Workshop 14
Jointly organised with the Gulf Research Centre (GRC), Dubai, UAE

The Geo-Economic Positioning of the GCC Countries

directed by

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Workshop abstract

Until the 1980s the position of the countries of the *Gulf Cooperation Council* (GCC) in the international division of labour was clear: oil was exported and manufactured goods were imported, mainly from Europe and the USA. Nowadays the situation has changed. Although the importance of oil and gas revenues is still paramount, the GCC countries command an increasingly diversified economic structure with new sectors emerging in the fields of petrochemicals, utilities, services and tourism. They are the world market leader in polymer production and lay specific emphasis on the development of energy intensive industries like aluminium, steel and fertilizer plants. For theses industries they have to import now raw materials themselves from countries like Australia and South Africa. On the other hand the focus of their trading relations has shifted and moves eastwards. The USA only account for roughly 10% of imports nowadays (2004) while the European Union is contributing one third and the Asian countries about a quarter of overall imports. Thus, they have become the most important trading partners for the GCC, most notably Asia, which purchases about two thirds of GCC energy exports. How could these interdependences of foreign trade be mapped out in detail? How will the GCC countries react to these challenges? How do they position themselves in the WTO process and the ongoing negotiations of free trade agreements with the EU and the USA? Which chances and which threats emerge from the opening of their economies? Which sectors and companies will benefit (e.g. petrochemicals) and which will likely face difficulties in facing increased competition (e.g. agriculture, so far monopolistic telecoms, banks)? Will petrodollar recycling move away from simple buying of US treasuries and move towards strategic investments and other

currencies like the Euro? And finally: is there a realignment of foreign policy discernible along the lines of geo-economic positioning?

Workshop description

Rationale

The importance of GCC countries for the world economy cannot be underestimated: OPEC countries currently represent 41% of world oil production and command a whopping 78% of official reserves.[1] Saudi Arabia, Abu Dhabi and Kuwait contribute about 50% of OPEC production and their relative importance in terms of reserves and future supply scenarios is even higher. Against this backdrop it is astonishing that the GCC region is under researched in comparison with other MENA countries such as Egypt or Palestine. Especially economic topics haven't drawn much attention and the little research that exists is rather focusing on political, cultural and historical aspects.

The workshop wants to assess the GCC countries' geo-economic interests and vulnerabilities at the juncture of lasting dependence on oil revenues and increasing efforts at diversification. Three major trends are discernible:

a) Lasting importance of the oil and gas sector
b) Diversification away from oil income
c) Diversification away from the US dollar and concentration on strategic foreign investments.

The workshop wants to map out interdependences in regard to trading partners and traded goods and wants to gain a deepened theoretical understanding of these trends. It links economic with political analysis and investigates whether the geo-economic interests of the GCC affect a possible realignment of political allegiances. An empirical assessment of economic processes in the GCC is hindered by incomplete, inaccurate and sometimes outrightly dubious statistics. Thus, apart from discussing trends, a major desideratum of the workshop is to critically discuss available data and resources and their reliability, in order to lay out the ground work for future research. Therefore the workshop should be a nice mixture between digging through dry statistics and indulging in theoretical speculations. Papers for the workshop will be published in an **edited volume by the Gulf Research Center in Dubai.** They should deal with one of the sectors outlined below or with the GCC trade relations with specific countries and economic blocs (e.g. USA, EU, China, Japan).

The Problem

Until the 1980s the position of the countries of the *Gulf Cooperation Council* (GCC) in the international division of labour was clear: oil was exported and manufactured goods were imported, mainly from Europe and the USA. Nowadays the situation has changed considerably. The GCC countries command an increasingly diversified economic structure, although oil revenues still account for roughly a third of the GDP, 75 percent of the budgets, and up to 90 percent of exports of the GCC countries.[2] New sectors are emerging in the fields of petrochemicals, utilities, services and tourism.

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1 OPEC, "OPEC Share of World Crude Reserves (2004)," available under: www.opec.org/home/PowerPoint/Reserves/OPEC%20share.htm

2 Khalid R. Al-Rodhan, "The Saudi and Gulf Stock Markets: Irrational Exuberance or Markets Efficiency?," *Center for Strategic and International Studies (CSIS)*, Working Paper (October 25, 2005), p. 4.

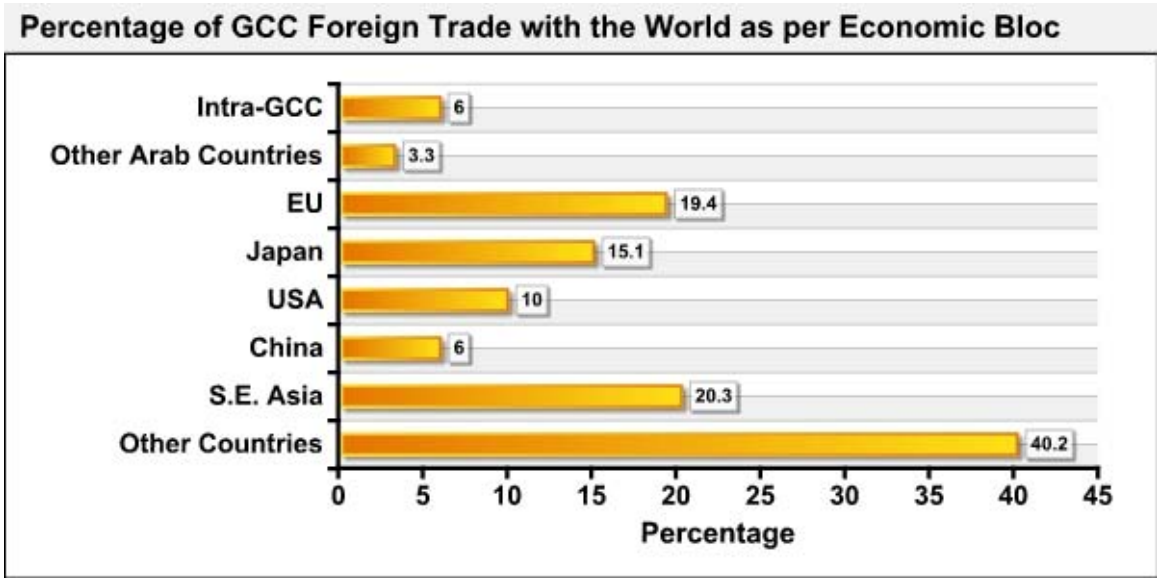
The GCC countries are a world market leader in polymer production and lay specific emphasis on the development of energy intensive industries like aluminium, steel and fertilizer plants. For theses industries they have to import now raw materials themselves from countries like Australia and South Africa. On the other hand the focus of their trading relations has shifted and moves eastwards. The **USA** only accounts for roughly 10% of imports nowadays while the **European Union** contributes a third and **Asia** a quarter to GCC imports (see Table 1). Thus, they have become the most important trading partners for the GCC, most notably Asia, which is the main customer for GCC energy exports (see table 2).

Table 1

GCC Foreign Trade with the World in the Years 2003 and 2004

Year	Million US$	GCC*	Other Arab Countries	EU	Japan	USA	China	S.E. Asia**	Other Countries	Total
2003	GCC Imports from	8,688	3,054	37,199	10,685	10,902	7,329	11,238	42,983	120,840
	GCC Exports to	9,582	5,489	20,145	38,374	22,069	8,120	48,838	85,137	188,917
	Total	18,270	8,544	57,344	49,060	32,971	15,449	60,076	128,120	309,757
	Balance (exports-imports)	894	2,435	-17,054	27,689	11,167	791	37,600	42,154	68,077
2004	GCC Imports from	11,758	3,864	49,980	12,488	14,256	11,332	18,231	47,956	151,635
	GCC Exports to	12,531	9,466	27,752	48,195	25,759	12,828	63,182	113,485	250,016
	Total	24,289	13,330	77,732	60,683	40,015	24,160	81,413	161,442	401,651
	Balance (exports-imports)	773	5,602	-22,228	35,707	11,503	1,496	44,951	65,529	98,381

Table 2



Source: Gulf Organization for Industrial Consulting, "Direction of GCC Foreign Trade as per Economic Blocs", April 2006, available under: http://www.goic.org.qa/goic/data/IMI_Reports/IMIreport1_E.pdf

At this juncture of lasting dependence on oil revenues and increasing efforts at diversification, the following three sectors are of crucial importance to the GCC countries: ***Oil and gas infrastructure; equipment and commodities for energy intensive industries and strategic foreign direct investments.*** Other sectors rank also highly in diversification strategies but do not have the same strategic

importance yet. These are ***real estate and construction; machinery; consumer goods; education; trade, services tourism and re-export business***. These sectors are in the focus of GCC development strategies and require special attention in regard to the foreign trade interdependences they entail.

Part I: Oil and Gas

Oil (and recently gas) continues to dominate the GCC economies and its price hike of recent years with the ensuing windfall profits has served to underpin the investment boom in other economic sectors. There is good reason to assume that in absence of a major recession, the oil price will stay on elevated high levels or might even rise further. The reasons for this are: a) increasing M3 US$ money supply b) rising demand (e.g. emerging markets like China, India) and c) tight supplies and refining capacities (e.g. declining oil production in the USA and North Sea).

The International Energy Agency (IEA) expects worldwide demand for oil to rise 50 percent from the current 82 million bpd to 121 million bpd in 2030.[3] Most of the hopes to meet this rising demand rest on the shoulders of the Gulf countries, as it is doubtable, whether new sources of unconventional oil (Canadian tar sands, Venezuelan heavy oil, deep sea oil) will be able to supply sufficient quantities of energy at economical levels. It is a question of debate, whether the Gulf countries can meat this demand. The IEA deems it a possibility, the Gulf countries themselves have cautioned a bit and "peak-oil" authors like Matthew Simmons have questioned it altogether.[4] In any case the sector will require substantial amounts of new investments and technological upgrading over the coming years, be it in form of technology import by the region's state owned oil companies (e.g. ARAMCO) or by FDI and joint ventures with foreign oil companies (e.g. Exxon: Qatar's Northern Gas Field and Abu Dhabi oil fields, Lukoil, Sinopec, Repsol and ENI: Saudi Gas Fields). It also has to be kept in mind, that the GCC countries in the meantime use already 17% of their own oil production with a rapidly rising rate of 4.5% per annum.[5]

The imports of oil technology for exploration, production and servicing are dominated by US American companies (e.g. Schlumberger oilfield research centre in Dharan). This is likely to continue, given for example the traditional ties between the US and Saudi Arabia in this sector since the 1930/40s and the close connection with the GCC dependence on the US in security matters. But other nations have developed an increasing interest in the GCC oil sector as well. Namely China in its relentless drive to secure international oil reserves (e.g. Sudan, Angola, Venezuela, Canada) is currently building a huge oil terminal in Pakistan to secure the oil shipping route to China. It has also invested in the Saudi gas project.

Special attention could be given to the developing gas market as gas is becoming a globalized commodity like oil with the rapidly developing **Liquefied Natural Gas (LNG)** facilities. The importance of gas for the regional energy needs and for Asian customers (e.g. South Korea) could be outlined and the successful Qatar gas story could be compared with the partly failed Saudi Gas Initiative.

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3 International Energy Agency (IEA), *World Energy Outlook 2004* (Paris: 2004).

4 Matthew R. Simmons, *Twilight in the Desert: The Coming Saudi Oil Shock and the World Economy* (Hoboken, New Jersey: 2005) See also the website of ASPO, the European based *Association for the Study of Peak Oil and Gas*: www.peakoil.net

5 For Asia it is 2.5% and for the USA 1%. In the latter case the rate has remained stable since the seventies. See Global Investment House KSCC, *GCC Oil Sector* (Kuwait: August 2005), pp. 17.

…. and why not Solar Power?

Given this oil scenario it is surprising that the GCC countries so far have done virtually nothing to develop solar energy projects. Their climatic comparative advantage is obvious and it would give them the opportunity to acquire production facilities in a technology that is new even in comparison to the internet, with low barriers of entry and huge economies of scale. It remains to be awaited whether the current plan of a Swiss-UAE consortium to launch a US$ 10 Bn solar power project for the production of (exportable) hydrogen is a change of mentality in that respect.

Part II: Energy Intensive Industries

An important aspect of the GCC diversification drive is a concentration on big, energy intensive industrial projects like petrochemical, fertilizer, aluminium and steel plants. The Saudi petrochemical giant SABIC produces about 10% of worldwide petrochemical products and makes the region as a whole a world market leader. In the aluminium market a recent report by the Gulf Organisation for Industrial Consulting (GOIC) envisages a market share of 10% for GCC countries by 2010.[6] These plants require huge joint ventures with companies from industrialized countries like the Rabigh petrochemical complex in Saudi Arabia, which is built by Sumitomo and trends in these strategic alliances deserve specific attention. While the feedstock for petrochemicals and fertilizer plants (oil and gas) is available in the GCC, the feedstock for steel and aluminium plants has to be imported and will require closer cooperation with export countries (e.g. Australia for bauxite). On the other hand the GCC countries are taking efforts to develop mineral extraction industries on their own. The geological potentials are best known in Saudi Arabia, where state owned Maaden was founded in 1997 and will go public over the coming year. Maaden is already producing gold, zinc and magnesite while other projects could come on stream with rising commodity prices (e.g. phosphates, copper). In other GCC countries (e.g. Oman, UAE) geological exploratory teams are currently on the ground. These projects might offer some relief from the commodity import dependency in the GCC but certainly will fall far short to abolish it altogether.

Part III: Currency Power Games and Strategic Foreign Direct Investments (FDI) of the GCC Countries

The GCC suffered badly by the oil price slump in 1986 and its lacklustre performance during the 1990s. While they became net capital importers during that period this situation has changed dramatically with the recent surge in oil prices and has placed them firmly on the map of currency power games. The USA currently needs to attract 80% of worldwide savings to finance its twin deficit. The current account surplus of Asian countries is good for 49% of the US American current account deficit while the size of the OPEC's current account surplus amounts to 35% of the latter with a projected 265 Bn US$. As Saudi Arabia, Kuwait and Abu Dhabi constitute about 50% of OPEC production the importance of the GCC in this respect is evident. Petrodollar recycling has become much smarter in comparison to the 1970s. GCC countries are increasingly envisaging strategic investments and partnerships abroad that could benefit their own economies rather than putting their money simply in US treasuries. The recent mega deals bear ample witness to this trend like Dubai's take over of P&O and Doncaster, ARAMCO's investments in Chinese refinery capacity for sour crudes or SABIC's take over of the petrochemical business of Dutch DSM in 2002. Currently the Abu Dhabi Investment Authority (ADIA) and the Kuwait Investment Authority (KIA) are mulling

6 Gulf News, April 16, 2006, p. 40.

the purchase of a 10% stake in the Industrial and Commercial Bank of China for US$ 2 Bn. The P&O deal and the failed Chinese bid for Unocal have also shown the considerable potential for political conflict between the USA and its creditors, once these creditors want to buy tangible majority stakes rather than just holding ever increasing amounts of potentially worthless paper dollars.

Part IV: Other Sectors

Real Estate and Construction

Real estate is a major driver of economic growth and diversification especially in the UAE and more specifically Dubai. The UAE currently accounts for 64% of new mega projects in the GCC.[7] Main drivers are population growth and in case of the UAE also a considerable portion of lifestyle and speculative demand from abroad. The real estate sector as such is a non tradable and does affect the trading relations only indirectly by its necessity for import of machinery and building materials, but because of its huge importance in the overall economy it should be followed closely.

Machinery and the Industrial Sector

Not only in construction there is a rising amount of small and medium enterprises that are relying on imports of machinery. It would be interesting to scrutinize the country of origins of these investment goods and take a look at how these companies would be affected by an increasing opening up in the wake of the WTO-process, because so far they produce mainly for the local GCC markets.

Consumer Goods

This sector is strategically less important, as goods can be substituted relatively easily between different countries of origin. The most striking dependence here is in food imports, where the GCC countries produce only about 10% of their own consumption. Food stuff is mainly coming from the USA and Europe. Otherwise the countries of origin are like in the rest of the world: Electronics, textiles and white goods from Asia, cars and machinery from Europe and Japan. Only Saudi Arabia and Kuwait have a considerable amount of imported American cars.

Trade, Services, Tourism and Re-export Business

Mainly Dubai tries to position itself as a trade and service hub between Asia, Europe and Africa. Similar plans are on their way in Saudi Arabia with the US$ 26 Bn construction of the King Abdullah Economic City near Jeddah. Services reach from Airlines, trade centres (e.g. Dubai Gold and Commodity Exchange, Financial Centres in Dubai, Qatar and Bahrain) to a centre for the re re-export of flowers. The plans for tourism are ambitious: The UAE wants to increase the number of tourists from currently 5 million to 15 million in 2010 and even Saudi Arabia wants to create 2.3 million jobs in tourism until 2020. While tourism is labour intensive and appears as a remedy to a growing unemployment problem, especially in Saudi Arabia, one has to caution that there are already serious traffic and infrastructure problems in Dubai and that the absence of archaeological sites and a diverse cultural life will make it difficult to compete with Mediterranean destinations like Italy, Egypt, France or Spain. This is especially true for Saudi Arabia.

Education and Academic Cooperation

Traditionally the GCC countries' orientation in education has been towards Anglo-Saxon countries, for example the USA in case of Saudi Arabia and England in the case of the UAE. GCC students abroad are not so much a recognizable drain on foreign exchange that shows in the trade and services balance, but rather an important "human factor" in trade relations, as they are likely to maintain close

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7 Gulf Research Center, Gulf Yearbook 2005-2006, Dubai, 2006.

relations with the country where they have studied in their later professional life. In that regard it is noticeable that Saudi Arabia has announced recently its plan to send more students to Asia. The openings of a branch of the Sorbonne in Abu Dhabi and an M.A in International Relations by the Free University of Berlin in the UAE are also worth mentioning.

Part V: Realignment of Political Strategies?

The first visit of King Abdullah of Saudi Arabia after his ascension to the throne was not to Washington or Paris but to Beijing. Is the increasing importance of Asia and Europe therefore reflected in a realignment of political strategies and allegiances? Is political, military and cultural cooperation intensified alongside the economic one? Is the special relationship with the USA about to be modified? And which stance do the GCC countries take in international agreements and negotiation procedures? The free trade negotiations with US and the EU and the WTO process come to mind. The Shanghai Cooperation Organization (SCO), which was founded in 2001, is less well known. It comprises China, Russia, Kazakhstan, Kyrgystan, Tajikistan and Uzbekistan; India and Iran have been invited to join the organization this year. The SCO can be regarded as a forum about energy issues via which Russia and China want to safeguard and enhance their geo-strategical positions. It has gained considerable importance in the last two years and it remains to be seen, whether the GCC countries regard the increased importance of Asia only as a chance or also as a threat. Most notably the Chinese-Iranian realignment (e.g. USD 70Bn gas deal in 2004) and the building of a huge Chinese oil terminal in Gwadar/ Pakistan.

Questions for the Workshop

How could these various geo-economic interdependences of the GCC countries be mapped out in detail? How will the GCC countries react to these challenges? How do they position themselves in the WTO process and the ongoing negotiations of free trade agreements with the EU and the USA? Which chances and which threats emerge from the opening of their economies? Which sectors and companies will benefit (e.g. petrochemicals) and which will likely face difficulties to stand increased competition (e.g. agriculture, so far monopolistic telecoms)? And finally: is there a realignment of foreign policy discernible along the lines of geo-economic positioning?

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Directors' individual paper abstracts

The Future of Petro-Dollar Recycling

Eckart Woertz

The oil price surge of recent years has brought the GCC countries windfall profits and the necessity to reinvest them. Apart from investments in their developing local markets, petrodollar recycling is gaining renewed importance – the dire years of low oil prices of the later 1980s and 1990s seem to be a thing of the past. OPEC's current account surplus amounts to 35% of the US current account deficit and the GCC countries have become once again crucial to balance the US deficit. But the GCC countries need to be aware of the dangers involved. They are dollar dependent. Their currencies are pegged to the dollar, their main source of income (oil) is factored in dollars and the majority of their investments abroad are held in US dollars. While after World War II the US dollar was still backed by gold and current account surpluses, it has turned into a potentially empty paper promise since the demise of the Bretton Woods system in 1971. Thus, there is a growing need for currency diversification and harmonization of reserve and investment policies with trade relations: Europe and Asia being the dominant trading partners are obvious candidates.

Hints in this direction are already discernible. Petrodollar recycling has become smarter than in the 1970s. Several GCC central banks have increased their share of Euro reserves or are mulling such a step. On the other hand, GCC countries are increasingly envisaging strategic investments and partnerships abroad that could benefit their own economies rather than putting their money simply in US treasuries. The recent mega deals bear ample witness to this trend like Dubai's take over of P&O or ARAMCO's investments in Chinese refinery capacity for sour crude. The P&O deal and the failed Chinese bid for Unocal have also shown the considerable potential for political conflict between the USA and its creditors, once these creditors want to buy tangible majority stakes rather than just holding ever increasing amounts of potentially worthless paper bills.

The paper traces the history of petrodollar recycling since the 1970s, assesses the current situation and the option the GCC countries have. It pays special attention to currency blocs like the Euro, the Yen and potentially the Chinese Renmimbi and outlines their advantages and disadvantages for a GCC currency diversification. Finally, it asks whether interlinked strategic foreign direct investments have the potential to complement diversification from oil income at home thus contributing to more independent and sustainable GCC economies.

Strategic Foreign Direct Investment in Saudi Arabia

Hind Al-Sheikh

According to International Energy Agency, world energy demand is projected to increase by over 50% between now and 2030, much of the demand coming from growing economies such as China and India where economic and population growth are one of the highest[8]. But the oil and gas resources of the most endowed areas are relatively under-exploited. Saudi Arabia which holds one-quarter of global proven reserve, the largest in the world, and who provide about 13% of global crude oil, needs a cumulative energy investment of $332 billion dollar over 2004-20309, this is equal to 2.2% of Saudi GDP. While the potential for FDI in the country conditioned on investment climate and natural resources is predicted to be 4 times the current level, Saudi Arabia currently receiving only about 0.8 % of GDP10. Faced with increasing regional and global demand, Saudi Arabia has to realize its international obligations as much as possible while doing what it can to meet its growth requirements. To do so Saudi Arabia has adopted a complex set of policies. First, as an important regional political force, and the second the largest economy in the region.

To fully grasp Saudi Arabia's vital role in meeting global energy demand we need to investigate to what extent the country is connected with global investment, identify their foreign trading partners and analyze the implications of their foreign trade interdependences. This paper will also look at how the country react to growing development challenges and meet its international obligations? And finally look at chances and threats emerging from opening up of the economy for FDI in general and in vital sectors to the economy?

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[8] "Non- OECD Asia including China and India accounts for 43 % of total increase in world oil use over the projection period" International Energy outlook 2006.

[9] World Energy outlook 2005, Middle East and North Africa Insights.

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