The Middle East's Asian Pivot

Trade Growth and Opportunities

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INTRODUCTION

The current global trade order is changing, as a result of not only the policy direction of world leaders but also economic shifts and transformations. Asia is comprised of dynamic economies that have grown rapidly over the past two decades and continue to lead global growth. Several are undergoing transitions from manufacturing-based economies to service- or innovation-led economies.

The Middle East, as a distinct region within Asia, is experiencing its own unique growth opportunities and challenges. Although most Gulf nation economies are predicted to grow in the coming years, low oil prices are expected to continue and the need for economies to diversify is inevitable. Population change is set to transform the region as urbanisation and connectivity continue to increase, creating larger and more educated urban digital middle classes. There is also set to be a dramatic increase in physical connectivity across the whole of Eurasia under China's Belt and Road Initiative (BRI), which could unleash economic development, investment and trade on a historic scale. These trends present many opportunities for international economic engagement in the Middle East.

As the Middle East's economic advancement and increasing connectivity draw it further into global markets, a question arises: Who will dominate trade with the region? Some Middle Eastern economies have had long-term relationships with traditional Western markets, but their political and economic engagement with Asia is continuing to increase. Throughout traditional markets – particularly the US – there are rising protectionist attitudes, and the global trade order is less certain now than at any time in the past few decades.

This research is part of Asia House's commitment to exploring these long-term trends and the opportunities arising from them. Prepared as part of the Asia House Middle East Programme, this paper compares Middle Eastern trade growth with the rest of Asia to its trade growth with traditional markets, such as

the US and UK. It then provides a detailed examination of trade flows between the Middle East and emerging Asian economies, highlighting specific areas of growth and opportunities.

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Executive summary

Amid an uncertain and dynamic global economic order, Asia is winning out in the competition for share of Middle Eastern trade. This century, Middle Eastern trade with the rest of Asia has grown more rapidly than Middle Eastern trade with traditional markets. Furthermore, while emerging Asia – China, India and countires in the Association of South East Asian Nations (ASEAN) – is taking an increasing share of Middle Eastern trade, the share of trade among Organisation for Economic Co-operation and Development (OECD) countries has significantly reduced. This paper explores these trends and examines trade flows between Gulf nations and the rest of Asia to understand future opportunities and risks in the region.

Trade growth between Asia and the Middle East is based on Asia's huge (and increasing) energy demands and the Middle East's increasing demand for primary and secondary sector consumer goods. The Gulf Cooperation Council (GCC) nations – Saudi Arabia; United Arab Emirates (UAE); Bahrain; Kuwait, Qatar and Oman – dominate economic ties with the rest of Asia, and the highest trade growth is taking place with emerging Asian economies. Growth has been driven by economic expansion, population increase and growing middle classes in each region. For example, between 2000 and 2016, the GCC's compound annual growth rate of bilateral trade with China was 13.5%, whereas the GCC's rate with the US was 4.4%. India's compound annual growth rate of bilateral trade with the GCC was 14.7%, whereas the European Union's (EU) was 5.5% (see Figure 4). In 2000, emerging Asian economies had an 18% share of GCC trade; in 2016, they had 30% – a 12% increase. In 2000, the OECD (consisting of 35 nations and all traditional Western markets) had a 63% share of GCC trade; in 2016, they had 42% – a 21% reduction (see Figure 3). China is also the largest trading partner of both Iran and Iraq. These long-term trends show the Middle East's growing focus on trade with the rest of Asia. They also highlight, from an Asian perspective, the elevated importance of Middle Eastern trade in comparison to traditional markets.

Figure 1. GDP growth forecast, GCC countries (%)

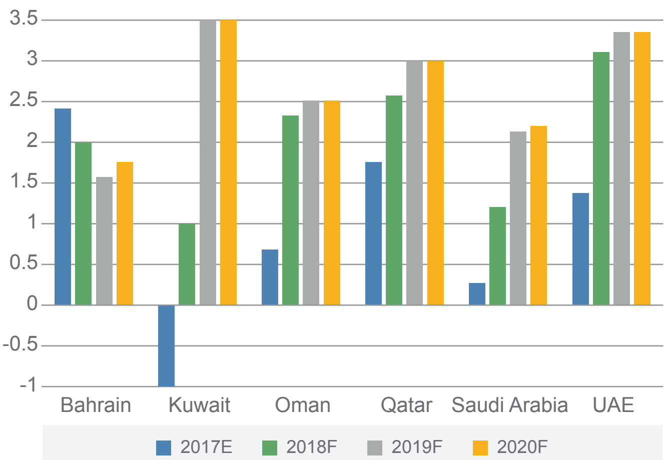
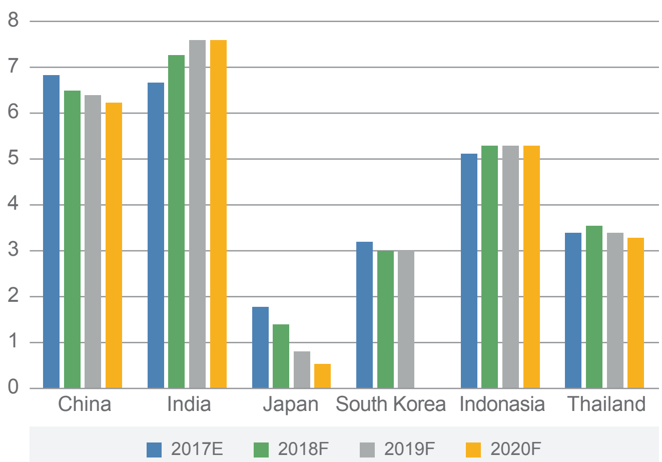


Figure 2. GDP growth forecast, Asian countries (%)



E: Estimate F: Forecast

The current trajectory suggests that these trends will persist, and that the economic relationship between Asia and the Middle East will continue to grow. There are robust rates for economic growth throughout Asia and increasing rates of growth in most GCC nations (figures 1 and 2). This is occurring alongside the general recovery in global output and trade. The ongoing trend will also be maintained by the need for many Middle-Eastern rentier economies to diversify and grow their non-energy sectors, due to low oil prices and widening fiscal deficits. The long-term commitment to increasing this economic relationship between the two regions is evidenced by increased diplomatic engagement and long-term bilateral strategic planning.

Areas of opportunity

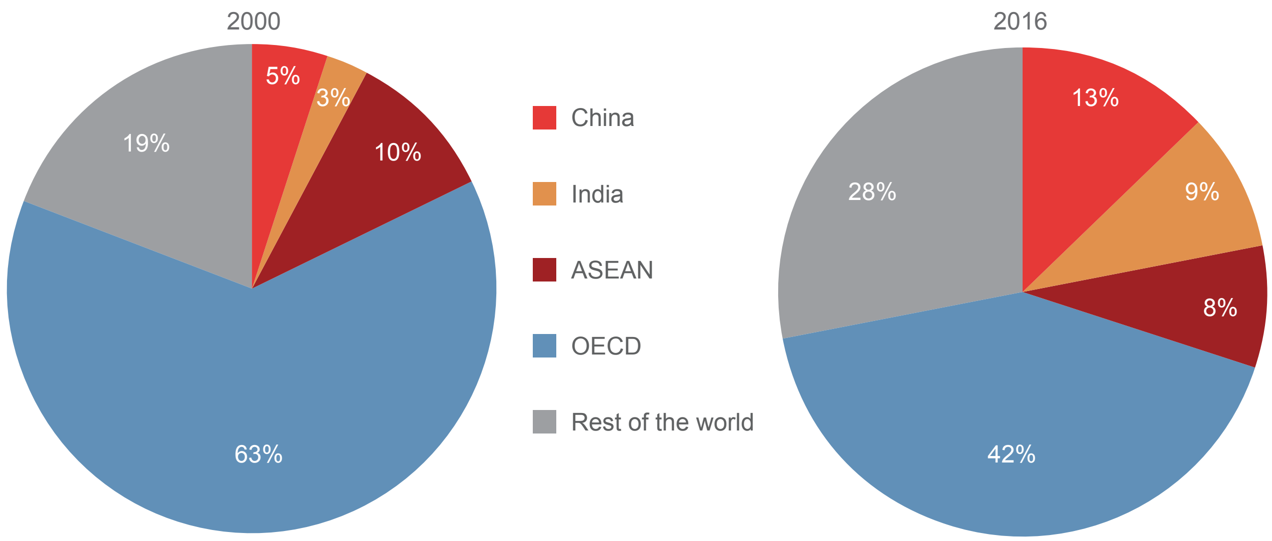
Continuing trade growth presents opportunities – both for multinational companies already in the region and for those looking to expand their global investments or operations. These opportunities are also tied to the transforming economies in many nations across both Asia and the Middle East. Particular sectors that will present opportunities include insurance and related professional services, tourism, plastics and renewable energy production. Macro trends to exploit include China's BRI, Saudi Arabia's 'Vision 2030', China's a-political approach to trade, the possibility for a GCC single market and the potential US political and security vacuum in the region. Nevertheless, there are still risks present. These include the vulnerability of both Asian and Middle Eastern economies to global price shocks and recessions, non-tariff barriers to trade, civil wars and geopolitical tensions.

Overview of trade

Gulf Cooperation Council (GCC) trade partners by share

Emerging Asia's trade with GCC countries (Saudi Arabia; United Arab Emirates (UAE); Bahrain; Kuwait, Qatar and Oman) has mainly been driven by rapid economic development in both regions. The trade has grown more rapidly than trade between the GCC and traditional markets of both North America and Europe. Combined trade with China, India and ASEAN amounted to 30% of the GCC's total trade in 2016 – almost double the combined total in 2000. China and India dominate the picture, as they are the GCC's largest trade partners. The share of GCC trade with China and India combined stood at 22% in 2016 – nearly a threefold increase from 8% in 2000. In contrast, OECD nations had a 63% share of GCC trade in 2000, but a 42% share in 2016 (Figure 3).

Figure 3: GCC share of trade with selected countries, 2000 vs. 2016



Source: UNCTAD statistics; author's calculations.

Percentage growth in bilateral trade with GCC

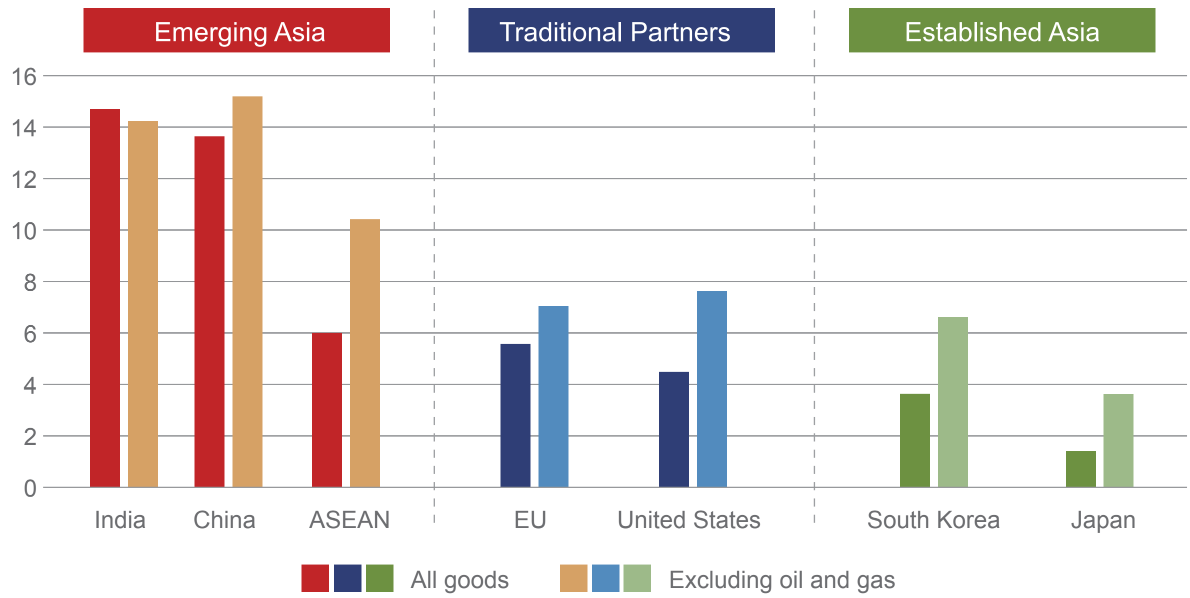
Between 2000 and 2016, China's bilateral trade with the GCC grew at an annualised rate of 13.5%, and India's grew at an annualised rate of 14.7%. This is higher than their overall trade growth rates: 8.9% and 10.2%, respectively. ASEAN trade with the GCC grew at 6% and 10.2% (excluding oil and gas), exceeding its overall trade growth of 4.5%. These figures also exceed the overall trade growth rate of the GCC, which is 6.9%. Notably, since 2000, GCC trade with Vietnam grew 25%. This is also much higher than Vietnam's overall trade growth of 14.4%. See the Appendix for all bilateral trade growth rates.

These figures are much higher than GCC growth rates with traditional markets. US trade growth with the GCC from 2000 to 2016 was 3.9%, while the EU's was 5.5% and the UK's was 3.9% (see Figure 4 for a comparison of trade growth rates). These figures are lower than the trade growth of India, China and ASEAN with the GCC, and lower than the GCC's overall world trade growth for the same period: 6.9%. It is also only marginally higher than the world trade growth of the US and the EU for the same period: 4.1% and 5.3%, respectively.

This highlights that Chinese, Indian and ASEAN trade growth with the GCC is increasing more than their trade with other regions. Importantly, it also highlights that GCC trade with these Asian nations is growing at

a quicker pace than its trade with traditional Western markets; China and India have already become the GCC's biggest trading partners, while the share of traditional markets (such as the US, Germany and the UK) is decreasing. The exceptions in Asia are South Korea and Japan. Although these countries already have a large amount of trade with the GCC, their percentage growth with the GCC was relatively low: 3.8% and 1.2%, respectively (Figure 4). This is in line with their relatively low overall world trade growth: 4.4% and 0.4%, respectively.

Figure 4: GCC bilateral trade growth (2000–2016 Compound Annual Growth Rate (CAGR)) (%)

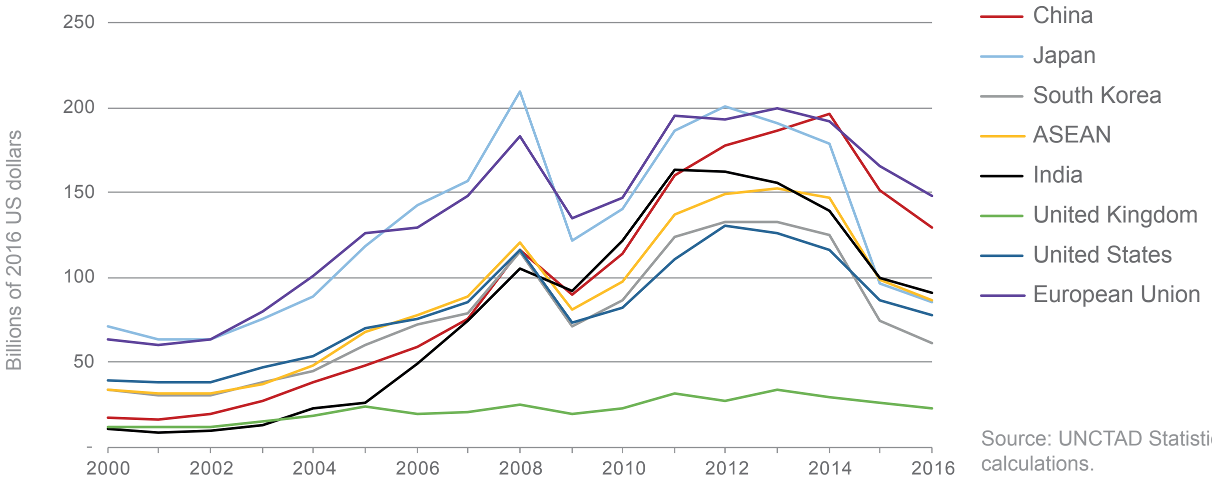


Source: UNCTAD Statistics; author's calculations.

Value of bilateral trade with GCC

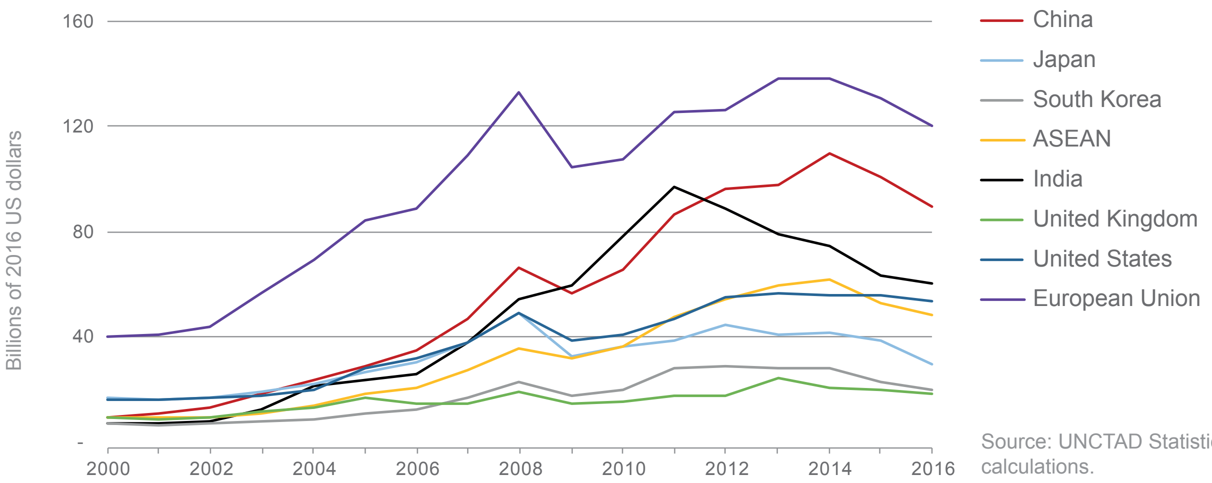
In 2016, trade between China and the GCC reached approximately $130 billion. This is nearly as much as the whole of the EU ($148 billion), and much more than with the US ($78 billion). Trade between India and the GCC also stood at higher than the US, at $91 billion in 2016. In recent years, the dollar value of bilateral trade between the GCC and all regions has dropped due to the decline in oil, gas and other commodity prices. But the decline has masked continued underlying growth in the trade of commodities and other goods between the GCC and Asia as measured by tonnage. See figures 5 and 6 for the trajectory of value of trade since 2000.

Figure 5: Value of GCC bilateral trade, 2000–2016*



Source: UNCTAD Statistics; author's calculations.

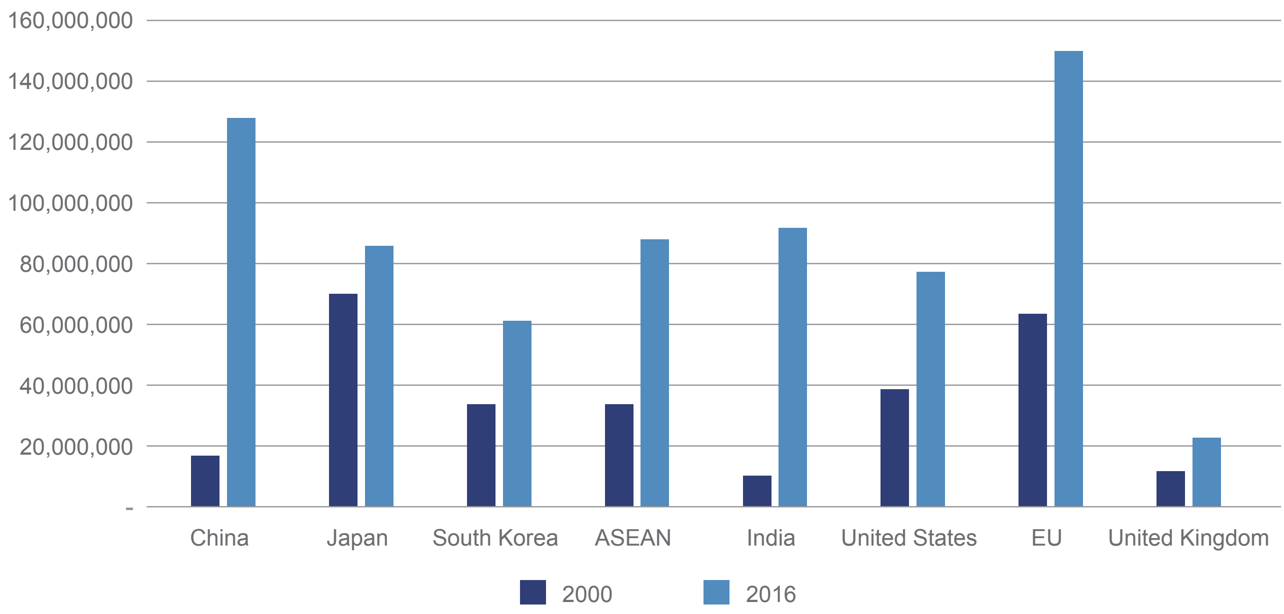
Figure 6: Value of GCC bilateral trade, excluding oil and gas products, 2000–2016*



Source: UNCTAD Statistics; author's calculations.

*** The value of trade, even excluding oil and gas, has reduced during the last two years, as seen in Figure 5. This masks overall growth in the amount of trade because the value of all commodity goods is affected by the fall in oil prices. This is due to the knock-on effect from the fall in energy prices. For example, the price of manufactured goods is affected as it becomes cheaper to run machines, factories and transportation. This is the same for agricultural goods and metals, which depends on the oil products in their production process.**

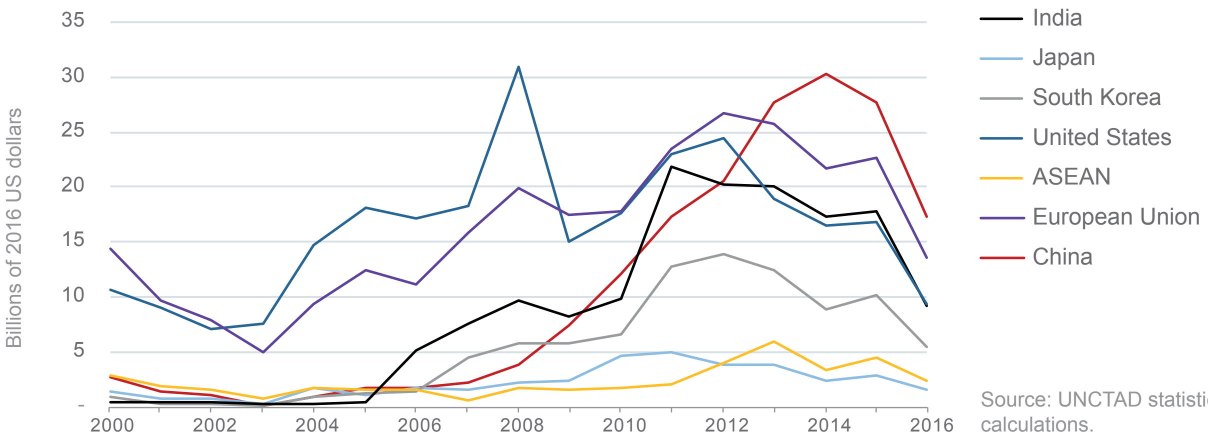
Figure 7: Value of bilateral trade with the GCC, 2000 vs. 2016 (US $billion)



Iraq and Iran

Iraq and Iran are two Middle Eastern economies outside of the GCC, which have increased their trade with the rest of Asia throughout the last decade. Iraq's trade growth with other Asian countries between 2000 and 2016 has been very strong: it grew 12.2% with China, 17.6% with the Philippines, 20% with India and 2% with Singapore. During the same period, it had negative growth with the US (-0.8%) and the EU (-0.4%), but grew 4.0% with the whole OECD and had 4.4% overall world trade growth. As Figure 8 shows, China dominates bilateral trade, but the value has been significantly diminished due to the drop in oil prices.

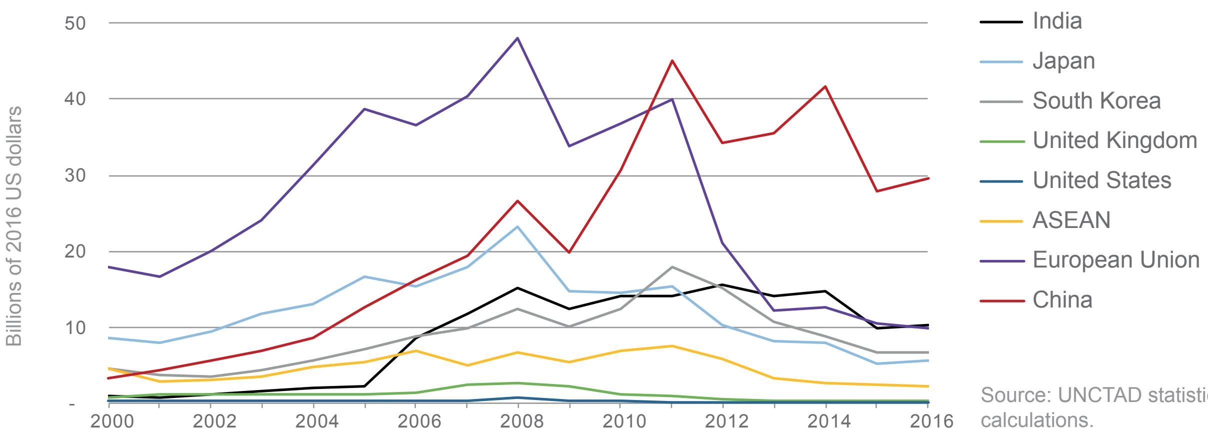
Figure 8: Value of Iraq's bilateral trade



Source: UNCTAD statistics; author's calculations.

China is Iran's biggest trading partner, with bilateral trade currently worth $18 billion. Its next biggest trading partners are India, Japan and South Korea (see Figure 9). This strong trade relationship grew during the most recent US sanctions (2010–2015), and has grown further since the inception of the Joint Comprehensive Plan of Action (JCPOA) in 2015.[i]

Figure 9: Value of Iran's bilateral trade



Source: UNCTAD statistics; author's calculations.

Gulf Cooperation Council–China trade

- China is the GCC's largest trading partner after the EU.
- Trade is driven by exports of energy products from the GCC and imports of a range of consumer goods from China.
- China was the second-largest source of foreign direct investment (FDI) into the GCC in 2015 (after the US), investing $299 billion.[ii]
- China and the GCC countries have enjoyed closer bilateral and business-to-business ties in recent years, with two-way investments in the upstream and downstream energy sector and infrastructure investments into the GCC.
- China has also sought to integrate its financial system more closely with the GCC.
- Growth in trade is outpacing the GCC's global trade growth as a whole; bilateral trade grew at a 13.5% annual rate between 2000 and 2016, compared to global trade growth of 8.9% for China and 6.9% for the GCC during the same period.[iii]

Sectors shaping the future

Energy

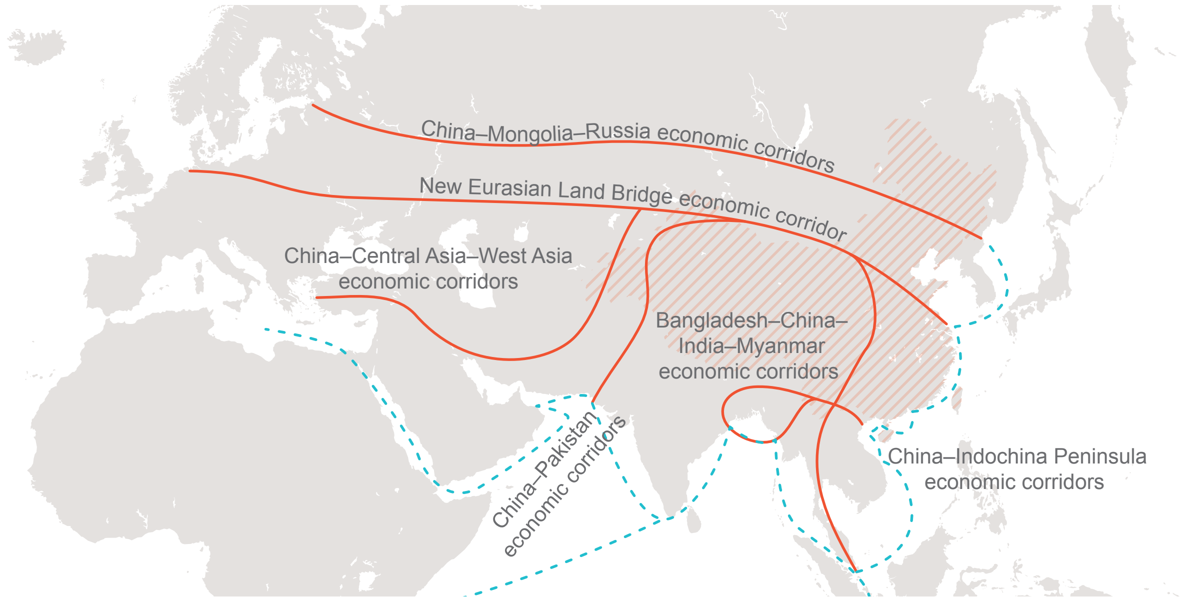
China and the GCC share a mutual reliance on hydrocarbons-based trade, which is set to continue to shape bilateral relations for the foreseeable future. China is reliant on GCC exports of crude oil and natural gas to fuel its expanding transportation needs. China's crude oil demand is increasingly driven by consumer demand for gasoline. Passenger vehicles are supplanting diesel-powered trucks and industrial machinery as the source of incremental demand.[iv] At the same time, growing production of crude oil and natural gas from shale deposits in the US are expected to reduce the US's energy imports from the GCC, putting pressure on GCC countries to find new markets for its energy products, including China. The global oil glut is also compelling the GCC countries to look for new markets in the East.

Infrastructure

China is also seeking to strengthen ties with the GCC countries in order to advance its Belt and Road Initiative (BRI); an ambitious development strategy, announced in 2013, to increase trade and ties between countries lying along the six land and maritime economic corridors that traditionally comprised the historic "Silk Road". The monumental scale of this proposed project (see Figure 10) has elicited the pledging of unprecedented amounts of investment capital for the completion of BRI projects. The Chinese Government has set aside US$1 trillion to finance the BRI, while the new international Asian Infrastructure and Investment Bank, co-founded by China, has earmarked US$65 billion as starting capital for the initiative.

The Middle East is already a part of this international investment push. China has already made several infrastructure investments in the UAE and Saudi Arabia, which have been labelled under the BRI (see case studies 1 and 2 below on UAE–China and Saudi Arabia–China trade relations, respectively). China could play a major role in the construction of a proposed high-speed railway project that would connect all the GCC Member States. In 2016, China Railway Signal and Communication Corporation and the Gulf Organization for Industrial Consulting signed a memorandum of understanding (MoU) to boost the development of rail transit lines in the Gulf.[v] Furthermore, all GCC countries except Bahrain have applied to be founding members of the China-led Asian Infrastructure Investment Bank (AIIB).[vi] Iraq and Iran are located centrally along one of the main land corridors and are expected to received BRI infrastructure projects. Furthermore, the GCC is in a very strategic maritime position along the main maritime corridor (Figure 10).

Figure 10: The Belt and Road Initiative: Six economic corridors spanning Asia, Europe and Africa



Financial market

China has also sought greater integration into GCC financial markets. For example, in 2015 China established a renminbi (RMB) clearing centre in Doha, Qatar – the first such clearing centre in the Middle East.[vii] Moreover, China's UnionPay can be used throughout the UAE, facilitating Chinese nationals' purchases in the country.[viii] The most significant development in this regard, however, has been the elevation of the Chinese Renminbi (RMB) currency to the status of an internationalised medium of exchange. The International Monetary Fund has granted the RMB special drawing rights, and the Chinese Government – which has concluded 32 currency swap agreements worldwide – has been actively promoting it as a global currency.

The consequent prevalence of RMB stocks outside of China acts as both a trade facilitator and a debt issuance mechanism, which will prove invaluable for the completion of Chinese-backed investment projects along the BRI. Egypt, Qatar and the UAE stand out as Chinese financial integration partners in the Middle East due to their conclusion of currency swap agreements valuing 18 billion RMB, 34 billion RMB and 35 billion RMB, respectively. Pakistan's central bank has also recently suggested that its firms may switch to using the RMB in bilateral trade and investment with the People's Republic of China (PRC). The growing importance of China to the region has led to growing calls for the adoption of a more internationalised renminbi – particularly in the GCC's central energy markets, where an increasing Chinese demand acts as an incentive to drop the dollar as an exchange currency for PRC-destined exports.

Case study 1: United Arab Emirates – China trade

China was the UAE's largest bilateral trading partner in 2016, recently surpassing India. Bilateral trade was over $53 billion in 2016, representing 41% of the GCC's trade with China. The UAE imported $36 billion of goods from China and exported $17 billion.[ix] Trade between the UAE and China has expanded rapidly, growing at a compound annual growth rate of 14.9% between 2000 and 2016.[x] This is higher than US and EU trade growth with the UAE between the same period (11% and 7.6% respectively), as well as US–UAE trade value ($25.8 billion in 2016).

Trade relations have been cultivated over recent years through frequent bilateral exchanges and agreements. The UAE initiated a 'Look East' policy in 2015, and has actively sought to attract investments from China. China's BRI has also targeted the UAE for a number of investments aiming to facilitate trade with the UAE, which lies at a strategic location on the maritime corridor between East and South Asia and the Arab world.

Sheikh Mohammed bin Zayed Al Nahyan, Crown Prince of Abu Dhabi, visited Beijing in 2015. His visit resulted in multiple agreements and MoUs concerning both the economic and social integration of the two countries, with key accords on academic exchanges, diplomatic training, currency exchanges, and oil exploration and production. The continued ability of Chinese firms to win major construction contracts in the UAE further accentuates the growing centrality of PRC investment projects, particularly in infrastructure, to the region.

Due to its modern ports, customs services, free-zone facility and logistics park, the UAE serves as a major transfer centre for Chinese products to the Middle East and African markets.[xi] Approximately 60% of China's total trade passes through the UAE's transport hubs, highlighting the country's central position in an African–European–Asian trade network. The UAE's main imports from China are diverse, ranging from mobile phones, computers and semi-precious metals to furniture, clothing and footwear. The UAE's main exports to China are crude oil, liquefied gasses and petrochemical products.[xii] China has played an active role in helping to develop the UAE's maritime trade infrastructure. For example, China's COSCO Shipping Ports is constructing a dedicated shipping terminal at Khalifa Port in Abu Dhabi, which will nearly double the port's shipping capacity by adding 2.4 million Twenty-foot Equivalent Units (TEU) a year.[xiii] In July 2017, five Chinese companies announced a $300 million investment in Abu Dhabi Ports to lease 2.2 square miles of the Free Trade Zone of the Khalifa Port.[xiv]

In 2015, Sheikh Mohammed bin Zayed Al-Nahyan and Chinese President Xi Jinping announced the creation of a Joint Investment Fund to deploy $10 billion in equity investments in energy, infrastructure, technology and advanced manufacturing. The UAE's Mubadala Development Company, China Development Bank Capital and the PRC's China's State Administration of Foreign Exchange (SAFE) jointly manage the fund.[xv] Since 2015, the Dubai International Financial Centre (DIFC) has hosted Dubai Week each year in a different city in China to promote Dubai's business and investment opportunities.[xvi] The countries have also cooperated on labour issues, developing service contracts in the industrial and retail sectors as well as construction and medical care centres.[xvii] Chinese state-owned enterprises (SOEs), such as PetroChina, maintain offices in the country.[xviii]

China has also sought to integrate its financial system more closely with the UAE's regional financial hubs. China's largest banks have established a foothold in the UAE; the Industrial and Commercial Bank of China, the Agricultural Bank of China and the China Construction Bank have all opened offices in the country. The UAE has been among the world's strongest adopters of the RMB; data from SWIFT (the financial messaging services provider) shows that the UAE registered among the highest growth globally in the adoption of the RMB as a payment currency. According to SWIFT data, in August 2016, more than 80% of direct payments made between the UAE and China (including Hong Kong) used the RMB.[xix] The Central Bank of the UAE and UnionPay International of China signed an agreement in 2015 to connect the electronic switch UnionPay with UAE Switch, allowing the use of UnionPay at over 4,800 ATMs connected to the UAE Switch service. The agreement eases Chinese investors' and tourists' ability to transact in the UAE.[xx]

An emerging area of trade is the automotive sector, a market previously dominated by European, Japanese, Korean and American brands, into which Chinese firms – such as Foton Motor, Chery Automobile Co., Dongfeng Motor Corporation and GAC Motor – are making inroads. Chinese cars are predicted to have a double-digit market share in the UAE by 2020.[xxi] Another area of growth is tourism; over 230,000 Chinese tourists visited the country in 2016,[xxii] and this number increased 60% year-on-year from 2015. China is the UAE's third-largest source of hotel guests, behind India and the UK.[xxiii] The UAE has facilitated this by allowing Chinese visitors to apply for a tourist visa on entry to Abu Dhabi, as well enabling the use of China's UnionPay at merchants and ATMs around the country.

Case study 2: Saudi Arabia – China trade

Oil is the basis of Saudi–Sino relations.[xxiv] China is Saudi Arabia's largest customer for crude oil, and Saudi Arabia is China's largest source of oil imports, at approximately 20%.[xxv] Saudi Arabia has agreed that it will participate in China's BRI initiative and is a founding member of the AIIB.[xxvi] Trade between Saudi Arabia and China has grown at a rapid 16% compound annual growth rate between 2000 and 2016. The volume of trade stood at $45 billion in 2016, representing nearly 35% of the GCC bloc's trade with China. Saudi Arabia imports from China were diverse in 2016, including mobile phones; computers; clothing; air conditioners; furniture, footwear and other goods.[xxvii]

Saudi Arabia's economic security is coming under increasing pressure due to lower oil prices and high defence spending. As a result, it has recently taken a more proactive approach to securing markets for crude oil and promoting investment and trade in Asia. In 2017, to deepen economic ties, King Salman undertook a six-week tour of China, Japan, Malaysia, Indonesia, Brunei and the Maldives. Following bilateral meetings between King Salman and Chinese President Xi Jinping, the countries announced $65 billion worth of economic and trade deals and 21 agreements on investments in oil, petrochemicals and renewable energy. The agreements included MoUs for building refineries in China that would use Saudi Arabian oil, and petrochemical plants in both China and Saudi Arabia.[xxviii] The agreements strengthen existing bilateral commitments, which focus on the downstream energy sector – including refining, oil product marketing and retail, and oil storage. For example, Saudi Basic Industries Corporation (Saudi Arabia's largest petrochemical company) and Sinopec (China's second-largest oil producer) jointly operate a 1000-kilo-tons-per-annum ethylene petrochemical plant, which opened in 2010, in the Chinese city of Tianjin. Chinese conglomerates are also involved in the construction of the Haramain high-speed rail link between Mecca and Medina.[xxix]

Increasingly, the Saudi–Sino relationship is becoming strategic as well as economic. In 2016, China elevated its relationship with Saudi Arabia to a 'strategic partnership'. Saudi Arabia has increased security cooperation with China as it hedges its bet on the ability and willingness of the US – its traditional security and political ally – to support it. Following a meeting between King Salman and a special envoy of Chinese President Xi Jinping in November 2016, the Saudi Government unveiled a five-year plan for Saudi–China security cooperation, which includes counterterrorism cooperation and joint military drills.[xxx]

Gulf Cooperation Council–India trade

- India was the GCC's third-largest trade partner in 2016, behind China and the EU.
- Bilateral flow of goods between the GCC and India totalled $91 billion in 2016 ($60 billion excluding oil and gas products).
- GCC trade with India represented 8.8% of all GCC trade in 2016 (8.6% excluding oil and gas products), while India's trade with the GCC represented 14.8% of its world trade (11.8% excluding oil and gas products).
- Bilateral trade has grown at a faster rate than global trade for each region, expanding at a 14.7% annualised rate between 2000 and 2016 (14.4% excluding oil and gas products).[xxxi]
- More than half of India's oil and gas exports came from GCC countries in 2016.[xxxii]
- Seven million expatriates from India live in the GCC, providing annual remittances of approximately $40 billion annually.[xxxiii]

As India aspires to become a global power, it has sought to increase its strategic ties to the GCC. As part of Prime Minister Shri Narendra Modi's 'Linking West' policy, Modi has made landmark visits to Saudi Arabia and the UAE in recent years, where a number of strategic business and investment partnerships and security pacts were announced (see sections on Saudi Arabia–India and UAE–India trade). For example, India and Saudi Arabia announced the strengthening of maritime security cooperation to protect vital shipping lanes through which oil and gas shipments to India flow.

The GCC's growing cooperation with India on security issues is notable in light of the former's historically close relations with Pakistan, which somewhat complicated GCC–India relations. These relations will likely continue to evolve beyond the economic pragmatism that characterised them in previous decades.

Case study 3: United Arab Emirates – India trade

In 2016, India was the UAE's largest trading partner and the UAE was India's third-largest trading partner.[xxxiv] Although they had historical trade relations due to their geographical proximity, trade has expanded rapidly since 2000, growing at a compound annual growth rate of 15.7%. The bilateral relationship is also one of the most important among the GCC countries. The UAE's trade with India represented over 57% of the GCC's trade with India in 2016.[xxxv] The value of goods traded between the UAE and India stood at $52 billion in 2016, with imports to the UAE representing about $27.5 billion of that amount. The UAE's imports from India in 2016 were diverse, including jewellery, precious metals, pearls, petroleum oils, ships, clothing and rice. Over 70% of the UAE's exports to India in 2016 consisted of pearls, petroleum and gold.[xxxvi] The UAE is the sixth-largest supplier of crude oil to India, while India represents the second-largest destination for UAE's crude oil exports.[xxxvii] The Indian expatriate community in the UAE stands at over 2.6 million, representing more than 30% of the country's population and making it the largest expatriate community in the UAE. Not included in the trade statistics is the more than $15 billion in annual remittances made by the Indian community.[xxxviii]

A number of high-level bilateral engagements have been undertaken in recent years, as well as regular ministerial- and senior official-level meetings, through joint commissions, committees and working groups.[xxxix] In 2015, Prime Minister Modi visited the UAE, marking the renewal of the two countries' strategic engagement. During the Prime Minister's visit, MoUs and agreements were signed pertaining to the facilitation of institutional investment in infrastructure; cooperation on the development of renewable energy resources and combating cybercrime; insurance, currency swaps and skills development – among other areas. In 2016, Crown Prince of Abu Dhabi, Mohammed bin Zayed Al Nahyan, made a state visit to India, where a joint statement was issued. The statement included a commitment by both nations to increase trade by 60% over the next five years, reiterated a $75 billion target for UAE infrastructure investments in India, established a Strategic Petroleum Reserve in India managed by the Abu Dhabi National Oil Company, and covered other issues related to military and security cooperation.[xl] The UAE–India relationship was also elevated to a 'comprehensive strategic partnership'. This is a remarkable development in light of the UAE's close business and political ties with Pakistan, which had previously created a stumbling block to closer cooperation between the UAE and India.[xli]

In January 2017, Mohammed bin Zayed Al Nahyan made another visit to India, where many of these commitments were reaffirmed and additional bilateral investments were announced. These included institutional cooperation on maritime transport that simplifies customs, bilateral cooperation in road transport and highways, and an agreement on strategic oil storage.[xlii]

The UAE's largest companies have invested in India, including DP World, Emaar and Rakia. The Government of India estimates that the UAE has invested approximately $8 billion in India, of which about half is FDI and the rest is portfolio investments. This represents India's largest source of investment from the Arab world, and makes the UAE India's 11th-largest foreign investor.[xliii] Major Indian companies also conduct business in the UAE, including L&T India; Essar; Dodsal Group; Punj Lloyd and Engineers India.[xliv]

China vs. India: Who will dominate in the GCC?

As China and India's bilateral trade with the GCC grows, will Chinese or Indian economic ties dominate the region? This is an important consideration for businesses and governments as they seek to increase investment in the region and attempt to determine the nature of investment flows, trade in goods and services, geopolitical relationships and the future opportunities and risks in the region.

India has deeper historic links with the GCC than China, due to its cultural and geographic proximity and a large expatriate population in the GCC. India's economy is more service-oriented than China's, which is attractive to GCC countries that seek expertise in the knowledge-economy sectors, such as IT and outsourcing services. China's economic growth has been based more heavily on manufacturing, and its transfer of know-how has largely been limited to infrastructure projects until now.

As Chinese labour wages are rising, however, basic manufacturing is moving into South East Asia, and production and services in China are moving up the value chain. As China develops new technologies and its economy becomes more service-driven, the country will play a larger role in the transfer of services expertise to the GCC. There has already been evidence of this knowledge transfer happening (for example, the use of UnionPay in the UAE; see section on UAE–China relations). Domestic demand is also growing rapidly in China, expanding import markets for consumer products and services, in which the GCC will participate.

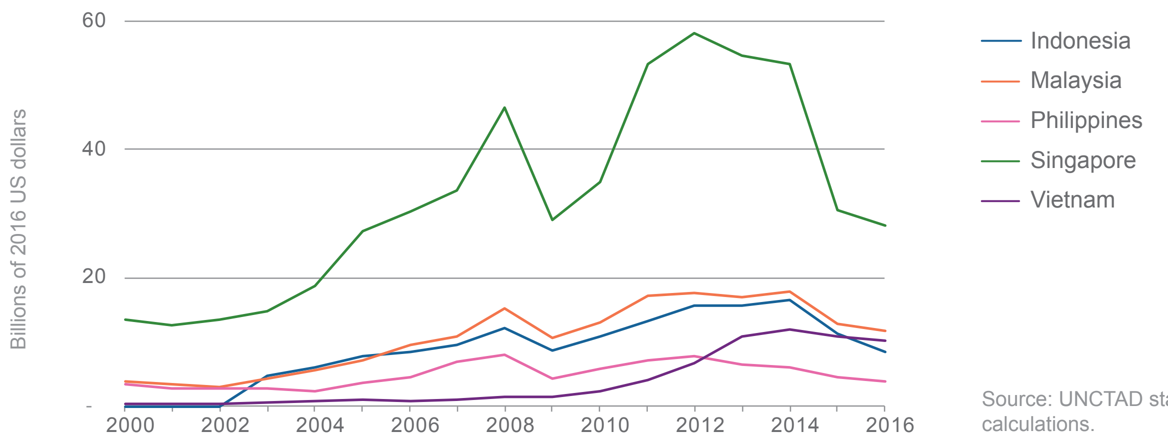
China's heavily SOE-driven outward trade and investment decisions are often guided by pragmatic considerations about economic opportunities and national domestic needs (for example, natural resources). Decisions tend to be made without regard for political or religious issues, and Chinese SOEs have shown a higher tolerance than Indian companies for riskier operating environments, most notably in Iraq. This is another source of Chinese advantage in developing trade relations, although it also means that bilateral relationships may be less deep and accompanied by less soft power and leverage.

India's future economic growth is generally viewed as riskier, due to poorer infrastructure, a less friendly business environment and more political uncertainty. Due to its more decentralised governing system and less predictable elections, it may be harder for India to build consensus and execute strategies (such as China's BRI) that will lead to stronger ties with, and leverage over, GCC countries.

Gulf Cooperation Council–Association of South East Asian Nations trade

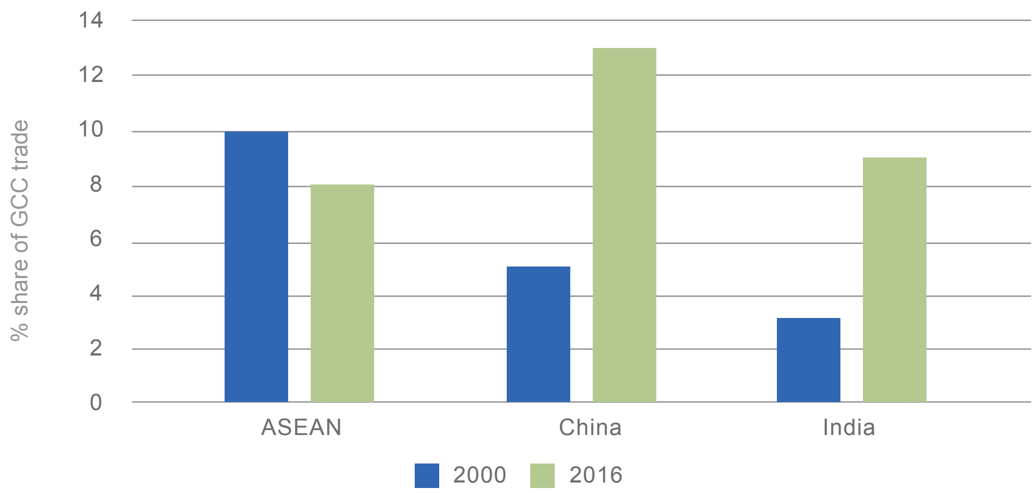
- The value of trade between the GCC and ASEAN was $87 billion in 2016 ($48 billion excluding oil and gas products), and grew at a 6% compound annual growth rate between 2000 and 2016 (10.5% excluding oil and gas products).
- Within the ASEAN bloc, the GCC's largest trading partners in 2016 were :
  o Singapore ($28 billion) ;
  o Malaysia ($12 billion) ;
  o Indonesia ($8 billion) (see Figure 11).
- Singapore serves as a major trade hub for ASEAN goods to the GCC, and much of its trade consists of re-exports.
- The GCC imported a variety of goods from the ASEAN in 2016, including mobile phones; jewellery; precious metals; cars, trucks and various food items.
- The bulk of GCC exports to ASEAN countries are made up of crude oil, plastics and other energy and energy-derived products.
- Vietnam has seen standout growth in trade with the GCC, growing at a compound annual growth rate of 25.0% from 2000 - 2016 – albeit from a small base of about $136 million in 2000 (see Appendix). Trade growth particularly sped up after Vietnam's ascension to the World Trade Organization in 2007, driven mainly by Vietnamese exports.
- The share of GCC trade with ASEAN countries has actually declined between 2000 and 2016, eclipsed by the growth in trade with China, India and other developing markets (Figure 12).

Figure 11: Value of GCC Bilateral Trade with Selected ASEAN Countries, 2000-2016



Source: UNCTAD statistics; author's calculations.

Figure 12. Percentage share of GCC trade



‘Food for oil’ principle

The relationship between GCC and ASEAN countries centres around a ‘food for oil’ principle, but has also expanded into other areas. ASEAN nations’ agricultural productivity complements the GCC’s food security needs, which became a concern when rising food prices in 2008 triggered riots among migrant labourers in the UAE and Bahrain. At the same time, ASEAN nations rely heavily on energy imports to support rapidly expanding domestic consumption and industrial needs, most of which the GCC supplies.

Free trade agreements

The GCC and ASEAN elevated their relationship to regular ministerial-level meetings in 2009. In 2015, the GCC and Singapore completed a Free Trade Agreement (FTA), which covers trade in goods and services; customs procedures; e-commerce; economic cooperation; government procurement, rules of origin and other areas. The FTA grants about 93.9% of tariff lines for Singaporean goods exported to the GCC concession-free, with an additional 2.7% to qualify for concessions in 2018. All GCC imports to Singapore are concession-free.[xlv] The Singapore–GCC FTA supplements the trade concessions covered in the Council’s other agreements with the European Free Trade Association and Syria. Moreover, multiple FTAs are currently under negotiation between the GCC and a number of Asian entities, including China; Japan; South Korea; India, Iran and ASEAN. Malaysia has also expressed interest in establishing an FTA with the GCC. Malaysia and the GCC established a framework for such an agreement in 2011, but negotiations appear to have stalled due to the decline in crude oil prices and the Arab Spring.[xlvi]

Investment into ASEAN

GCC countries have made a number of large investments into ASEAN nations in the energy field, particularly in Malaysia. UAE's Mubadala Development Company has participated in gas exploration in Malaysia through a joint venture with Petronas (the Malaysian national petroleum company), and has also participated in oilfield development projects in Vietnam, Thailand and Indonesia.[xlvii] The UAE signed a $6.75 billion deal to establish petroleum storage facilities in Malaysia. Saudi Arabia's King Salman's month-long trip to Asia in early 2017 included the ASEAN nations of Malaysia, Brunei and Indonesia. A number of agreements were signed, including a $7 billion investment by Saudi Aramco in Petronas' refining and petrochemical plant in Malaysia, Saudi Aramco's largest downstream investment outside the Kingdom.[xlviii] Qatar has invested in several downstream projects in ASEAN countries, including a $5 billion investment in 2013 in the Pengerang Integrated Petroleum Complex in Malaysia.[xlix] In 2017, Kuwait Petroleum Corporation established a $9 billion joint refinery project in Vietnam and a partnership with Indonesia's Pertamina to develop a refinery in East Java.[l]

Financial Services

Malaysia, Indonesia and Singapore, together with the GCC, also serve as major financial centres for Islamic banking and have benefited from synergistic interests in the sector. Islamic banking is an important conduit for Gulf wealth and is one of the fastest-growing areas of financial services. Total assets in the Islamic finance industry increased from $700 million in 2005 to $2 trillion in 2016.[li] Malaysia, Indonesia and the Gulf countries have cooperated to establish regulations governing Islamic finance and to create liquidity-management bodies for the industry.[lii]

Gulf Cooperation Council–Japan trade

- GCC–Japan bilateral trade value stood at $86 billion in 2016, representing about 8.3% of all GCC trade.
- Within the GCC, Japan's largest trade partner in 2016 was the UAE ($33 billion in bilateral trade), followed by Saudi Arabia ($26 billion) and Qatar ($16 billion).
- In 2016, exports from Japan to the GCC mainly consisted of cars, trucks, vehicle parts and accessories. GCC exports to Japan consist mainly of energy for domestic fuel consumption, including oil, hydrocarbons and natural gas.

Energy

Given Japan's lack of local energy sources, its trade relations with the GCC have historically centred around its dependence on energy imports to fuel domestic consumption and industrial production. Its reliance on foreign hydrocarbons has grown since the Fukushima Daiichi nuclear accident, which resulted in a shutdown of all nuclear facilities in Japan, leaving a 30% energy gap.[liii] In 2015, Japan was the world's fourth-largest crude oil importer after China, the US and India. Imports totalled 162 million tonnes, 80% of which came from the Middle East (Figure 13) – 35.8% from Saudi Arabia, 26.0% from the UAE, 9.0% from Kuwait and 6.2% from Qatar (Figure 14). Saudi Arabia has made significant investments in Japan to secure a market for its crude oil. It has a 15% stake in Showa Shell Sekiyu (one of the largest refineries in Japan), and leases large oil-storage tanks on Okinawa Island to serve its customers in Japan and other countries in the region.[liv] Japan is also heavily dependent on imported natural gas, 52.4% of which came from Qatar in 2015. Japan has become increasingly reliant on Qatar for imports of liquefied natural gas (LNG); its share of imports from Qatar increased by 103% from 2005 to 2015, replacing imports from Indonesia, Nigeria and Australia.[lv] There was discussion of Japan investing in Iran's infrastructure to export LNG and petrochemicals to Japan, which would represent a significant competitive threat for the GCC. However, in light of continuing uncertainty about the future of the nuclear deal that waives international trade sanctions on Iran, the prospect of Japan–Iran energy investment cooperation is now unclear.[lvi]

Figure 13: Share of Japanese oil imports

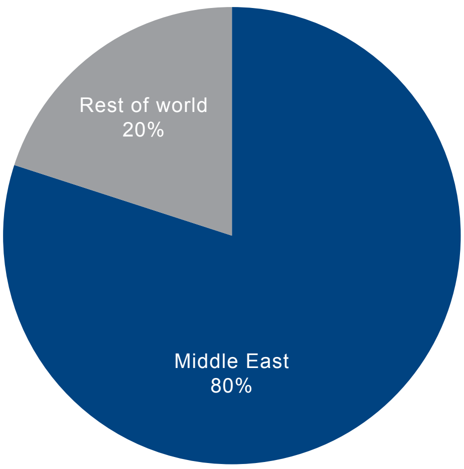
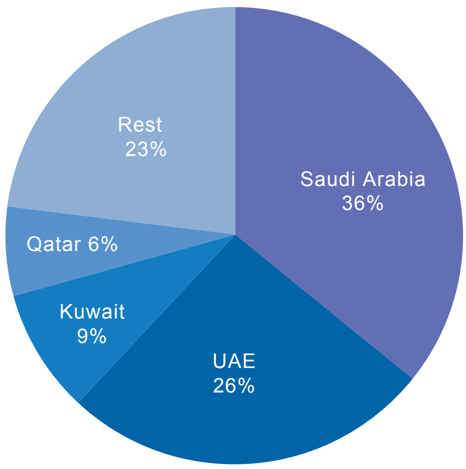


Figure 14: Middle East share of Japanese oil imports



Foreign direct investment

Japan is regularly among the top sources of foreign FDI in the UAE and Saudi Arabia. Japan has also been one of the most successful countries in pursuing a wide range of public–private partnerships (PPPs) with GCC countries, with over $50 billion in deals, mostly in the power and desalination sector.[lvii] A number of large Japanese companies maintain a presence in the UAE, including Panasonic, Sony, Sharp and Toshiba, as well as all of the major Japanese car companies. Hitachi was involved in the construction of the Burj Khalifa and the Dubai Metro. Japanese companies are also involved in preparations for the 2022 FIFA World Cup in Qatar.[lviii] Saudi Arabia has identified Japan as a key strategic partner in fulfilling its ambitious Vision 2030, which aims to diversify its economy from its reliance on hydrocarbons. In September 2016, a Saudi delegation led by Crown Prince Mohammad bin Salman visited Tokyo to discuss how the country can play a role in Vision 2030. Saudi Arabia is interested in Japan's expertise with PPPs, as well as its strategic advice on how to manage its system of royal patronage and increase female labour-force participation. In October 2016, Japan and Saudi Arabia announced the creation of the SoftBank Vision Fund for new technologies. The fund will invest up to $45 billion from the Public Investment Fund (Saudi Arabia largest sovereign wealth fund) and up to $25 billion from Japan's SoftBank.[lix]

Case study 4: United Arab Emirates – Japan trade

- The UAE is Japan's largest trade partner in the Middle East and Japan is the UAE's third-largest trade partner in Asia, with $33 billion of goods exchanged in 2016.
- The dollar amount of trade between the countries grew at an annualised rate of about 1% between 2000 and 2016.
- The UAE's major exports to Japan in 2016 were crude oil, LNG, liquefied propane and butane, and aluminium.
- The UAE is Japan's second-largest source of oil (after Saudi Arabia), accounting for 22% of Japan's oil imports. Japanese companies also hold oil concessions on offshore oilfields in the UAE.
- The UAE's imports from Japan in 2016 included cars, car parts and electronic products.
- The UAE represents a crucial re-export hub for Japanese goods throughout the Middle East, Africa and Europe.

Gulf Cooperation Council–South Korea trade

- The GCC–South Korea trade value in 2016 stood at $61 billion, representing about 5.9% of all GCC trade.
- Within the GCC, South Korea's largest trading partner in 2016 was Saudi Arabia ($21 billion in bilateral trade), followed by the UAE ($16 billion) and Qatar ($13 billion).
- Cars represented the majority of Korean exports to the GCC (24% of the value of exports), followed by a range of goods including mobile phones; air conditioners; televisions; electrical distribution lines, ships and civil engineering plants and equipment.[lx]
- Korean imports from GCC countries consist mainly of energy imports.

Energy

Like Japan, South Korean trade with the GCC centres around its dependence on energy imports. South Korea imported about 2.8 million barrels of crude oil per day in 2015, making it the fifth-largest importer in the world. Of these imports, 85% came from the Middle East (Figure 15): 30% from Saudi Arabia, 14% from Kuwait, 13% from Iraq, 11% from Qatar and 10% from the UAE (Figure 16). South Korea's reliance on the GCC for its energy demands has increased since 2011; it reduced its imports from Iran to comply with US and EU sanctions on Iran. South Korea was also the second-largest importer of LNG in the world in 2015 (after Japan), consuming an estimated 1.6 trillion cubic feet (Tcf) of dry natural gas that year. Qatar was the largest source of South Korea's LNG imports (37% of total imports), followed by Oman (12%).[lxi]

Figure 15: Share of South Korean oil imports

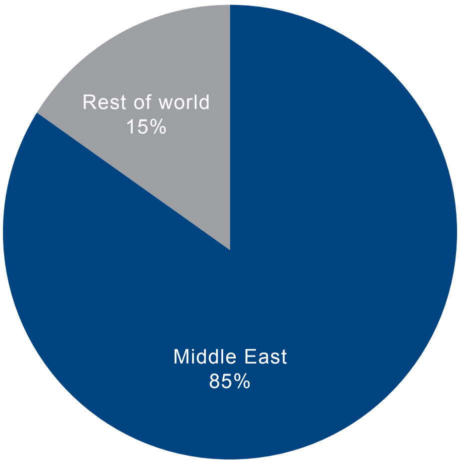
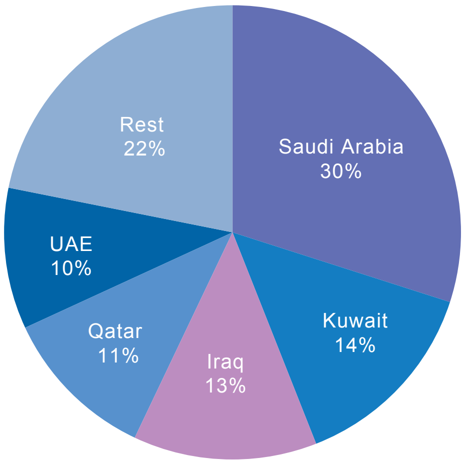


Figure 16: Middle East share of South Korean oil imports



Technology and infrastructure

South Korea has signed nuclear cooperation agreements with the UAE and Saudi Arabia. In 2009, Abu Dhabi awarded a Korean consortium, led by the Korea Electric Power Cooperation (KEPCO), a contract to build the UAE's first nuclear power plant.[lxii] The plant will be comprised of four APR-1400 nuclear reactors, the first of which is expected to come online in 2018. An agreement was signed with Saudi Arabia in 2015 to build smaller System-Integrated Modular Advanced ReacTor (SMART) units there.[lxiii]

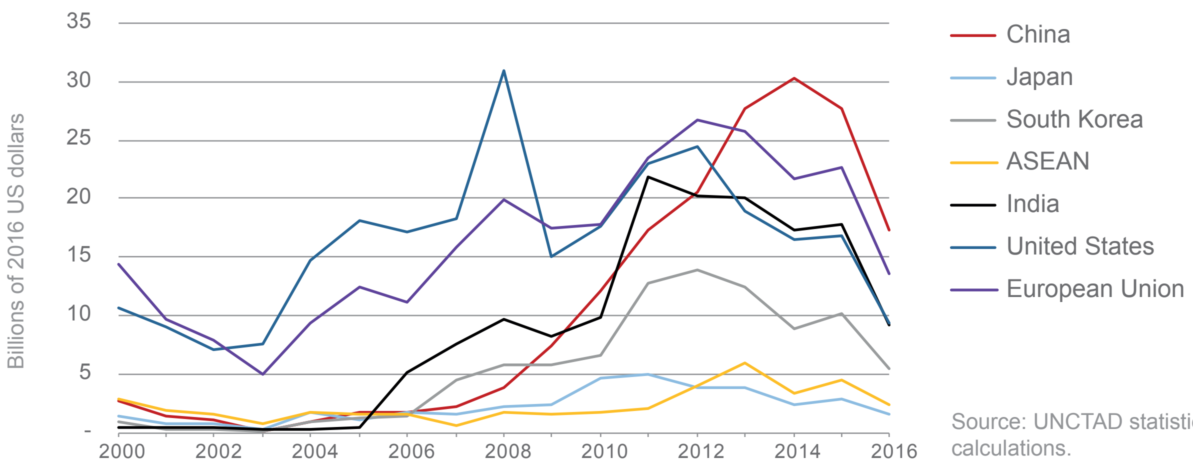
In 2015, then-President Park Geun-hye visited four GCC countries and signed several agreements aiming to export South Korea's technology to the region, including a Korea–Kuwait deal on building energy efficient grids; a collaboration between Saudi Arabia's Saudi Telecom Company and South Korea's SK Telecom to develop new technology in Saudi Arabia; an agreement with Qatar to conduct joint research and development in energy technology; and cooperation with the UAE in the realm of advanced agricultural technology.[lxiv] South Korean companies – such as Samsung, Hyundai, GS Engineering & Construction, Hanwha Group and Daewoo (among others) – have a substantial presence in the Gulf, where they have been involved in constructing major projects, including the Burj Khalifa in Dubai and the Doha Metro in Qatar.[lxv]

Iraq–Asia trade

Iraq is included in this study because of its potential, as it rebuilds itself following years of sanctions and war, to renew or establish trade relations with Asia.

- Iraqi trade with Asia has largely comprised of energy exports.
- Iraq is the second-largest oil producer in the Organization of the Petroleum Exporting Countries (OPEC).
- Iraq's crude oil production rose from 1.5 million barrels per day (b/d) in 2011 to 4.3 million b/d in 2018, as the country's oil and gas infrastructure was rebuilt.
- In early 2017, Iraq became India's largest source of crude oil, overtaking Saudi Arabia.[lxvi]
- Iraq was China's second-largest source of crude oil imports in 2015[lxvii] and fifth-largest in (2016 behind Russia, Saudi Arabia, Angola and Oman).
- Together, India, China and Korea imported more than half of Iraq's crude oil exports in 2015.[lxviii]
- Iraq's largest bilateral trade partner in Asia in 2016 was China ($17 billion), followed by India ($9.2 billion), South Korea ($5.5 billion) and Japan ($1.6 billion) (Figure 17).
- The principal exports from Iraq in 2016 were crude oil products. Imports from Asia were diverse, including iron, steel, tubes and other construction material, air conditioners and mobile phones, among other goods.[lxix]

Figure 17: Value of Iraq bilateral trade, 2000–2016



Source: UNCTAD statistics; author's calculations.

Relations with China

The increase in Iraq's oil production since the US-led invasion has required large amounts of investment in its oil-production infrastructure. China has played an early and significant role in building this infrastructure since the end of the US-led invasion. Chinese SOEs were among the first to move into the sector as they were more risk-tolerant. Chinese SOEs have invested on average $2 billion a year in the oil sector since 2009, including the China National Petroleum Corporation's (CNPC) $5.6 billion purchase of a stake in the large Rumaila oil field in southern Iraq.[lxx] In a number of cases, China's SOEs have outcompeted Western firms for Iraqi oil contracts. This is because the Chinese firms are willing to accept lower payments and Iraq's strict oil contract terms, such as waiving rights to future reserves. Compared to Western companies, Chinese companies tend to view oil contracts with more economic pragmatism and are less politically intrusive and bureaucratic.[lxxi] CNPC and China National Offshore Oil Corporation are the dominant players in southern Iraqi fields, while Sinopec is prominent in the Kurdistan Region.[lxxii]

Figure 17 shows the remarkable ascendancy of Chinese bilateral trade since the mid-2000s. The fall in the value of trade seen since 2015 is due to the same reasons outlined on page 10. Iraq and China have engaged in cooperation in several areas. In 2015, they signed an MoU that established a long-term energy partnership, including plans to invest in oilfield projects and refinery construction, as well as in infrastructure building for electric power and telecommunications as a part of BRI.[lxxiii]

Relations with India

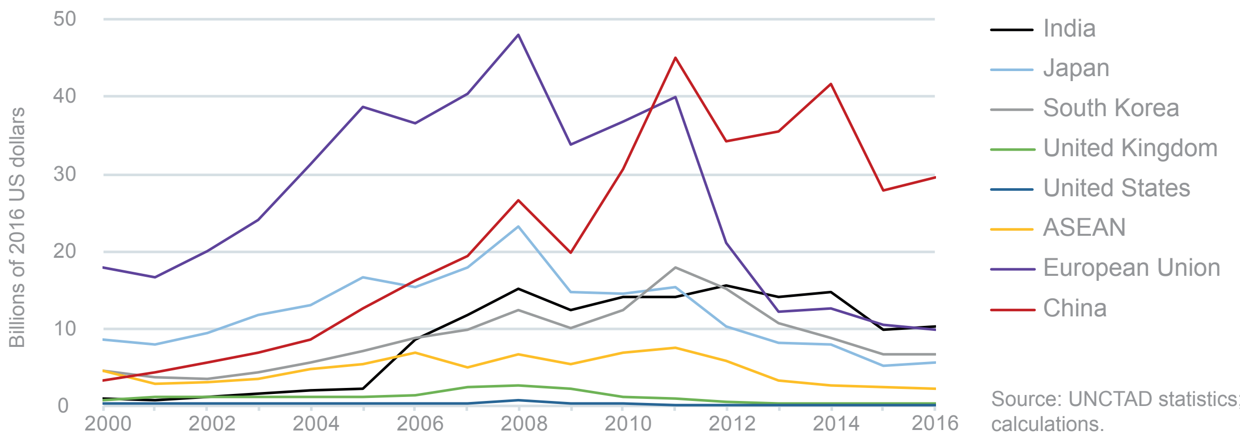
Iraq had longstanding and close relations with India prior to the fall of Saddam Hussein. Previously, Iraq was the largest international destination for Indian companies' private investment.[lxxiv] India also provided military training for Iraqi forces, and Iraq was India's largest supplier of crude oil.[lxxv] After dramatically slowing during the Iraq War, relations have slowly grown again in the post-war period, including in areas of technical economic cooperation, education ties and bilateral visits; furthermore, India is one of Iraq's largest trading partners (see Figure 17).[lxxvi]

Iran–Asia trade

Iran is included in this study because of its potential to increase trade relations with Asia if there is a renewed disintegration of its relations with the West, as well as the possibilities of increased international economic engagement if the JCPOA is successfully implemented. Furthermore, Iran is pursuing new bilateral trade agreements; for example, in 2018, Iran and Malaysia indicated intentions to sign a preferential trade agreement.[lxxvii]

- In 2016, Iran's largest trading partners were China ($30 billion), India ($10 billion) and the EU ($10 billion), including $6 billion of trade with the UK (see Figure 18).
- The US has imposed various economic sanctions on Iran since 1979. From 2006 to 2015, the UN Security Council imposed sanctions on Iran as a response to its uranium enrichment programme.
- Many Chinese goods and services filled the void in Iran during the period of US sanctions, when goods and services (for example, banking) from companies with US operations could no longer be imported to Iran.[lxxviii]
- The future of the JCPOA is now uncertain. The JCPOA is an agreement between the P5+1 (China, France, Russia, the US, the UK and Germany), the EU and Iran to ensure the Iranian nuclear programme is peaceful and, in return, to lift the sanctions. President Trump is to decide on the US position in May 2018; there remains considerable uncertainty as to his position, as well as that of US allies after his decision.
- Iran has a large middle class (as high as 50% of the population), making it an attractive export market.[lxxix]

Figure 18: Value of Iran bilateral trade, 2000–2016



Source: UNCTAD statistics; author's calculations.

Relations with China

China has maintained significant trade relations with Iran throughout the international sanctions; it was Iran's largest import and export partner in 2016,[lxxx] and is Iran's largest importer of crude oil.[lxxxi] China also imports Iranian iron ore, the trade of which Iran promoted to counter the effects of lost revenues from the fall in crude-oil exports.[lxxxii] China exports a range of goods to Iran, including machinery, electrical equipment and cars.[lxxxiii]

Iran also plays an important role in the China's BRI strategy; it maintains a railway line that connects China with the Arab Gulf States, known as the 'Silk Road train'.[lxxxiv] China is also in discussions with Iran to develop two rail projects: the Tehran–Qom–Isfahan High Speed Rail project, and Qom Monorail project.[lxxxv] China had also expressed interest in developing the Chabahar Port in south-eastern Iran, which will serve as a major trade hub for goods destined for Central Asia. However, negotiations were suspended after India – the project's initial sponsor – reaffirmed its commitment to help build the port after the international sanctions against Iran were waived (see next section, 'Relations with India').[lxxxvi]

In January 2016, China and Iran agreed to increase trade to $600 billion over the next 10 years; in January 2017, they drafted a $3 billion agreement for China to upgrade Iran's oil refining facilities.[lxxxvii] Iran and China have also cooperated on security issues. In 2012, Chinese warships conducted a joint military exercise with the Iranian Navy in the Gulf for the first time. Most recently, in 2017 the two countries signed a defence cooperation agreement, which covered counterterrorism efforts and exchange of personnel training.[lxxxviii]

Relations with India

India has been one of the main importers of Iranian crude oil. During the sanctions on Iran, it developed a workaround to pay for its crude oil: a barter-like scheme that involved paying rupees to a small state bank, which Indian companies could then receive as payments for goods exported to Iran.[lxxxix] Since the sanctions were lifted, Iran's crude oil exports to India have increased steadily, and Iran became India's third-largest supplier of crude in 2016.[xc] India has also taken a role in developing Iran's Chabahar Port – the country's only southern port, and India's primary gateway to transport good and products to Afghanistan and Central Asia, avoiding the land route through Pakistan. In May 2016, Prime Minister Modi visited Tehran, agreed that India would develop the port and said it would invest $500 million.[xci] India's investment in the port and interest in developing a proposed $1.6 billion rail link that would bypass Pakistan[xcii] are intended to counter influence from China, which is developing the Gwadar Port in Pakistan for the similar purpose of facilitating trade of its goods in Central Asia.

Relations with Japan

Iran has attained a vital position in Japan's trade network due to the centrality of its oil exports to the Japanese economy's industrial output. As Japan's third-largest source of oil, trade relations between the two countries are dominated by the exchange of petroleum products for Japanese manufactured products. In 2010, Japan sourced 10% of its crude oil imports from Iran, but this proportion shrank by more than 80% after Japan supported the US-led sanctions on Iran in 2012.[xciii] The agreement of the JCPOA in 2015 and consequent lifting of sanctions allowed the Iranian Government to promote its trade with Japan, as exemplified by a 31% jump in petroleum exports in late 2015. Moreover, a 2017 bilateral investment treaty, which secures investor protections, will allow Japanese capital to increasingly flow into midstream petrochemical industries in Iran.

Strategic opportunities

Real GDP growth rates throughout the Middle East continue to be high, indicating that the region as a whole will maintain its status as a prime destination for Asian capital investment and will achieve further financial integration and trade engagement (Figure 19). The long-term trend of this relationship will be reinforced by the increased diplomatic engagement and long-term strategic planning outlined throughout this report.

Figure 19: Real GDP growth rates at market prices

	2017 estimate	2018 forecast	2019 forecast	2020 forecast
Bahrain	2.4	2.0	1.6	1.7
Iran	3.6	4.0	4.3	4.3
Iraq	-0.8	4.7	1.7	1.9
Jordan	2.1	2.2	2.4	2.5
Kuwait	-1.0	1.0	3.5	3.5
Lebanon	2.0	2.2	2.0	2.0
Oman	0.7	2.3	2.5	2.5
Qatar	1.7	2.6	3.0	3.0
Saudi Arabia	0.3	1.2	2.1	2.2
UAE	1.4	3.1	3.3	3.3

Source: World Bank, *Global Economic Prospects*, January 2018, pg. 122

Macro trends

The Belt and Road Initiative

President Xi Jinping launched the BRI in 2013 as part of a more assertive trade and foreign policy. This web of ports, logistic centres, railway tracks and highways will comprise the largest infrastructure project in world history, spanning three continents. China's proposed project will improve the trade networks of 60 countries, with a combined population of over 4 billion and one-third of the world's GDP. The project seeks to alleviate the infrastructure gap between East, South and Central Asia – a gap that impedes continued high growth rates – as well as to balancing out excess capacity in China's steel, cement and construction industries.

Due to the huge scale of the project, there will be a number of opportunities for multinationals along and surrounding the six main economic corridors. While the infrastructure investments needed to realise BRI are likely to continue to be led by Chinese SOEs and local firms, there will be opportunities for multinationals to enter joint ventures and other strategic partnerships with regional governments or Chinese firms – particularly in areas such as clean energy and sustainable projects, in which China has already sought international expertise.[xciv] This creates an opening for Western professional services firms in consultancy, accounting, banking and insurance to implement good governance and transparency, enhancing the impact of BRI. The project will also open new consumer markets along the trade routes that run through the Gulf.

As BRI corridors connect with existing and new economic zones, opportunities will emerge to relocate manufacturing centres along the BRI and to rethink global supply chains – particularly as manufacturing wages become more expensive in China. Increased connectivity through rail and road links will decrease transit times to major markets in Europe and East Asia. There will be opportunities for logistics companies to participate in these new corridors; for example, DHL Global Forwarding already operates a freight line along the 'Belt' from Lianyungang (China) to Istanbul, with transit times of just 14 days.[xcv]

China's apolitical approach to trade and investment

Economic pragmatism and domestic need generally determine China's trade policy and SOE-driven outward trade and investment decisions. China generally lacks concern for political issues, such as democratic governance and human rights, in these decisions – unlike in democratic nations, where interest groups and political considerations can be influential in trade policy. This will allow China's trade to develop in the Middle East without political constraints, and will open trade routes from China to areas that may not be open to Western nations (see section on Iraq-Asia trade). Moreover, given China's political reality, the will and policy of President Xi Jingping will be carried through on a long-term basis, which ensures long-term continuity of the BRI.

GCC single market

The GCC is currently a common market with a customs union, agreed in 2003 and implemented in 2015. Today, the GCC as a whole is the world's ninth-largest economy; however, if remaining non-tariff barriers were removed and the GCC acted as a single market, it could become the world's sixth-largest economy. This is based on projections assuming the GCC economy would grow at 3.2% for 15 years – a realistic growth rate, considering each individual nation's growth projection and the increases that would come from further liberalisation. This would increase overall GCC GDP by 3.4% ($36 billion), 96% of which would result from removal of bureaucratic barriers to efficiency.[xcvi] The biggest increases in GDP would be seen in Saudi Arabia, UAE, Bahrain and Oman.

The impact on GDP would result from not only enhancing intra-GCC trade but also making foreign investment and international trade relations easier. A single market would create streamlined and aligned foreign investment regulations, and would increase investor confidence by enhancing transparency and predictability. In turn, this would increase revenue, create jobs and improve the private sector, facilitating the economic transformations already underway throughout the GCC.[xcvii]

There are, of course, barriers to a GCC single market, including political tensions and current policy direction. As of March 2018, the Qatar diplomatic crisis presents a large political barrier, although GCC nations have taken initials steps to resolve this situation. National governments would need to give up some elements of sovereignty, which they are generally reluctant to do. Most governments are also currently focusing on diversifying economies and dealing with the current economic situation created by low oil prices, rather than long-term economic integration.

Saudi 'Vision 2030'

The King and Crown Prince of Saudi Arabia initiated the Saudi Vision in 2016. It aims to reduce Saudi Arabia's dependence on oil, to diversify its economy and to develop public service sectors, such as health, education, infrastructure, recreation and tourism. The plan is based on three pillars: Saudi's position as a leader of the Arab and Islamic worlds; its investment power, which will drive economic diversification and sustainability; and its strategic location, which will enable it to drive and take advantage of international trade.

To develop public service sectors and diversify the economy, Saudi Arabia will seek international expertise. It will also seek FDI, which is key to diversifying the economy and providing jobs for younger generations. Saudi's desire to exploit its strategic location at the centre of Asia, Europe and Africa will result in increased investment in trade infrastructure, as well as harmonisation of regulatory regimes.

UAE Vision 2021

Launched in 2010, UAE Vision 2021 outlines six national priorities for the UAE to maintain economic competitiveness and improve public services in response to a changing economic landscape. These priorities include building a competitive knowledge economy, a first-rate education system, a world-class healthcare system and a sustainable environment and infrastructure.[xcviii] Similarly to Saudi Arabia, UAE seeks international expertise and FDI to achieve these goals. Aside from this, the plan is likely to enhance the UAE's role as a re-export hub, which will facilitate its increase in trade with the rest of Asia, as well as creating further opportunities in trade infrastructure development and trade financing.[xcix]

Iraqi post-war reconstruction

While reconstruction efforts have been ongoing in Iraq, they have surged since Islamic State was ousted from most of its territory at the beginning of 2018. This has led to a variety of sources pledging huge amounts of capital investment, including $5 billion from Turkey, $3 billion from Iran, $2 billion from Kuwait, $500 million from the Islamic Development Bank and $510 million from the World Bank.[c] In total, $30 billion was raised in February 2018 – but this falls short of the $88.2 billion Baghdad is aiming for, and the Government must now seek the remaining $58.2 million from other sources. The area for reconstruction is approximately one-third of the country and includes economic reconstruction as well as infrastructure projects.

US policy uncertainty (opportunity and risk)

The current US administration has projected uncertainty over policy related to trade, economics and security. In particular, US regulations that reverse some aspects of free trade leave other nations to take leadership on policy issues throughout Asia and the Middle East. Trump's 'America First' policy – through which the US will be generally less involved in security and economic cooperation in both the Middle East and Asia – reinforces this. For example, US withdrawal from the Trans-Pacific Partnership (TPP) in January 2017 allowed Japan to take on leadership for promoting free-trade policy throughout Asia. Japan became the main driver of the TPP's reincarnation – the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) – and is now looking to pursue the Regional Comprehensive Economic Partnership (RCEP).[ci] This trend will allow regional trade between the Middle East and the rest of Asia to continue growing, with less influence from their traditional trading partner, as they look to grow new markets. The US policy change nevertheless has inherent risks, such as damaging world trade growth and creating uncertainty, which curbs business investment.

Growth sectors

Insurance

In 2016, the combined value of the GCC's insurance market stood at $26.2 billion. The sector is set to achieve significant growth in the subsequent five-year period, with Alpen Capital projecting 67.9% market growth until 2021. The continued strength of the insurance services industry rests on the introduction of compulsory health insurance, new regulatory regimes and risk-based pricing in Saudi Arabia and the UAE. With just under 40% of the GCC's insurance market, these two countries are leading the way in insurance-based growth. This is reflected in the plans of other GCC states, such as Oman, to introduce compulsory healthcare, as well as in an influx of expatriates to the region, driving a major demand spur. Moreover, new rules on risk-based capital reporting and actuarial-led pricing are likely to boost the strength of the region's financial services sector in general. Due to the GCC's focus on certain types of insurance (90.4% of the insurance market is projected to be dominated by motor, health and property insurance by 2021), it is set to witness significant growth in professional services in general as domestic populations increase and large-scale construction projects near completion within the next five years.[cii]

Plastics

In 2016, 27.1 million tons of plastic polymers were produced in the GCC – a 5% increase on the previous year. This steady rate of growth is consistent with the Gulf Petrochemicals and Chemicals Association's (GPCA) projections for expansion in the plastics sector, with a predicted export size of 34.5 million tons by 2022. This, in turn, will allow the region to meet rising global demand and secure its share of global plastic production, which in 2016 stood at roughly 5%. Prospects for growth are focused on the demand for synthetic rubbers, with a boom in automotive production as well as the transport and logistics sectors. In the coming five-year period, 70% of all supply growth is likely to come from commodities polymers, in which the GCC is increasingly gaining a foothold. Furthermore, the regional boost in the construction sector is likely to boost local demand for plastics, along with consumer packaging, which already account for 20% and 44% respectively of regional consumption. The construction and development of large industrial parks dedicated to polymer production in Saudi Arabia, the UAE and Oman further underline the potential for large sectorial growth in the coming years.[ciii]

Tourism

In 2017, a report at the Arabian Travel Market coined the term 'mega source markets', referring to the projected emergence of a large GCC tourism market based on major influxes of tourist groups from the PRC and India. While the region witnessed the arrival of 400,000 Chinese tourists in 2014, this figure is set to increase by 125% until 2020. The great economic potential of this growth market is, in turn, boosted by contemporary debates concerning visa facilitation schemes for GCC countries, as well as by a sectorial shift towards meeting the hospitality expectations of Chinese and Indian visitors (for example, adopting a Chinese social media presence). In particular, the UAE is emerging as a major magnet for incoming tourists, as reflected in Colliers International's tourism compatibility metric for GCC cities. Out of a maximum of 40, Dubai scores 33 and 38 for compatibility with Chinese and Indian visitors respectively, Abu Dhabi achieves scores of 29 and 33, and Riyadh scores 10 and 13. Investment in leisure tourism – traditionally underdeveloped for non-GCC markets – consequently suggests a larger pivot to accommodating a new Chinese and Indian tourism surge in the near future.[civ]

Renewable energy

As mentioned above, the GCC's collective economy is heavily based on the export of energy resources, with a notable focus on oil and gas reserves. With increased global competition in these areas, and the uncertain future of worldwide fossil fuel consumption and pricing, many leaders in the region are turning towards alternative, more sustainable forms of energy. As regional demographics and industrial output continue to grow (thus fuelling demand for domestic energy consumption), a growing need is developing to recalibrate the domestic energy market towards renewables. This, in turn, will allow for a more sustainable energy market back home while freeing up fossil fuel resources for export markets. Moreover, cost studies for the GCC have shown that investment in renewables represents a major cost-saving alternative to current strategies of expanding natural gas extraction in the face of a drop in global oil prices. These economic incentives, as well as a global reduction in the costs of renewables technology, will be major drivers of a regional renewable energy market in the coming decade.[cv]

Risks

Vulnerability to global volatility and oil prices

Trade flows between the GCC and Asia – as well as trade-intensive economies, such as those of the UAE, Singapore and, to a lesser extent, China – will be especially vulnerable to global economic shocks and recessions. Global trade and output have been steadily recovering the last few years; however, there are rising protectionist attitudes in the US and financial vulnerabilities throughout Asia. Although it is unlikely that tariffs will be imposed on energy products, the value and demand of these products is likely to drop following any widespread economic downturn – especially considering the currently oversupplied status of the energy markets. Furthermore, any downturn would affect the region's re-export hubs of Dubai, Jeddah and Singapore, as fewer goods flow through both Asia and the Middle East.

This would lead to slower economic growth, job losses, lower public revenue and – indirectly – financial instability. Slower economic growth impacts the debt service capacity of corporate borrowers and leads to lower equity prices.[cvi] There would also be a decrease in the Gulf's spending power, putting large investment projects on hold. Lower revenue could force Gulf countries to further curb expensive social subsidies, potentially triggering social unrest.

Without economic diversification, a prolonged decline or further collapse in already low oil prices would also lead to these outcomes, as both public and private revenues would drop throughout the region. The continued expansion of the US and Russian petroleum industries, and the consequent drop in global oil prices, also presents risks to the main drivers of GCC trade. The continued reliance on petroleum exports in exchange for

Asian primary and secondary goods, as well as investment capital, will be a serious disadvantage for the region if growth in this sector is weaker than expected.

Obstacles to trade an investment

While economic reforms are taking place across the Middle East, major operational and structural obstacles to achieving high growth rates and increased investment remain. Non-tariff barriers to trade include lack of regulatory harmonisation, lengthy border checks, costly border controls and several bureaucratic layers, which could block licenses or slow down trade in other ways. These factors raise the cost of goods, increase the cost of doing business and reduce the attractiveness of the region to global supply chains.[cvii] The lack of a stable, transparent and predictable regulatory environment caused foreign investment flows into the GCC to halve between 2010 and 2016. Current regulations force companies to execute multiple strategies for investing in each different GCC nation.[cviii]

Structural barriers to high growth rates include high youth unemployment, women's low labour-force participation and the slow-paced liberalisation of investment regulations.[cix] All GCC nations are experiencing a 'youth bulge': a demographic phenomenon in which up to two-thirds of the population is under 30 years old. This can present an opportunity or a critical challenge to economic development. South Korea, for example, used the bulge to create a demographic dividend by harnessing the youth to power economic transition and expansion.[cx] For Gulf nations, however, the lack of available employment, tighter regulations on small-business owning and more restrictive social mobility has led to high youth unemployment. Moreover, while women constitute half the GCC population, they represent only approximately one-quarter of the workforce. High unemployment and low labour-force participation will limit potential growth, drag on public resources and limit overall productivity levels.[cxi]

Civil war and insurgencies

Aside from affecting political stability, civil wars, violent insurgencies and terrorist attacks impact trade routes and trade infrastructure. They can also disrupt other industries, such as financial services and retail, by damaging infrastructure and tourism via rendering the destination too dangerous. In particular, the conflicts occurring in Syria and Yemen have the potential for regional spillovers, which can bring both uncertainty and risk to the investment climate and impede the proper functioning of national economies. Secondary effects from a lack of foreign investment include slower economic advancement, which in turn leads to less FDI and a cycle of stagnation. A further indirect effect is the policy attention that conflicts demand; governments may focus on immediate security need rather than improving long-term economic diversification and integration.

The Gulf countries are focusing on these security needs through new security cooperation with Asian trading partners (see sections on Saudi–India and UAE–India relations). Despite shrinking revenues from hydrocarbon exports, the Gulf countries have made record arms purchases from Western arms companies and nations in recent years; for example, Saudi Arabia signed a massive $350 billion deal Saudi Arabia signed with the Trump administration in May 2017,[cxii] and the UK has sold over $3.5 billion worth of arms to GCC countries since 2015.[cxiii]

Geopolitical tensions

Simmering rivalries within the Gulf and across the Middle East could significantly reduce trade or create economic recessions that spread across the region. The aforementioned Yemeni Civil War is a proxy war, fought between political and religious rivals Iran and Saudi Arabia. Meanwhile, Saudi Arabia has led a boycott against Qatar since June 2017, based on claims it sponsors terrorist groups (such as the Muslim Brotherhood and al-Qaeda) and on its building of closer relations with Iran. The boycott includes a cut-off of diplomatic ties and imposition of trade and travel bans. The economic blockade has had a major impact on Qatari trade, with imports falling 40% as of June 2017.[cxiv] Gulf states are currently in discussion to break the deadlock, with suggestions they could work out a deal to remove the travel ban as a first step.[cxv] It is unclear when the situation will be resolved, but it is clear that, in general, the elevation of risk and military interventions in vital land or maritime trade corridors will slow down investment and economic development in the region.

These potential trade frictions may be overstated, however, because of the Gulf's centrality to the trade networks and growth ambitions of Asian markets. Despite the Middle East's domestic and international political conflicts, large-scale projects – such as the BRI, which is driven by Chinese excess capacity and the vital Asian infrastructure gap – will provide a counterweight to political risk considerations in years to come.

Appendix

Bilateral trade growth rates, 2000–2016 CAGR

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE	GCC	Iraq	World
China	4.2%	16.9%	5.7%	15.7%	15.8%	14.9%	13.5%	12.2%	8.9%
India	0.2%	10.7%	14.2%	22.8%	14.0%	15.7%	14.7%	20.0%	10.2%
Japan	0.2%	-0.7%	-1.4%	4.4%	1.0%	0.8%	1.2%	0.9%	0.4%
South Korea	-3.5%	5.5%	0.3%	8.8%	2.8%	2.8%	3.8%	11.3%	4.4%
ASEAN	-1.5%	2.9%	-1.2%	8.4%	5.3%	8.1%	6.0%	-1.4%	4.5%
Indonesia	-4.2%	-4.7%	7.4%	21.0%	3.7%	8.7%	4.7%	11.7%	4.6%
Malaysia	-0.4%	7.4%	-3.0%	12.9%	6.8%	9.5%	7.4%	4.2%	2.4%
Philippines	-5.8%	20.4%	-15.8%	4.4%	-0.6%	-2.1%	0.8%	17.6%	2.1%
Singapore	-3.4%	1.7%	2.5%	5.7%	2.6%	8.1%	4.7%	22.0%	3.2%
Vietnam	7.7%	8.7%	26.5%	38.8%	33.3%	33.8%	25.0%	-13.6%	14.4%
UK	-1.9%	2.3%	-1.8%	15.0%	1.6%	5.0%	3.9%	2.6%	3.1%
US	-0.7%	2.5%	6.1%	8.5%	2.2%	11.0%	4.4%	-0.8%	4.1%
EU	-0.9%	3.1%	4.6%	13.8%	3.6%	7.6%	5.5%	-0.4%	5.3%
OECD	3.7%	2.0%	3.9%	7.7%	2.2%	6.5%	4.1%	4.0%	2.6%
World	2.0%	5.0%	4.8%	9.8%	4.8%	9.5%	6.9%	4.4%	-

Note: Indonesia growth figures for 2003–2016 period. Trade growth figures reflect commodity prices. The slump in oil, gas and other commodity prices has reduced dollar trade volumes significantly in recent years, even as flows of goods continue to grow.

Source: UNCTAD statistics; author's calculations.

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