1975, at approximately 3. 67 Dirhams per dollar.

On the other hand, the use of monetary policy measures is constrained because of the peg to the dollar. However, the authorities can limit the growth of the monetary system and therefore money growth from external capital inflows resulting from higher oil revenues, by investing the strong current surpluses outside the UAE.

The dollar peg means the authorities have little independent control on interest rates. Therefore, they can require banks to curb lending or obtain legal restrictions, for example on lending to property, for equity purchases and so on. They could also offer banks’ reserve requirements, which would freeze role of banks’ deposit base.

2. Interest and inflation rate policies:

Over the past two decades, UAE introduced significant changes in the form of monetary policies and in its instruments, intermediate targets and ultimate goals. Targeting the inflation rate as opposed to the growth rate of GDP has been gaining significant popularity among policymakers. This recent move has been supported by strong empirical evidence pointing to the fact that positive and uncontrolled inflation rates tend to distort private sector incentives to save, consume, invest and produce, which eventually lead to slower growth rates in real GDP. United Arab Emirates was moving in that way before 2003. In the UAE, inflation rate appeared to have been recently

contained, and monetary policy appears to be gradually geared towards price stability, where inflationary pressures of the 1980s appeared to have been contained by 2002. However, oil revenue increases since 2003 have rekindled inflation in the United Arab Emirates and possibly in other countries of the Gulf area.

High inflation is an essential macroeconomic policy challenge faced by the UAE. Since the inflation implies a grinding down of purchasing power with the dirham in anybody pocket commanding fewer goods as well as services; therefore, the real value of money declines. Moreover, it has to be addressed by a combination of policy measures, including structural policy measures that will reduce housing and real estate shortages, while focusing on the growth of government spending on infrastructure services that can increase overall productivity growth.

The periods of currency devaluations were coupled with rising inflationary pressures. In UAE, inflationary pressures of the early 1980s seem to have been contained and inflation rates were approximately 1. 5 per cent by the end of 2009. Owing to the downward trend in the inflation rate, inflationary pressures in UAE appeared to have been heading towards more containment before the recent rise in oil prices and revenues in 2008. This is beside that Lower inflation rates in UAE have translated into significantly lower interest rates.

Limitations:

While the GCC countries area is not yet fully integrated, it is interdependent. Consequently, the challenge of integration gives rise to issues that are vastly

different from those raised in the integration processes within the GCC countries. However, when investigating the issue of economic integration in the GCC countries, the starting point needs to be from the proposition that integration is desirable. Subsequent to such resolve, the issue becomes one of how best to achieve integration.

Recommendations:

There are a number of recommendations, which can be addressed at the micro level in order to retain, attract and encourage foreign direct investment flows in the UAE. Since such macroeconomic Policy Recommendations On the national front, and after all, above discussions, and besides the light of the recent economic downturn, also and in order to improve the investment climate and increase foreign direct investment inflows, a number of policy recommendations are worth considering, suchlike:

UAE needs to continue to work to achieve a stable macroeconomic environment and thus reinforcing credibility in the economy.

This is besides, ensuring that legislation has a clear interpretation.

Additionally, to speed up the implementation of new laws and amendments to existing legislation that will assist the investment climate.

As well, it should improve the business climate in UAE. As another point, this should go along with attempting to develop UAE as a transparent business centre with open market-oriented economic conditions.

Extend more government guarantees, since more control guarantees to the financial system will have a crowding-in effect on foreign direct investment flows as the financial sector might be considered as " safe" place to invest by foreign investors.

Adopt of additional fiscal stimulus packages, as more public investment programs, mainly aimed at infrastructure investments builds up confidence in the economy, which will have a definite impact on foreign direct investment inflows on the end of new investment opportunities.

Inject more liquidity, because other monetary liquidity injections will also have a positive impact on foreign direct investment flows. Moreover, building on the initial liquidity injections will in effect reassure confidence and therefore attract foreign direct investment into UAE.

Change the ownership laws, whereas change the company law to provide 100% ownership rights in some sectors which will benefit from foreign direct investment flows.

Open up constricted economic sectors, as while opening up some economic sectors that are off limits to foreign investment, such as services to increase competitiveness and productivity.

Change real estate laws, as we can observe that changing existing caveats on foreign ownership of land or real estate in UAE to attract more foreign direct investment.

Expand Free Trade Zones (FTZs), as expanding existing FTZs in UAE, which will certainly attract and develop new foreign direct investment flows.

Finally, and debatable most influential of all, promoting the participation of the private sector and increasing the speed of the implementation of privatization programs is essential in boosting foreign direct investment flows.

Conclusion:

The stable outlook on UAE balances the country’s strong financial position, which should support it to overcome most understandable stress scenarios without weakening its creditworthiness, against the regional geopolitical risks. The future also assumes that pressures deriving from strong population growth and related high inflation, as well as any correction of the exuberance in the UAE economy and for example such like the property market, will be managed carefully. On the other hand, reductions of geopolitical risk in the context of continued domestic political stability and a successful implementation of the government’s development and renovation plans would be essential for a future rating upgrade. However, almost all-economic sectors benefit from the macroeconomic policies that provide tariff exemptions for inputs, raw materials and equipment and an environment that is free of income and profit tax.

Furthermore, it is indispensable to emphasize, which there is no inconsistency between the long-term strategies that lead to strong national currencies or to monetary union. For the most part, the requirements are comparable. Both require a strong fiscal position, strong prudential regulations and supervision of the financial system, and flexible labor

markets. Despite the final decision concerning the status of policy coordination, the policy agenda therefore needs to be identical.

Finally, we can disclosed that exchange rate flexibility would reduce the need for domestic prices in the oil-exporting economies to rise and fall along with the price of oil, make more capacity for monetary policy reflect domestic conditions, and help oil-exporting economies handle the large swings in government revenue that accompany large swings in the oil price. The time has come to decouple the currencies of high oil-exporting economies from the dollar.