

The Gulf in the new world order: a forgotten emerging power?



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This working paper concludes FRIDE's contribution to the Al-Jisr research project, and draws from research undertaken by a team comprising Edward Burke, Ana Echagüe, Richard Youngs (all of FRIDE), John Sasuya and Natalia Alshakhanbeh (both of the Gulf Research Centre).



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Talk abounds of 'emerging powers' taking a greater share of global economic and political power. The international system is being recast, and attention focuses on the more assertive roles being assumed by China, India, Brazil, and South Africa, as well as the likes of Malaysia, South Korea, Mexico, and Russia. It is striking that relatively little attention is paid within such debates to Middle Eastern states. It is important to ask whether indicators in the states of the Gulf Cooperation Council (GCC) may or may not merit this region also being included in discussions of new emerging powers.

As part of the Al Jisr research project looking at a wide range of issues related to the Gulf, in FRIDE we have overseen a branch of work looking at the Gulf's changing international relations. As this projects draws to its close, this final synthesis paper offers an overview of our findings.¹ In extracting the main conclusions from our research, we ask how justified it is to conceive of Gulf states as rising in influence and global projection. In dissecting the different dimensions of the Gulf's changing international relations, we also explore the policy implications for external powers.

Economic rise

Since 1998, the GCC's real GDP has expanded by an annual average of 5.2 per cent and by a cumulative 65 per cent. The population has risen from 28 million in 1998 to 39 million in 2008. The GCC is no longer merely conceived of as a hydrocarbon exporter, but also as investment destination with major infrastructure projects and financial services sectors. GCC investors have also begun to diversify and show growing interest in Asia and Africa.² The GCC is set to diversify its

¹ Al Jisr is a major public diplomacy and research project funded by the European Commission. The project is led by the Gulf Research Centre; FRIDE is one of several partners. We have been responsible for delivering research on one strand of the project, focusing on 'The Gulf in the new global economic context'. This paper provides a synthesis of research carried out under this strand; this working paper extracts the main conclusions from all the strand's publications, which are available on the Al Jisr website, www.aljisr.ae

² Economist Intelligence Unit, 'The GCC in 2020: outlook for the Gulf and the global economy', London: Economist Intelligence Unit, March 2009.

foreign alliances and economic relationships towards emerging markets and powers.

All GCC member countries enjoy high GDP per capita ratios compared to other countries in the region. High growth in their economies is mainly due to a boom in oil and natural gas revenues, coupled with a building and investment boom in recent decades. GCC states have weathered the financial crisis well thanks to reserves from high oil prices during the mid-2000s. The GCC's share of the world economy is set to grow as it expands with an annual average growth rate of 4.5 per cent, compared with the 3.3 per cent aggregate global growth rate. The GCC is set to grow in importance as an economic and trading hub. Emerging markets will become increasingly important trading partners and investment destinations.³

The financial crisis has raised the Gulf's growing international profile. Gulf support has been sought for the re-injection of short-term liquidity into European economies. Indeed, as the GCC's weight in international finance and economics has increased, European policies have failed to keep pace with the magnitude of the changes afoot in the region. GCC investment in the EU has now begun to decline. In contrast, the GCC's geographic location and increasing trade links with Asia and Africa will allow it to benefit from expected growth in the developing world.

Some evidence exists that GCC economies are beginning to diversify and move beyond pure rentierism. Small islands of technological efficiency are starting to appear across the region. Since 2003, non-hydrocarbon exports have more than doubled. The percentage of non-oil sectors in national GDPs has increased markedly. Export revenues increased from 200 billion dollars in 2000 to 950 billion in 2008. Public employment as a share of total employment is decreasing. There is talk across the region of a putative shift in basic economic structure, from allocation to production states. Some say that regimes are responding well politically too, to the extent that they

³ Ibid.

are distributing rents to a wider proportion of the population. Optimists insist that these regimes have learnt the right lessons from the squandered 1970s boom.

The shortcomings of education in the MENA have long held the region back as a centre of innovation and affected its governance standards. But recent investment by the GCC states in educational reform is an acknowledgement of the need swiftly to address this deficit. Such investment is desperately needed – not one MENA university features among the Times Index of the top 200 universities in the world. Encouraging signs have been the establishment of the Abu Dhabi Centre for Executive Education and Research, which opened in 2007 and aims to develop educational strategies for the MENA region. In that same year, the Sheikh Mohammed bin Rashid al-Maktoum Foundation donated 10 billion dollars towards supporting the education of young Arabs in the region. In surprisingly frank remarks, Sheikh Mohammed acknowledged the scale of the problem facing the region, citing the ‘wide knowledge gap between us and the developed world in the West and in Asia’. Access to GCC universities with a focus on technical innovation and excellence is critical to the development of the wider MENA region. A root and branch reform of the region’s secondary level education, including the provision of funds for teacher training, is also urgently required, something on which the GCC has yet to show leadership.

Changing trade patterns

GCC countries have long had open economies, and international trade has always been, and continues to be a very important component of their GDP. Among GCC member states, the United Arab Emirates (UAE) has the highest trade to GDP ratio (159), followed by Bahrain, Oman, Qatar, Saudi Arabia and then Kuwait. Trade liberalisation has led to an increased GCC share in world exports and imports of goods and services. The degree of openness of the national economies of GCC countries (measured as the share of GCC states’ merchandise exports and imports to the total world exports and imports) has risen over recent years. Intra-regional trade in the MENA grew 700 per cent in 2000–8 and a Greater Arab free trade area (FTA) entered into force in 2005. A plethora of new agreements has been signed between Arab states and Turkey on trade and investment.

Despite a deadlock in FTA talks, trade between the EU and GCC has grown and has risen steadily to well over double 2000 levels. The EU runs a significant trade surplus with the GCC. The GCC is commercially more dependent on the EU than vice versa. The EU is the GCC’s major source of imports, with one third of the GCC’s imports coming from the European Union. Around 12 per cent of the GCC’s exports are destined for the EU, making the latter its second biggest export market after Japan. In turn, the GCC is the EU’s fifth largest export market and its seventh largest source of imports. Despite the absence of a free trade agreement, prior to the crisis European investors had been taking more of an interest in the Gulf. However, still less than 3 per cent of EU foreign direct investment (FDI) goes to MENA states. Little noticed, in 2006 the EU was displaced by the GCC as the largest source of new FDI in North Africa – although Gulf investments are for now still going to a small number of very large infrastructure projects.

Trade talks between the EU–GCC have failed to keep pace with changes to the global economy. Negotiations for a free trade area began in 1989. After years of stagnation, GCC states pulled the plug on talks in December 2008. They complained about the EU’s human rights clause, but also the lack of generosity in European trade positions. The EU has constantly argued that a key part of its overarching policy is to help further integrate the GCC states into global markets. In practice, it has contributed little to assisting such a process.

For years, European governments have blocked duty-free access for petrochemicals from the Gulf.⁴ The EU has finally moved on petrochemicals, but GCC states still complain about the trade provisions now on offer. European policy-makers place the blame for the failure to conclude an FTA on GCC states. In addition to the human rights clause, a second block on the FTA is that Gulf states refuse to commit to removing all duties on exports to European markets. The EU has long sought to reduce Gulf states’ differential pricing of gas exports; barriers to European companies’ access to the GCC services sector; and the lack of transparency in GCC government procurement regulations. Despite Saudi Arabia’s accession to the World Trade Organisation (WTO) in December 2005, obstacles remain on investment, procurement and services. This has been a growing source of complaint from the Commission. The EU insists that concessions be reciprocal despite the fact that – aside from oil – there are only a small number of GCC products that could be exported in significant quantities to the EU, compared to the thousands of European products that the FTA agreement will make more competitive in GCC markets.⁵ Gulf states argue that the EU’s offer in overall terms is not far-reaching enough to merit their fully discarding export duties.

The EU refuses to accept any conditions that do not match those offered to the US. Of considerable

importance to the Gulf, the EU has also refused to reciprocate the GCC’s liberalisation of visa requirements. Another key factor is that the EU’s insistence on negotiating trade liberalisation on a region-to-region basis has militated against advances in free trade and economic cooperation. This is in contrast to the US’s success in concluding free trade agreements with Bahrain and Oman.

As Europe prevaricates, interest and competition has intensified from other countries. Asia has become the most important destination for exports from Saudi Arabia, Kuwait and the UAE. China’s market share in the Gulf states increased from 3.6 per cent in 1994 to 8.3 per cent in 2004. A first Asia-Middle East Dialogue was held in Singapore in 2005, with a second intergovernmental conference held in Cairo at the end of 2007. China’s mercantilist trade diplomacy has been far more proactive and tightly coordinated in targeting the Gulf than has EU trade policy. The GCC is India’s second largest trading partner and is expected to overtake the US as largest trading partner. India’s market share in the GCC has almost doubled in the past ten years.

In June 2009, ministers from Southeast Asian and Gulf countries, as well as the Secretary Generals of the Association of Southeast Asian Nations (ASEAN) and the GCC inaugurated the first trans-regional ministerial meetings, which could herald a new level of interaction between these two regions. Relations between countries in Asia and the Gulf region have been driven by the Asian demand for oil and the Gulf countries’ demand for cheap labour from Asia. For many decades, heavy dependency on hydrocarbon products dominated the pragmatic trade relations between East Asia and the Gulf region. In 2007, East Asia imported about half of its oil requirements from the Gulf. With an expanding economy, East Asia’s demand for petroleum products is increasing continuously. While Japan continues to be the biggest importer of petroleum from the region, purchasing about sixty per cent of its total requirements from the Gulf, growing demand in the region has further intensified its reliance on the Gulf’s petroleum

⁴ A. Babood, ‘EU-GCC relations: a study in inter-regional cooperation’, Dubai: Gulf Research Centre, 2006, p. 162.

⁵ A. Aziz Abu Hamad Aluwaisheg, ‘The EU-GCC free trade area negotiations: the home stretch or first base?’, *GCC-EU Research Bulletin 2*, Dubai: Gulf Research Centre, 2005.

industry. The average dependence of East Asian countries on Gulf oil is almost 50 per cent. For some countries – such as Japan, Philippines, South Korea, and Thailand – imports from the Gulf region exceed imports from the rest of the world. From the point of view of the East Asian economies, it is important to maintain a strategic alliance with the Gulf countries to ensure a constant supply of oil. Historically, the oil trade had been a foreign policy objective for many East Asian economies. The competition for energy sources, which are primarily supplied by Gulf states, is a clear policy objective for East Asian countries.

In recent years, governments of East Asia and the Gulf have broadened and diversified their economic networks by signing several FTAs. Trade between East Asia and the GCC increased by 20 per cent, from 19.1 billion dollars in 1996 to 22.9 billion in 2007. While in the past more than half of this trade was based on hydrocarbon products, a new structure of trade relations between East Asia and the Gulf economies is emerging with the conclusion of FTAs between them. The GCC has also started to negotiate FTAs with Japan and South Korea.

The first FTA to be signed involving East Asia and the Gulf region was the GCC–Singapore agreement in 2008. The agreement was the first for the GCC as a bloc, which signalled the GCC's desire for further trade liberalisation in the midst of deadlock of its negotiations with the European Union. The GCC was Singapore's sixth largest trading partner, with bilateral trade reaching a record high of 28 billion dollars in 2007. The GCC is currently in the process of negotiating FTAs with Australia, New Zealand, China, Japan, India, Pakistan, Turkey, and the Southern Common Market (MERCOSUR). GCC countries are dealing with these negotiations as a trade bloc. The GCC signed an FTA with Syria in 2005 and recently concluded its negotiations with the European Free Trade Association (EFTA).

The Gulf states have also started to invest in other East Asian countries. Several investment agreements have been signed with Indonesia, including Ras Al-

Khaimah Investment Authority projects to construct an integrated port at Tanjung Api-Api and a railway line from Palembang to Tanjung Api-Api worth 1.3 billion dollars. Qatar Telecom became the majority owner of Indosat in 2008 with the increase of its share from 29 to 65 per cent, with an investment worth 1.8 billion dollars. The Saudi Binladin Group has started financing its agricultural projects in the Indonesian island of Papua. The project has an estimated price tag of 4.3 billion dollars and would ensure a reliable supply of rice and other agricultural products for the Saudi market. Qatar Telecom also entered the Philippine telecommunication market with the acquisition of 33 per cent of Liberty Telecoms. It also entered a joint venture project with the San Miguel Corporation to access the broadband and mobile telecommunication sector in the Philippines. The Malaysian government and Saudi Arabia's Petro Saudi International set up a 2.5 billion dollar investment fund in Malaysia in 2009 to finance renewable energy and real estate projects. Additionally, Saudi Telecom bought a 3 billion dollar stake in Maxis, a telecommunication provider. In 2007, a consortium of Gulf companies led by Mubadala Development Co, Aldar Properties, Kuwait Finance House and Dubai-based Saraya Holdings agreed to develop the Iskandar zone in southern Malaysia to rival Singapore's industrial zone. The investment in RHB Capital of Abu Dhabi Commercial Bank was the biggest foreign investment in the financial sector.

It is not only through trade and investments that these two regions are cooperating. Japan and South Korea are also contracting large-scale infrastructure projects in the GCC. In 2009, a Korea Electric Power Corp-led consortium won a landmark contract to build four nuclear reactors in the United Arab Emirates. The project, which is valued at around 20 billion dollars, also involved Korea's Samsung and Hyundai. Korean companies are also active in constructing high-rise buildings in the UAE. In Saudi Arabia, KEPCO also won a contract from the Saudi Electric Company (SEC) to build, own and operate a power plant for a period of 20 years until 2033. Another South Korean infrastructure conglomerate, Doosan Heavy Industries and Construction, was

awarded contracts to build a 1,330-megawatt power plant near the eastern city of Damman. The project is expected to be operational by 2013. Samsung Engineering was contracted to build two refinery plants of the Jubail Export Refinery Complex project under the consortium of Saudi Aramco and Total of France, which amounted to 1.6 billion dollars. In Qatar, Hyundai Engineering and Construction, together with Italy's Saipem, were awarded the contract to build a fertiliser plant worth 610 million dollars by the Qatar Fertiliser Company. Meanwhile, Japanese companies are active in building urban railway projects in Dubai. In July 2005, the government awarded the 3.4 billion dollar contract to a Mitsubishi-led consortium to build the Dubai Metro lines. The consortium also involved Obayashi and Kajima of Japan, and Yapi Merkezi of Turkey. Marubeni, Hitachi, Obayashi were contracted by Dubai's Nahkeel to build the passenger monorail system, which will connect the city's mainland and the reclaimed Palm Jumeira island.

The GCC countries' membership in the WTO and their participation in other trade arrangements offered GCC merchandise exports further market access. Based on their date of accession, GCC countries are divided into two groups: original members in the WTO (i.e. members since the establishment of the Organisation) and recently acceded members (RAMs). The first group includes four GCC states, namely Bahrain and Kuwait, which became members as of 1 January 1995, followed by Qatar and the United Arab Emirates that became members as of 13 January 1996 and 10 April 1996, respectively. GCC recently acceded members are Oman, which joined on 9 November 2000, and Saudi Arabia that concluded its negotiations and joined on 11 December 2005. One vital result of this distinction is that newly acceded members to the WTO had to go through difficult processes of negotiations and to reform their policies in order to comply with the multilateral trading system's principles, a process that lasted several years and resulted in obvious reforms and change. The results of these negotiations were included in the protocols of accession. Original members in the WTO did not go through such

negotiations and do not have protocols for their accession where all the commitments are stated, although all members have schedules of concessions.

Sovereign Wealth Funds

Gulf Sovereign Wealth Funds (SWFs) have accumulated considerable assets as a result of the recent oil boom, even allowing for the losses of the last two years.

Despite the EU agreeing on a voluntary code of conduct on Sovereign Wealth Funds in February 2008, EU member states have operated very different screening processes for such investment, some of a highly restrictive nature.⁶ Silvio Berlusconi caused consternation in the Gulf when he threatened to limit Saudi funds to a mere 4 per cent ownership of any single Italian entity. Gulf SWFs accounted for a third of the emergency financing made available by European governments in response to the crisis in the autumn of 2008. But after this injection, GCC states expressed anger at new restrictions being put in place and began to withdraw from European markets in favour of investing in recession-hit local economies in the Gulf. The protectionist attitude of some countries towards SWFs is likely to moderate as capital becomes scarcer from other sources. The Abu Dhabi Investment Authority took a 6 billion dollar stake in Barclays Bank.⁷ SWFs are also likely to diversify their assets into Asia and Africa.

China is a recipient of significant foreign direct investment from the Gulf region, particularly in the form of Sovereign Wealth Funds. For instance, the Kuwait Investment Authority has a 15 per cent investment in the Kuwait China Investment Company,

⁶ N. Biberovic, 'A common European approach to SWFs – continuity of the status quo?', *GCC-EU Research Bulletin* 10, Dubai: Gulf Research Centre, pp. 4-7.

⁷ *The Economist*, 8 November 2008, p. 45.

(agreed during the Kuwaiti Emir's state visit to China in 2005), and a 19.1 billion dollar stake in the Initial Public Offer conducted by the Industrial and Commercial Bank of China (ICBC). In addition, Dubai's Istithmar is constructing office space in Shanghai and paid 50 million dollars for a stake in Hans Energy, an oil and gas logistic company. In the petrochemical sector, a joint venture company between SABIC and China Petroleum built a 1.7 billion dollar plant in Tianjin with a capacity of one million metric ton ethylene derivatives annually.

Middle Eastern SWFs have emerged as the most prominent international backers of Agricultural Bank of China's planned 23 billion dollar-plus initial public offering (IPO). The Sovereign Wealth Funds of Qatar and Kuwait have agreed to invest 2.8 billion dollars and 800 million, respectively, as cornerstone investors in what is expected to be the world's biggest IPO.⁸

Qatari Diar Real Estate Investment Company, which is one of the investment arms for the Qatar Investment Authority (QIA), has also made major investments in Egypt, Lebanon, Morocco, Oman, Sudan, Syria, and Yemen. Diar has also been exploring opportunities in the fields of health, education and industries in Palestine, contributing 245 million dollars to a construction project in the West Bank, which has alternatively been labelled as 'investment' or 'aid', effectively blurring the distinction between the two. The QIA appears to be the most overtly political of the Gulf SWFs in that it also invested 500 million dollars in a development in Yemen, in a way that appeared to be linked to its mediation between the government and the Zaydi Shia rebels in the north of the country. Similar Qatari investments followed the Doha Accords, which paved the way for elections to be held in Lebanon in 2009. This trend of 'investment as aid' has been mirrored by Saudi Arabia, which has pledged up to 1 billion dollars to Palestine following the Israeli invasion of Gaza in December 2008, some of which was channelled through Saudi companies.

⁸ 'Mideast funds back China's AgBank', *Financial Times*, 22 June 2010.

Energy power

The economic crisis will lead to a decrease in energy demand at a time when there is also an increased focus on the environment and sustainability. Still, as resources dwindle elsewhere the region will be one of the last repositories of sizeable hydrocarbon reserves. The world's dependence on GCC oil and gas is set to rise. The Middle East's share of world oil production is predicted to increase from 30 per cent in 2001 to 49.2 per cent in 2030; its share of gas production from 9 to 23.9 per cent over the same period.⁹ The Middle East has the bulk of the world's proven oil reserves and low production costs. Much will come from the GCC, as Iraq and Iran have long-term output potential but are currently hampered by political factors. Large state-owned energy companies with access to state financing, like those in the GCC, are well placed to invest in new crude capacity and refineries. The scope for non-OPEC supply growth appears to be limited.

The rise of China and its influence is generating competition for energy resources. The increasing oil demand in China and other ASEAN emerging economies is creating tighter supply. Chinese demand will continue to rise during the next decades and by 2030, the International Energy Agency has forecast that Chinese demand will have increased to about 25 per cent of the total world consumption. About a quarter of all import requirements is being supplied by the GCC states. Chinese strategies in the Gulf region are closely linked to the strategies of the three biggest state-owned energy corporations in China, namely the China National Petroleum Corporation (CNPC), the China National Petrochemical Corporation (SINOPEC), and the China National Offshore Oil Corporation (CNOOC). Rising demand has led Chinese authorities to encourage their energy companies to invest in the Gulf. During the 1999 Saudi visit of then President Jiang Zemin, several cooperative agreements

⁹ For figures see Commission of the European Communities, 'European energy and transport trends to 2030' – Update 2007, Brussels: European Commission, 2007, p. 27.

on oil were signed, including the opening of several exploration and production sites to Chinese companies and the opening of the Chinese market to Saudi Aramco. Chinese companies were given access to explore and produce natural gas in the Rub al-Khali Basin. SINOPEC is also investing with Saudi Aramco to develop the Ghawar gas field, in exchange for the 25 per cent stake in SINOPEC-Exxon Mobil oil refinery in Fujian province. This type of oil diplomacy was further accentuated during the visit of King Abdullah to China in 2006, wherein agreements on oil, natural gas and minerals were signed. As a result of these agreements, Chinese mineral fuels and oil imports from Saudi Arabia increased more than threefold from 3.7 billion dollars in 2003 to 13.6 billion in 2007. China also has investments in Oman, where SINOPEC was able to buy rights to explore and produce oil in the south of the sultanate.

Then Foreign Minister Taro Aso characterised the Gulf region's importance to Japan by emphasising that 'in 2006 Japan was dependent on the Middle East for 89.2 per cent of its imported crude oil, with the Gulf Cooperation Council states, or GCC states, providing 76.4 per cent of our total imported crude oil', stating also that 'as an oil consumer, clearly Japan must maintain a tangible presence in the Middle East.' In 2006, when then Prime Minister Shinz Abe visited Saudi Arabia, he offered King Abdullah a stockpiling facility in Okinawa to be utilised as a base for Saudi Arabian oil exports to other Asian countries. Additionally, there is substantial Japanese investment in the oil and petrochemical sectors of Gulf economies. Japanese companies have been investing in the region since the early 1960s. Japanese-owned Arabian Oil Company (AOC) operated the Khafji and Hout oil fields located in the Partitioned Zone between Saudi Arabia and Kuwait from the 1960s until the concession ended in 2000. When the concession on these oil fields expired, Japan was able to maintain its interest with a purchase agreement with Kuwait, so that AOC could buy 100,000 barrels per day for 20 years from the Kuwait Gulf Oil Company (KGOC), which overtook the oil fields' concession. Another Japanese oil company that is active in the region is

Inpex, and its subsidiary, Japan Oil Development Corporation, which made substantive investments in the United Arab Emirates offshore oil fields. Additionally, Sumitomo Chemical Co and Saudi Aramco have formed a joint venture to build the Petro Rabigh Petrochemical Complex worth 12.5 billion dollars.

South Korean firms are also active in contracting to develop some of the major oil fields in the region. Korean involvement in the Gulf includes Samsung's contract with SABIC to construct a polypropylene plant in Al-Jubail; Hyundai Heavy Industries' 1 billion dollar contract with Abu Dhabi Gas Liquefaction Company to build an integrated gas plant on Das Island; and SK Construction's contract to build gas compressor units at the Bab oil fields developed by Abu Dhabi Company for Onshore Operations.

Aside from oil, the region is also increasingly becoming the largest source of Liquefied Natural Gas (LNG) for China, Japan and South Korea. While Malaysia and Indonesia are the largest producers in East Asia, the development of the industry in Qatar and Oman has complemented the needs of East Asian markets.

The Gulf also remains pivotal to European energy interests. In 2005, 31.7 per cent of EU oil imports and 26.8 per cent of EU gas imports came from the Middle East. A far lower share (under 20 per cent) of US oil and gas imports come from the Middle East.

The GCC states will likely aim to turn more of their oil into refined products or petrochemicals and to use their oil and gas resources as feedstock for industries that will add more value and provide more jobs. The focus will be on petrochemicals, aluminium and resource-based industries. GCC firms will gain market share in chemicals, metals and plastics.

There is much talk about the GCC's potential in renewable energy and much new planning for investment in this sector – a key question will be whether such development also begins to weaken the rentier dynamics that condition the region's politics.

Regional integration

Crucial to GCC international projection has been the advance of regional integration within the Gulf itself, as well as between the Gulf and other Middle Eastern states.

A GCC Unified Economic Agreement was concluded and ratified by all member countries in 1981, followed by the FTA among GCC countries that came into force in March 1983, and finally the GCC Customs Union that was established in January 2003. The GCC Common Market came into force on 1 January 2008. The FTA led to the free movement of national goods across GCC member states and exempted all imports from Gulf Cooperation Council countries from tariffs, and the Customs Union provided for a common external tariff and free movement of goods across member countries without tariff or non-tariff barriers. The Common Market brought common economic policies, as well as the granting of national treatment to all GCC firms and citizens from any other GCC country. This in turn led to the elimination of all barriers to cross-country investment and services trade. GCC member countries have also liberalised services trade within the trade bloc.

However, the prospects for even deeper regional integration have been dealt a serious blow by the financial crisis. Whereas in recent years progress had been made in strengthening pan-Arab communications and trade, albeit at relatively modest levels, these achievements are now in serious jeopardy of being reversed, as arguments for more open trade give way to calls for protectionism. Yet, the mounting problems facing the MENA will become unmanageable should the GCC cede its newly found leadership of the region in favour of investing in more secure markets. The GCC is undoubtedly the only part of the MENA with the resources to mitigate rising political and economic pressures that afflict the region through increased and more efficient allocation of development funds and investments to foster job creation.

The GCC should recognise that it is in its own interests to provide MENA countries with the benefits of the Gulf experience in stimulating the growth of private sectors (indeed the Gulf model of 'decoupling' economic from political reform is attractive to many autocratic regimes in the region). This will require moving away from merely facilitating loans and grants in the region towards the type of in-country development assistance programmes that GCC countries have in the past rejected as being too 'intrusive'. Yet financial resources, recent experiences of diversification and linguistic/cultural ties place the GCC in a uniquely stronger position than traditional Western donors to lead economic reform in the region. This will require strengthening regional institutions and creating development agencies that are able to implement effective development programmes abroad.

The non-GCC MENA states have begun to look towards the recent boom and diversification projects of the GCC as a potential economic lifeline. GCC investment and general engagement with the region has undergone a significant expansion even if this increase has been from a very low base. Most intra-Arab trade is between the GCC states, and non-Arab FDI in the MENA is almost three times higher than intra-Arab investment. Of the 542 billion dollar outflow of GCC funds between 2002 and 2006, only 60 billion was invested in the non-GCC MENA. This limited amount of intra-MENA trade should not be dismissed, however. In fact, as a proportion of GCC investment, this figure represents a rapid increase from an extremely low base and holds significant political and economic consequences for the region. The GCC countries' limited but growing investment and development aid to the region represents one of the MENA's greatest hopes for pulling itself out of economic stagnation.

In 2007, intra-regional trade constituted 11.1 per cent of total foreign trade, which represents a significant increase from the stagnant levels of the mid-1990s. In the non-energy sector, intra-regional trade accounts for just under 25 per cent of all exports, but this varies considerably from the relatively closely integrated

economies of the GCC to Libya and Morocco where this figure slips into single-digits. In recent years, Saudi Arabia has far outstripped other MENA countries in receiving new intra-Arab investments, accounting for more than half of these in 2007. Increased investment in the region can be attributed to increased oil revenues prior to the global economic crisis in 2008 and improvements in regulations governing FDI.

Bilateral trade agreements between GCC states and other MENA countries are not consistently applied. While some GCC states such as Qatar and the UAE have signed several trade agreements with non-GCC MENA states, others including Oman and Saudi Arabia have been reluctant to do so. Saudi Arabia's closest economic ties outside the GCC in the MENA are with Jordan, Lebanon, Morocco and Egypt but bilateral trading ties with the GCC have not advanced to the level these countries would have liked.

The largest share of the net increase in intra-regional trade in the MENA is between the GCC states. While Bahrain's MENA trade is considerable, amounting to 35 per cent of its total non-oil exports, 83 per cent of this trade is with Saudi Arabia, the UAE and Oman. A full 81 per cent of Qatar's MENA trade is with the UAE, Saudi Arabia and Bahrain. Among the top three regional trading partners for each respective GCC country in 2005, only Egypt (third place for Saudi Arabia) and Yemen (third place for Kuwait and the UAE) featured as significant trading partners from the non-GCC MENA region.

GCC investments in the MENA have grown considerably, due to a boom in oil prices and an increase in investor confidence following market reforms that have been undertaken in some neighbouring countries. This is corroborated by the Institute of International Finance, which has reported a rise of 10-15 per cent in FDI holdings from the GCC in other MENA countries. The type of GCC investment has also shifted; whereas in the 1970s and the 1980s GCC investments in the MENA were mainly in hydrocarbons and real estate, today the evolution of the GCC economies is reflected through their holdings

in the wider region, including in financial services and manufacturing – these two sectors together add up to 70 per cent of GCC investments to Egypt for 2008. GCC investment constitutes a third of foreign holdings in Egypt and almost half in Jordan, a remarkable increase since the turn of the century. There is, however, a growing chasm between countries such as Egypt, Jordan and Morocco, which have moved to ease regulations to encourage FDI in recent years, and the stagnation of Algeria at the other end of the scale, which the GCC has avoided due to the complexity of regulations and the erratic behaviour of the government in Algiers.

In terms of seizing new prospects for investment and innovation in the MENA, the GCC states are clearly leading the way. Kuwait's telecommunications leadership in the region is an example in kind: in less than ten years, it has become a telecommunications hub for the MENA connecting over 27 million mobile subscribers in the MENA and sub-Saharan Africa. The GCC originally led calls for the loosening of communications regulations in the region, resulting in the successful privatisation of an industry that was formerly the preserve of the state. The GCC also has a disproportionate influence in news and entertainment channels in the region. *Arabsat* provides more than 350 television channels and has more than 164 million viewers, carrying such channels as *al-Jazeera*, which has a major influence on pan-Arab opinion. An important recent measure led by the GCC states was the establishment of an Arab Network of Regulators, which has moved to harmonise regulatory practices including National Information and Communication Technology. This is despite significant obstacles to investment such as violent conflict, high transportation and communication costs and perhaps, most importantly, the inefficiency of a corrupt and bloated public sector in managing the economies of many MENA countries. Customs procedures can be notoriously complex and restrictive. This discourages GCC investment. In addition to tariff barriers, the Arab market is highly limited by physical obstacles in the transport sectors. Air transport, which is the main mode of transportation of goods and people, is

concentrated in a few key airports, most of which are state-owned.

The value of Gulf investments over those from Europe can be measured in sheer scale. An average Gulf investment in the MENA is 268 million dollars compared to 70 million from Europe. Gulf investors have become a vital source of job creation in the region. Despite an increasing diversification of interests, just over 50 per cent of investments in the region are still in real estate, tourism, and American-style shopping malls, while heavy chemistry accounts for 13 per cent and telecommunications/banking 15 per cent. In 2007, nine out of eleven real estate projects that cost above 500 million euro in MENA were by investors from the GCC – five of which are in Egypt. Kuwait and the UAE both have respective investments in Egypt of approximately 3 billion dollars, while UAE company Bukhater is investing 5 billion dollars into the Tunis City of Sport and a further 1.9 billion is being invested by Qussor Marina into Tunisian tourism projects. Meanwhile in 2008, the Gulf Finance House announced it was investing 3.8 billion dollars in energy projects in Libya. Tourism from the GCC in the MENA has also boomed in recent years, with Egypt reporting a three-fold increase in Gulf visitors since 2002. Following the economic crisis, some GCC projects in the region appear to have significantly scaled back, prompted by a drop in total income of GCC listed companies of almost 20 per cent during 2008.

Politics and security

The Gulf's proactive internationalism is not limited to economics and energy. In security and politics too, a myriad network of new agreements and initiatives has been forthcoming in recent years. These include the Saudi peace initiatives for Palestine in 2002 and again in 2007, which gained support from all Arab League states; Qatari mediation in Lebanon; new military cooperation between Gulf and North African states; deeper cooperation between Arab interior ministers on

counter-terrorism issues; and Saudi re-engagement with Syria, in an effort to broker regional cooperation.

Again, Western efforts have atrophied in comparison. NATO's Istanbul Cooperation Initiative has made little progress, faltering even on agreeing basically what security means: Gulf states want a security guarantee, while NATO presses security sector reform simply (it is perceived in the region) to boost capabilities aligned to its own perceived concerns.¹⁰ The European decision to deal with MENA in sub-blocs magnifies the region's failure to agree on a cooperative security framework.

Leadership of the Arab World has shifted decisively from the ancient capitals of Cairo, Damascus and Baghdad to the Gulf. Hydrocarbon revenues have not only facilitated the exercise of conventional political leverage through the funding of other Arab governments, but the GCC countries have also invested heavily in influencing Islamic movements, confirming the Arabian peninsula as both the political and spiritual centre of the region. Arab leaders have also spoken admiringly of the Gulf's recent management of its hydrocarbon revenues in contrast with other countries in the region. The long decline and traumatic implosion of Iraq, the isolation of Egypt following its recognition of Israel, and suspicions over Syria's relations with Iran and Hizbullah, combined with the poor economic performance of all three countries, has resulted in the rise of Saudi Arabia as the most influential country in the Arab World. The increased economic clout of Riyadh has had significant repercussions for the foreign relations of countries in the region. Signs of this expanded reach are readily apparent: the careful attention paid by Morocco to an alleged slight to Bahrain by a senior Iranian official in 2009, leading to the severing of diplomatic relations between Rabat and Tehran, played particularly well in Riyadh at a time when Saudi investments in the country were under consideration following the global economic downturn. Saudi Arabia's growing

¹⁰ T. Schumacher, 'Transatlantic cooperation in the Middle East and North Africa and the growing role of the Gulf states', *GMF Mediterranean Paper Series*, Washington, D.C.: German Marshall Fund of the United States, 2010.

diplomatic prestige was clearly demonstrated through the 2002 Arab Peace Initiative, which promised universal Arab recognition and normal ties with Israel in exchange for the establishment of a Palestinian state along 1967 borders. This agreement was ultimately rejected by the Israelis but hailed throughout the region and beyond as a major offering from the Arab states. This was followed in 2007 by the Saudi-brokered Mecca Agreement between Fatah and Hamas. The resourceful mediation tactic of bringing both sides to the holy city of Mecca to negotiate a power-sharing government was augmented by a Saudi promise of extensive development assistance to Palestine. Ultimately, however, the agreement collapsed under US pressure.

MENA is held together more by cultural affinity than economic expediency. Most countries belong to an Arab community and share an Islamic identity. This combination of Arab nationalism and Sunni Islam has effectively replaced the loose Ottoman political, economic and religious network that previously linked much of the region. Although the potency of Arab nationalism has declined from the heady days of Gamal Abdel Nasser half a century ago, largely replaced by various trends of political Islam, pan-Arab institutes and a residual sense of solidarity serve to bind the region together. Indeed, it is obvious that the MENA as a region could not be said to exist were it not for its Arab identity.

Perhaps with the failure of Mecca in mind, Prince Saud al-Faisal, Saudi Arabia's Foreign Minister, has consistently trumpeted the need for the Arab World not to rely upon the US to broker peace in the Middle East. Such an empowered, independent Arab role on the world stage has met the approval of King Abdullah but may not endure after his death. Yet Saudi Arabia has been slow to follow up its Mecca mediation with an intensive effort to renew dialogue between the Palestinian parties and reduce Iranian influence in Gaza following the election of an Obama Administration more sympathetic to a 'Mecca II'. The occasionally sluggish reaction of Saudi Arabia to regional events is perhaps indicative of the weak

capacity of the Saudi Foreign Ministry, which is severely limited by appointments made due to royal favour rather than merit. Ideological intransigence has also reduced Saudi Arabia's impact regionally – the refusal to engage in a meaningful way with any of the Shia Islamist parties in Iraq and the delay in nominating an Ambassador to Baghdad resulted in Saudi Arabia effectively ceding a role in trying to steer the Iraqi government away from Iranian influence, to the great frustration of more nationalist Iraqi Shia politicians.

Qataris may account for only 350,000 of the MENA's population, but their country boasts one of the highest per capita GDPs in the world. Both its small size and enormous wealth, derived from possessing the third largest gas reserves in the world, has been key to the country's unique brand of foreign policy. Qatar's greatest success in regional diplomacy has undoubtedly been the Doha Accords in 2008, which negotiated an end to the precarious constitutional deadlock in Lebanon since the withdrawal of the 8 March opposition coalition from government in 2006. Qatar conspicuously used its considerable wealth as leverage, providing over 1 billion dollars in aid to Lebanon. Agreement with Hizbullah on reconstruction assistance to Lebanon was an important milestone in bringing the Lebanese opposition in from the cold. Qatar's close working relations with Tehran also facilitated its mediation in the country – Prime Minister Sheikh Hamad raised eyebrows by hosting President Ahmadinejad at the GCC summit in December 2007. Qatar's investments in Syria – including a 350 million dollar tourist complex in 2007 – and its refusal to join Saudi Arabia, the UAE and Kuwait in offering to fund the UN-led Hariri tribunal also gave it more influence in persuading Damascus to back the agreement.

Since the collapse of the Mecca agreement, Qatar has infuriated US officials by providing essential economic support to Hamas. However, Sheikh Hamad was thwarted by Egypt in calling for a Qatari hosted summit to discuss the Gaza crisis in January 2009. In Yemen, Qatar pushed the Yemeni government to agree

a truce with Shia Zaydi rebels in the north of the country. The process was derailed on several occasions before a final effort in the summer of 2008 succeeded in brokering a ceasefire. However, Saudi irritation over the presence of a Shia militant group on its southern border and suspicions over alleged links between the insurgency and Iran contributed to the collapse of this ceasefire in July 2009. Although Qatari investment in Yemen during 2007 and 2008 was critical in securing leverage to mediate an eventual ceasefire, increasing Saudi and Yemeni reservations regarding Qatari mediation means that a renewed mediation role is unlikely in the near future.

Qatari mediation in Darfur, although periodically successful in reducing tensions, has also been viewed with suspicion by the parties and neighbouring countries, despite effusive praise from UN and European representatives. Rebel groups have been wary of a Qatari role due to close ties between Doha and the Sudanese regime, which includes military cooperation and a multi-million dollar investment in a housing complex near Khartoum. Qatar's surge to diplomatic prominence has left other Arab countries unsure as to whether Qatar is an emerging Switzerland for the region or an unfit maverick with suspiciously close ties to Tehran. What is obvious, however, is that such hyperactive regional diplomacy could not be possible without an enormous cash leverage to invest in poor Arab countries experiencing conflict.

Conclusion

By way of conclusion, three issues merit reflection.

First, the evidence of an impressive deepening of economic integration between the Gulf and the broader world economy also reveals that such links are advancing at a far faster pace with trade and investment partners outside the West. If the Gulf is showing increasing potential and elements of 'emerging power' status, the EU in particular seems not to have grasped this nearly as fully as other international

actors have. Europe is also behind the game in responding to the more geostrategic bridges that Gulf states are building with non-Western states.

Second, while our research has centred on the GCC's incipient positive potential and progress, serious problems clearly remain in the region. Pessimists say that reforms implemented in the GCC are nowhere near enough to deal with social frustration, raised expectations from a period of high revenues and the region's demographics. Military spending is still rising, not falling, diverting resources from social priorities. There is still much evidence that evokes Giacomo Luciani's original, seminal argument that rentier states only significantly open up during times of serious fiscal crisis.

There is only real urgency in long-term planning for diversification in Oman and Bahrain as these two states are running out of oil and gas. Only in these two countries is there an emergent private sector of any significance. Even those new planning strategies that aim for diversification resemble fiefdoms, silos of clientelism, with planning aims for modernisation run by different princely factions; progress still depends on a small number of people within regimes wanting to push reforms. Given the inevitable political successions that must relatively soon occur in several states, the recent progress made in the region should not be seen as irreversible.

Third, the GCC's international projection will be strongly conditioned by the dynamics of cooperation and rivalry within the Gulf itself. Advances have been made in regional integration in the Gulf. But, like any integration project, the GCC exhibits much zero-sum competition among its member states alongside new areas of policy coordination. The small size of all but one GCC member means this balance between coordination and rivalry will be key in determining how well the Gulf fares on global economics and politics. Our research suggests that this may yet prove to be the most serious obstacle to the Gulf gaining convincing status as an 'emerging power bloc' in the new global economic and political context.

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Talk abounds of 'emerging powers' taking a greater share of global economic and political power. The international system is being recast, and attention focuses on the more assertive roles being assumed by China, India, Brazil, and South Africa, as well as the likes of Malaysia, South Korea, Mexico, and Russia. It is striking that relatively little attention is paid within such debates to Middle Eastern states. It is important to ask whether indicators in the states of the Gulf Cooperation Council (GCC) may or may not merit this region also being included in discussions of new emerging powers.

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