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GCC's External Trade Integration: An Assessment

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Samir Pradhan

Introduction

Beyond-the-border integration of national economies has been a recurring phenomenon throughout the evolution of the world economy. The history of global economic integration can be traced back thousands of years to when Romans unified their geographically detached empires through an extensive transportation network and a common currency, language, and legal system. Although the scope, depth, pace and scale, and structure and pattern have transformed considerably since then, trade continues to be the most deterministic source of global economic integration.

The current phase of global economic integration is unprecedented in the history of the world economy. An unusually prolonged and widespread global expansion during the first half of the 2000s (till 2007) saw the proliferation of several bilateral, plurilateral, sub-regional, regional, and multilateral forms of economic integration involving nations across the globe. The main driving force behind the extraordinary growth of global economic interdependence was the continuously shrinking geographical distance or “width of the border”¹ between nations that facilitated the seamless movement of goods, services, manpower, and capital. However, a sense of

1. This is an indicator of implicit trade cost that hinders trade due to measures imposed by countries in the form of tariff and nontariff barriers, as well as costs arising from differences in language, culture, legal traditions, and political systems.

ambivalence and protectionist tendencies emerged in the aftermath of the 2008 financial crisis which caused an economic crisis in the industrialized West and a transitory slowdown in the fast moving regional economies. Nevertheless, there is a growing consensus and acknowledgement among nations and their leaders about the multidimensional trade benefits of increasing economic integration.

Against such a scenario, this paper sets out a policy perspective on trade aspects of global economic integration of the Gulf Cooperation Council (GCC) as an important regional bloc as well as bilateral attempts by individual member states. The main objective of the paper is to critically assess the current trends of external preferential trade agreements (EPTAs) of the GCC, identify hindrances, and lay out a policy perspective for the future.

Given the increasing vulnerability due to the GCC's overwhelming trade dependence, it is imperative to enhance economic integration with its main trading partners. While regional integration within the GCC has been moderately successful in terms of overall outcome, the bloc's attempts at external economic integration continue to be sub-optimal except for two cases of successful external integration, the GCC-Singapore FTA and the FTA with the European Free Trade Area (EFTA). For a sustainable trade outcome, the GCC needs to expedite the process of negotiating EPTAs with its main trading partners, as consolidating trade benefits of external economic integration is critical to its long-term economic growth and diversification. EPTAs will not only provide access to an enlarged market for foreign trade, but also will ensure a stable institutional framework for the GCC's future economic growth, which otherwise would continue to be dependent on the cyclical and highly fluctuating oil sector and an emerging yet less mature services sector.

Trade Benefits of Economic Integration: Conceptual Brief

The basic rationale behind economic integration is that countries can benefit if each specializes in the production of those goods and services that they can produce best and satisfy their demand for other goods and services through international trade. Economic integration involves cooperation among countries/regions in order to remove trade barriers or impediments, thereby allowing free movement of trade, investment and services across national boundaries. Economic integration is viewed as a spectrum with several integrative agreements at three levels: (i) Global: trade liberalization by GATT and WTO, (ii) Regional: preferential trade agreements (PTAs) at the regional level (EU, NAFTA, ASEAN, GCC, etc.) and (iii) Bilateral: preferential treatment between two countries (US-Oman, US-Bahrain, etc.). Of late, hybrid trans-regional or external PTAs have emerged such as the EU-ASEAN

FTA, the Trans-Pacific Partnership Agreement (TPP), and the Trans-Atlantic Trade and Investment Partnership agreement (TTIP). There are four types of economic integration in practice, namely; (i) Free Trade Area (FTA): free and open trade among members including no internal tariffs among members, but each country imposes its own external tariffs with respect to a third country, (ii) Customs union: no internal tariffs and common external tariffs, (iii) Common market: free movement of products and factors (resources), which is customs union plus factor mobility, and (iv) Economic union: common market plus common currency and coordination of fiscal and monetary policy (see Table 1).

Table 1: Main characteristics of different types of trade integration arrangements

	Tariff Reduction in intraregional trade	Tariff Elimination in intraregional trade	Common Tariff for rest of the world	Free factor mobility	Harmonization of economic policies
PTA	Yes				
FTA		Yes			
Customs union		Yes	Yes		Desirable
Common market		Yes	Yes	Yes	Desirable
Economic union		Yes	Yes	Yes	Yes

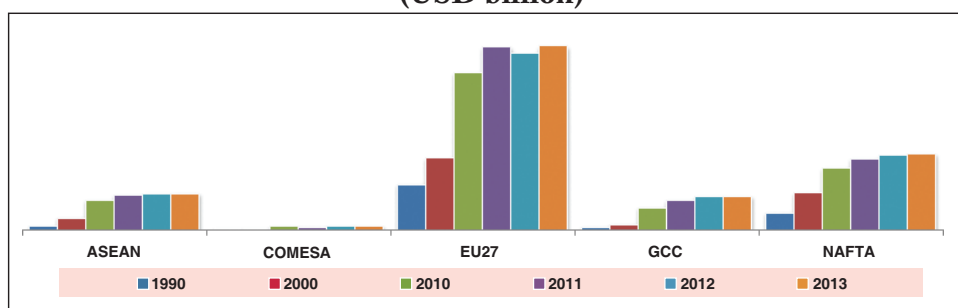
Source: UNCTAD secretariat.

External economic integration brings significant benefits to member countries with more efficient allocation of resources. In the static or short term, it leads to trade creation with production shifting to more efficient members from inefficient member countries and leads to specialization and comparative advantage. In the dynamic or long term, economic integration leads to cost reduction due to economies of scale and increasing competition in which both producers and consumers benefit from more efficient resource allocation. For resource-based and import-dependent small economies like the GCC, trade benefits of external economic integration are significant including increased market access to competitively priced imports of goods and services, joint business ventures, technology transfers, and capacity building for an improved business climate leading to extended economic diversification.

GCC's World Trade: Recent Trends and Policy Rationale for External Integration

The GCC is the world's fourth largest regional economic bloc in terms of trade volume. The GCC countries are highly open economies, with a total average trade-to-GDP ratio² of 120 percent in 2012.

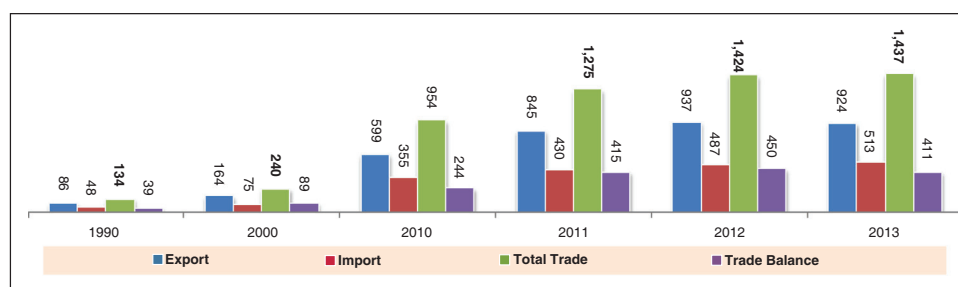
Figure 1: GCC: Fourth largest regional bloc by trade volume (USD billion)



Source: Author's calculation; IMF DOTS, May 2014; UNCTAD Statistics.

Both exports and imports of goods and services constitute a highly significant portion of each country's GDP, signifying the importance of international trade for the GCC economies. The peculiar factor endowment of the GCC - which is rich in oil and poor in water - makes international trade an indispensable factor in the growth and economic development of the region, but simultaneously makes the region highly vulnerable to the cyclical pattern of world trade movements.

Figure 2: GCC's world trade indicators (USD billion)

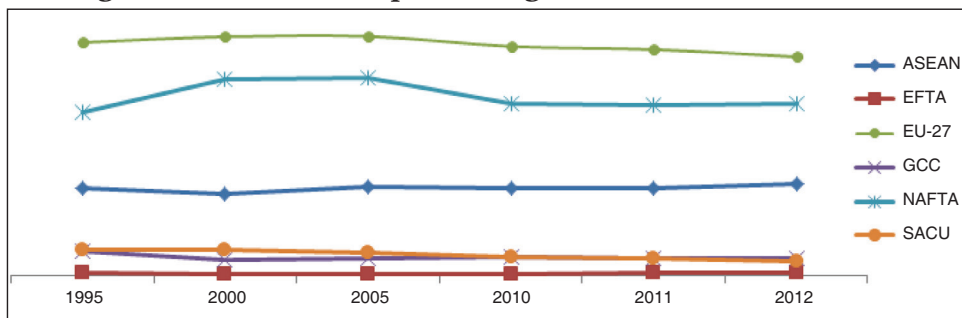


Source: Author's calculation; IMF DOTS, May 2014; UNCTAD Statistics.

- Trade-GDP Ratio is estimated as an economy's total trade of goods and commercial services (exports + imports, balance of payments basis) divided by GDP, on the basis of data for the three latest years available. GDP is measured in nominal terms and with market exchange rate.

One important aspect is that intra-regional trade of the GCC as a regional bloc is very low compared to other regional blocs across the world. This makes it even more dependent on world trade. Given the similar factor endowments of the GCC member countries, the regional export basket is dominated by petroleum and petroleum related products. With low levels of economic diversification and manufacturing related value addition, the GCC countries are overwhelmingly import dependent for almost all goods and services.

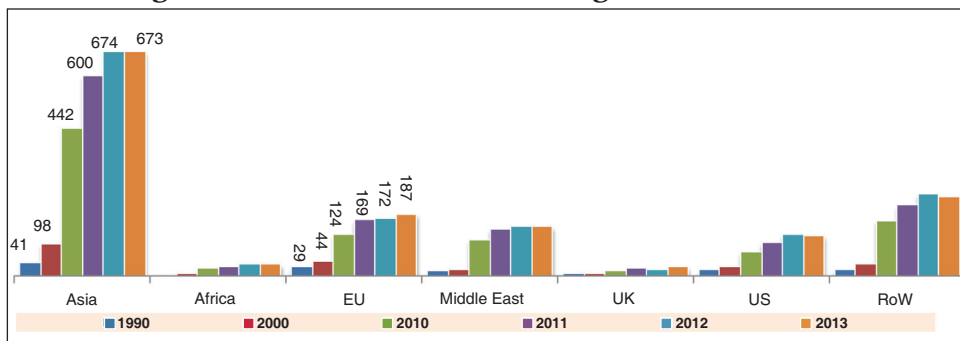
Figure 3: Intra-trade (export) of regional blocs (% of total trade)



Source: Author's calculation; IMF DOTS, May 2014; UNCTAD Statistics.

Importantly, a clear shift is currently taking place in the geographic direction of the GCC's world trade in conjunction with the changing economic strength of its trading partners, which puts forward a set of trade challenges. GCC-Asia trade accounted for 3 percent of total world trade in 2013. Asia is the GCC's largest trading partner – bilateral trade touched \$673 billion in 2013. Asia accounted for 52 percent, 37 percent and 48 percent of the GCC's world exports, world imports, and total world trade, respectively, in the year 2013.

Figure 4: GCC's trade with other regions (USD billion)



Source: Author's calculation; IMF DOTS, May 2014; UNCTAD Statistics.

While the GCC's trade with Asia has expanded considerably primarily due to energy exports, its imports from the EU, US, and other industrialized countries also continues to be robust. There are clear complementarities and huge scope for further expansion of trade with all regions. As shown in Table 2, the GCC's trade correlation index³ with respect to regional blocs such as the EU and ASEAN are negative, which implies that both are GCC's natural trade partners. However, the irony is that the GCC does not have robust trade related arrangements with its major trade partners. This is perhaps the key factor behind the GCC's trade vulnerability.

Table 2: GCC's trade correlation index with major regional blocs

	1995	2000	2005	2010	2011	2012
ASEAN	-0.004	0.027	0.035	-0.141	-0.142	-0.113
EFTA	0.194	0.152	0.17	0.253	0.273	0.250
EU-27	-0.232	-0.224	-0.228	-0.183	-0.225	-0.246
NAFTA	0.07	0.034	0.034	0.279	0.275	0.234
SACU	0.237	0.234	0.234	0.211	0.246	0.219

Source: UNCTAD Statistics.

The GCC's trade vulnerability can be substantiated from the long list of protectionist measures implemented by various countries and regions in the aftermath of the global financial crisis in 2008. As per data from the Global Trade Alert Database,⁴ during the period October 2008 to May 2014, nearly 293 discriminatory trade measures (categorized as Red⁵) were implemented that negatively affected the GCC countries.⁶ Importantly, the GCC countries have undertaken several trade

3. Trade correlation index is a simple correlation coefficient between economy A and economy B's trade specialization index. The resulting coefficient can take a value from -1 to 1. A positive value indicates that the economies are competitors in the global market since both countries are net exporters of the same set of products. Consequently a negative value suggests that the economies do not specialize in the production/consumption of the same goods, and are therefore natural trading partners.
4. Global Trade Alert provides information in real time on state measures taken during the global economic downturn that are likely to discriminate against foreign commerce; for details, see <http://www.globaltradealert.org>
5. Red coded are those state measures that have been implemented and almost certainly discriminate against foreign commercial interests.
6. The UAE is faced with the highest number of discriminatory trade measures followed by Saudi Arabia, Oman, Kuwait, Bahrain, and Qatar.

liberalizing measures during the same period (categorized as Green in the database: this refers to measures that involve liberalization on a non-discriminatory (i.e., most favored nation) basis. Importantly, the GCC countries have also suffered due to export restrictions⁷ imposed by some of its major trading partners in the past. Such bans put enormous cost on the GCC economies in their search for new import sources for essential consumption items, which usually have serious socio-economic implications at the domestic level.

Given such constraints, it is imperative for the GCC to enhance its external economic integration especially with its natural trading partners through preferential agreements. This will not only address GCC's trade vulnerability and consequently serious macroeconomic bottlenecks, but will also provide a platform for economic diversification through trade integration. External economic integration should be viewed as a middle path between complete self-reliance at one end and complete openness on the other (Second Best Policy). External PTAs will enable the GCC countries to overcome the small size of their domestic markets, achieve larger economies of scale in production and attain specialization, and, importantly, reduce shocks of external vulnerability. It will also help the GCC to take a collective regional stand on major global issues and provide a strong bargaining leverage.

In fact, there are formidable liberalizing factors in favor of GCC's greater trade integration. Due to the peculiarity of its narrow production base, the GCC countries continue to maintain low external tariff barriers compared to other regional blocs. The 2003 GCC Customs Union implemented a common external tariff of 5 percent on most imported goods and zero percent on essential goods that account for approximately one-fifth of GCC's total imports. All GCC countries, being WTO members, usually give MFN (most favored nation) status on a multilateral basis. Over the years, they have also implemented several reform measures pertaining to trade and investment.

External Economic Integration: Trends and Assessment

Given structural bottlenecks, such as small market size and limited diversity, the GCC member states have initiated several external preferential agreements both bilaterally as well as multilaterally in order to promote trade and investment (see Table 3). Until 2005, the GCC countries were engaged in external trade negotiations on a unilateral basis through FTAs and Trade and Investment Framework Agreements (TIFA).

7. For instance, in 2007, India's export ban on non-Basmati rice had a direct negative effect on rice prices in the GCC, as it is an essential consumption item of the majority of South Asian expatriates.

Following the signing of the bilateral US-Bahrain FTA in 2005, the GCC member states agreed to collectively coordinate future trade negotiations through the GCC Secretariat. Currently, the GCC is engaged in trade negotiations with the EU, China, Japan, US, Australia, New Zealand, India, and Pakistan among others. It has ratified FTAs with Singapore and EFTA.

Table 3: Status of GCC's external PTAs

Country	WTO	EU	US	Others
Bahrain	1995	Cooperation agreement signed in 1988; FTA negotiation started in 1990 and currently in stalemate	FTA signed in 2004 and effective since 2006	GCC - Singapore FTA ratified on December 15, 2008 came into force on September 1, 2013
Kuwait	1995		TIFA signed in 2004	GCC signed FTA with EFTA States (Iceland, Liechtenstein, Norway and Switzerland) on June 22, 2009 and it came into force on July 1, 2014
Oman	2000		FTA signed in 2006	
Qatar	1996		TIFA signed in 2004, FTA negotiation suspended	GCC undertook trade negotiations with China, India, Japan, Australia, New Zealand, Jordan, Turkey, and MERCOSUR among others
Saudi Arabia	2005		TIFA signed in 2003	GCC countries are members of GAFTA
UAE	1996		TIFA signed in 2004, FTA negotiations suspended	

Source: Author's compilation.

Despite such initiatives, the GCC's trade integration through external PTAs has been lackluster. The GCC is constrained in conducting effective external trade negotiations collectively due to several institutional deficits such as the limited progress of the GCC's own economic integration, continued asymmetries in the trade policies of individual GCC members, lack of a clear and effective mechanism to arrive at internal consensus, inadequate regional capabilities for trade-related negotiations, and lack of political support among others.

Externally, the GCC is also faced with challenges in successfully negotiating PTAs due to several conditionalities put forward by the negotiating partners, especially the EU and India. Negotiations on the GCC-EU FTA which started 24 years back have not reached their logical conclusion initially due to the EU's insistence on the inclusion of a commitment to human rights and political development and later because the EU wanted the GCC to completely drop their export duties. Another issue of concern relates to the EU holding the right to suspend an agreement unilaterally in the case of a violation of any of the treaties' clauses. Similarly, in the case of GCC-

India FTA negotiations, India wants to include clauses to safeguard its domestic industry/companies associated with the chemical and petrochemical sectors, which is the only sector after crude oil where the GCC enjoys global competitive advantages.

The GCC's integration with PAFTA, which came into effect in 2005, is also constrained due to the existence of pervasive non-tariff barriers preventing trade. Moreover, some other important trading partners of the GCC, namely, Yemen, Libya, Lebanon, Algeria, and Iran among others, are not WTO members, which complicates trade negotiations.

Conclusion – The Way Forward

External trade integration is critical for the long-term economic sustainability of the GCC. Despite relative success in the emergence of the GCC as a regional bloc, its external economic integration through preferential trade agreements has been sub optimal. Faced with a challenging trade environment, the GCC's institutional policy deficit has been the main factor hindering external trade integration. In the current economic environment, it has become imperative for the GCC to recalibrate its trade strategies vis-à-vis its major trading partners in order to ensure trade security. Since the success of any trade policy hinges on its actual contribution toward improving market access for imports as well as for domestically produced products and services and its ability to minimize the consequences of openness, trade liberalization, and globalization on the domestic market, the GCC countries need to reorient their trade strategy to address the increasing proliferation of trade discriminatory measures across the globe. This in turn makes it imperative for them to enable appropriate policy regimes for enhancing external economic integration. The GCC should strive towards policy expediency in successfully negotiating external PTAs especially those with its major trading partners such as the EU. In this regard, certain policy enablers are worth considering:

- Attempts should be made to establish a high-powered trade task force (TTF) team at the GCC Secretariat. The primary agenda of the TTF should be to identify short term “wins”- start negotiations on specific trade issue/item and arrive at consensus for liberalization – which will not only address negative impressions caused by past disappointments, but will also act as a positive accomplishment for long-term FTA negotiations.
- There is an urgent need to identify and discuss sector-specific mutual issues and concerns, which then should be targeted for early liberalization.

- A clear agenda and specific, time bound strategic negotiation framework should be developed vis-à-vis major trading partners.
- Promoting the GCC as a regional bloc at the multilateral level should be the guiding principle to garner potential leverage.

Lastly, a holistic view should be the guiding principle behind policy expediency for deepening GCC's external economic integration. Within the post-crisis economic landscape, where the fortunes of national economies are no longer restricted to comparative advantages alone, the GCC needs to think of out-of-the-box solutions in order to reap and maximize the benefits of seamless trade and investment. What is needed is for the GCC to replicate the successful strategy of its FTAs with Singapore and EFTA in negotiations with other countries and regions. As a first step, the GCC should strive, with renewed vigor and business astuteness, to expedite the FTA negotiations with the EU. If it succeeds in formalizing an FTA with the EU, it will send a positive signal to its other trade partners about the GCC's commitment to win-win propositions for increasing interdependence and long-term mutual economic benefit.

About the Author

Samir Pradhan is an economics specialist based in the UAE. Previously, he served as a senior consultant, macroeconomics research, at Tanween, a leading consultancy in Doha, Qatar. He has been senior researcher, GCC economics and Gulf-Asia programs, at the Gulf Research Center. He has extensive research and consultancy experience in GCC and emerging Asia. His research interests include the political economy of the Gulf, GCC-Asia interdependence, GCC-India relations, energy security, and regional economic integration. Dr. Pradhan is a regular commentator in major international and regional newspapers in the Gulf region. He has also several peer-reviewed publications to his credit, including two books. He holds an M.A. in Economics and a Ph.D. in West Asian Studies from the School of International Studies, Jawaharlal Nehru University, New Delhi, where he conducted research on emerging energy interdependence between the GCC and India from the perspective of international economic relations.



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