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COMMENTARIES

Trade and Investment Cooperation between the EU and the Gulf Cooperation Council: Current trends and future prospects

by Rym Ayadi and Salim Gadi

In the aftermath of the Iran-Iraq war of the 1980s, security concerns triggered the creation of the Gulf Cooperation Council (GCC), one of the richest regional groupings in the world, comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. Soon after its establishment, the GCC and the EU sought to deepen relations by engaging in a process of rapprochement, which culminated in 1988 with the signature of the EU-GCC Cooperation Agreement.[1] Among broad political, social and cultural objectives, the Agreement sought to create a free trade area (FTA), but now, after more than 20 years of talks, the negotiations are stalled. Nevertheless, trade and investment relations between the two regions are flourishing: the GCC is among EU's top ten export markets, and estimates suggest that 30 percent of Gulf investments were made in the EU. Against this backdrop, this commentary provides with a brief overview of EU-GCC trade and investment patterns, highlighting current trends and future prospects.

Explaining EU-GCC trade links

With an average per-capita income above €19,000 in 2010, the EU and GCC countries are among the richest in the world, as reflected in their diversified production structures and hydrocarbons endowment, respectively.[2] Since the 1990s, trade relations between both actors have gained increased importance: the GCC has become the EU's 6th largest export market and trade flows have proved resilient to the worldwide economic and financial crisis, especially as regards EU exports to the region (Figure 1). Patterns of trade revolve around exports of machinery and electrical products; manufactured goods and chemicals from the EU (45, 13, 12 and 11 percent, respectively). For obvious reasons, EU's imports from the GCC are mainly constituted of hydrocarbons.

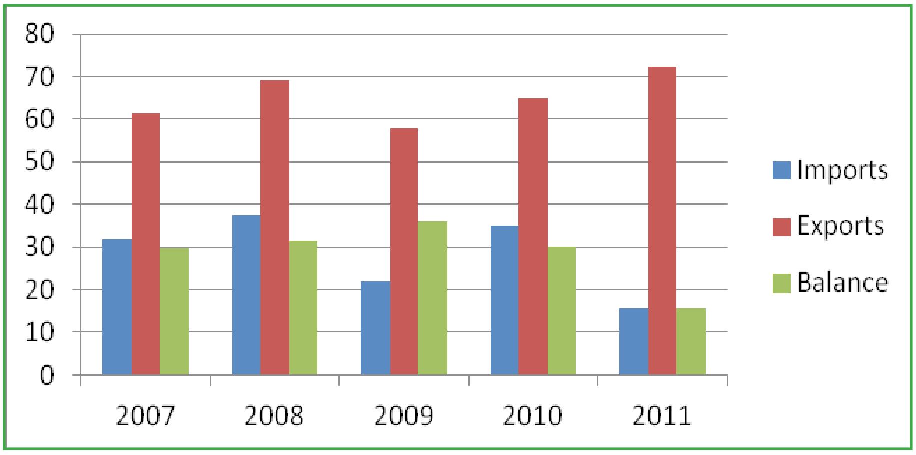
Besides the differences in natural resource and human capital endowments between the

1 EU-GCC Cooperation Agreement, Official Journal L 054 of 25/02/1989, p. 3-15, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1989:054:0003:0010:EN:PDF.

2 See Annex 1 for general socio-economic indicators of the EU and the GCC.

two regions, two elements help explain EU-GCC trade patterns. First, since 2000, the GCC countries have engaged in important development plans which, among other objectives, have sought to upgrade the region's infrastructure and favour internal economic activities. Second, after the US invasion in Iraq, political developments in Iran, and increased instability in neighbouring countries (Yemen, Somalia), the GCC countries have strived to deepen ties with EU member states on security and defence matters. Examples include the 2009 Saudi-French €2 billion deal for the provision of air, sea and ground defence systems along the Yemeni border as well as Germany's sale of aircraft parts.

FIGURE 1. EU TRADE WITH THE GCC, 2007-11 (€ BILLION)*



**Trade in goods only. Same trends are reported for trade in services, with a cumulative €53 billion surplus in favour of the EU.*

Source: European Commission (2010a and 2012).

Despite evolving trade relations, negotiations for the conclusion of the EU-GCC FTA have long been stalled regardless of recurring pledges and declarations aimed at finalisation.[3] Contentious issues on both the EU's and GCC's sides regarding hydrocarbons are the main reason behind the FTA's failure. On the GCC's side, Saudi Arabia refused to stop subsidising its energy industry,[4] and other countries decided to maintain a differentiated pricing of gas exports, non-transparent public procurement procedures, and entry barriers to foreign investors in the services sector. On the EU's side, the petrochemicals industry lobbied against trade liberalisation, arguing that the GCC's double-pricing policy was an implicit subsidy that would allow dumped imports to enter the EU.[5] The industry also fought against the FTA

3 See for example the Conclusions of the 2011 EU-GCC Ministerial Meeting where both parties vowed to "continue consultations […] with a view to conclude the FTA as soon as possible".

4 R. Youngs, "Impasse in Euro-Gulf Relations", *FRIDE Working Paper*, No. 80, April 2009, http://www.fride.org/publication/596/impasse-in-euro-gulf-relations.

5 A. Antikiewicz and M. Bessma, "Pursuing Geopolitical Stability through International Trade: The EU's Motives for Negotiating with the Gulf Cooperation Council", *Journal of European Integration*, Vol. 31, No. 2, 2009.

due to Saudi Arabia's potential in petrochemicals. The national petrochemical firm, SABIC, is the regional leader in the industry and the FTA would promote its expansion in Europe. For the regional hydrocarbon industry in general and for the Saudi petrochemical company in particular, trade integration between the two regions could facilitate the acquisition of world-class technology, which could be a potential threat to the EU's competitive advantage and global market power.[6]

Turning to the future, EU-GCC trade cooperation is expected to consist mainly of 'soft measures'. According to the 2010-13 EU-GCC Joint Action Programme for the Implementation of the Cooperation Agreement, commercial cooperation is expected to take the form of trade fairs; exchange of business delegations; sector-specific workshops in areas such as e-commerce, consumer protection and export requirements; opening dialogue on market access and the exchange of views on multilateral level topics.[7] However, such soft measures may not be sufficient to warrant a long-lasting EU-GCC partnership, in particular in view of the growing importance of EU-GCC investment relations.

Investment relations

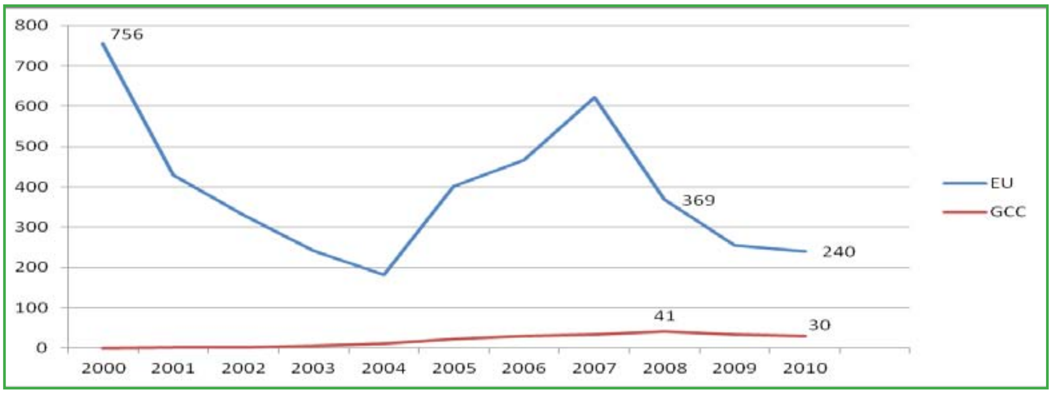
EU-GCC investment relations are even more important in magnitude. While GCC inward FDI lagged behind during the 1990s, the reforms initiated in 2000 yielded important results for Gulf countries' attractiveness to foreign investors. In 2000, total FDI inflows in GCC amounted to €424 million, increasing to €1.6 billion in 2002 and reaching €22 billion in 2005. Since that date, they have consistently been above €25 billion (Figure 2). The reforms contributed to enhancing the region's business environment by privatising important segments of the economy, easing entry of foreign investors, creating free trade zones and concluding bilateral investment treaties with a number of countries.

Moreover, Saudi Arabia's accession to the WTO in 2005 has played a significant role in the region's FDI performance. Data limitation on FDI prevent us from making a precise estimate of the sector distribution of FDI, but secondary evidence suggests that banking and financial services, petrochemical industries, and telecommunications have concentrated more than half of inflows between 2004 and 2009.

6 PriceWaterHouseCoopers (PWC), "Sustainability and Impact Assessment (SIA) of the Negotiations of the Free Trade Agreement between the European Community and the Countries of the Cooperation Council for the Arab States of the Gulf", Report for the European Commission, 30 May 2004, http://trade.ec.europa.eu/doclib/docs/2005/january/tradoc_121208.pdf.

7 Joint Action Programme for Implementation of the GCC-EU Cooperation Agreement of 1988, 2010-2013, , http://eeas.europa.eu/gulf_cooperation/docs/joint_action_programme_en.pdf.

FIGURE 2. FDI INFLOWS TO THE EU AND THE GCC, 2000-10 (€ BILLION)



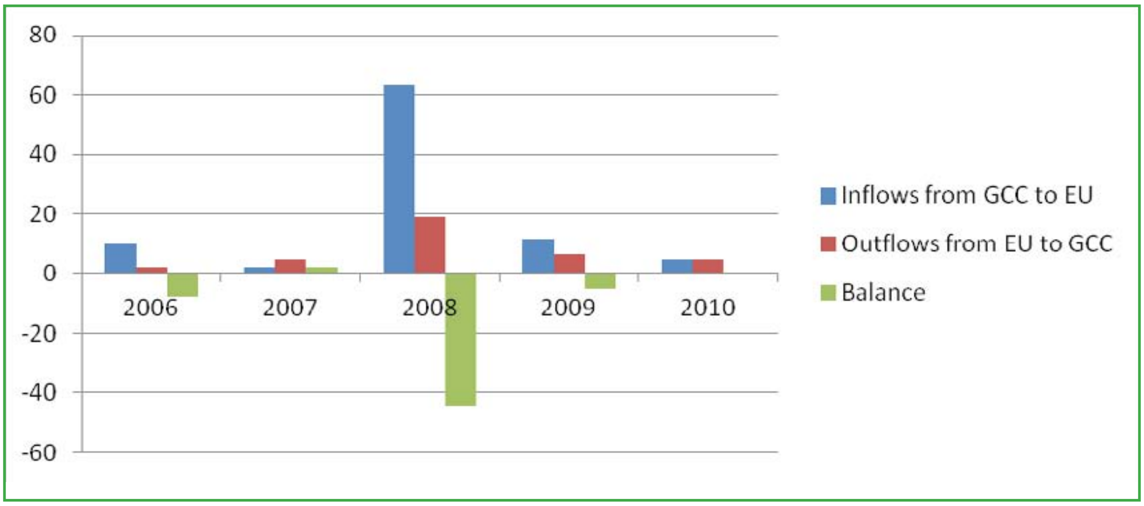
Source: United Nations Conference on Trade and Development (UNCTAD), Online Statistics Database.

According to data by Eurostat and UNCTAD, EU investors are small players in GCC economies and bilateral investment flows have been affected comparatively more by the economic and financial crisis than trade flows.

While EU FDI to the GCC has amounted to a yearly average of €4.5 billion since 2006, GCC's investments in the EU have been declining: starting from a level €10 billion in 2006, they have decreased by nearly 50 percent, reaching €4.6 billion in 2010 (Figure 3). However, reflecting past investments' profitability in both regions, EU and GCC FDI stocks have been on the rise (Figure 4).[8]

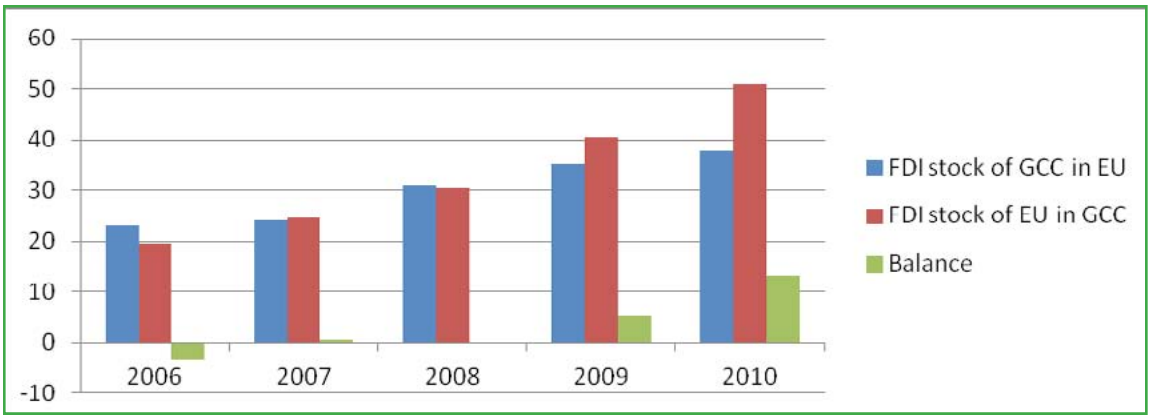
8 UNCTAD defines FDI as an investment involving a long-term relationship and reflecting a lasting interest in and control by a resident entity in one economy (foreign direct investor or parent enterprise) of an enterprise resident in a different economy (FDI enterprise or affiliate enterprise or foreign affiliate). Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates. FDI stock is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise, plus the net indebtedness of affiliates to the parent enterprises. Source: International Monetary Fund, *Balance of Payments Manual*, 5th Edition, Washington, http://www.imf.org/external/pubs/ft/bopman/bopman.pdf.

FIGURE 3. EU-GCC BILATERAL FDI INFLOWS, 2006-10 (€ BILLION)



Source: European Commission (2010a and 2012).

FIGURE 4. EU-GCC FDI BILATERAL FDI STOCKS, 2006-10 (€ BILLION)



Source: European Commission (2010a and 2012).[9]

9 European Commission, Directorate General for Trade (DG TRADE), "EU Bilateral Trade with the GCC and Trade with the World", September 2010 and March 2012, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113482.pdf.

Depending on the stake acquired by the foreign investor,[10] figures on GCC FDI inflows to the EU might or not reflect investments made by sovereign wealth funds (SWFs).[11]

The accumulation of wealth generated by oil exports has allowed GCC states to build vast reserves channelled into SWFs. Between 2002 and 2006, approximately $100 billion of the $642 billion surplus concentrated in these funds was invested in EU countries, especially in the financial sector. Since the beginning of the crisis in 2008, GCC SWFs emerged as important purveyors of emergency financing. For example, the Abu Dhabi Investment Authority an Emirati SWF, took a $6 billion stake in the British Barclays Bank; and in August 2011, Paramount Services Holding, an investment vehicle of the Qatari royal family[12] injected €500 million in a new entity resulting from the merger of Greek financial institutions Alpha Bank and Eurobank.[13] The same year, Qatari Prime Minister Hamad bin Jassim bin Jaber bin Muhammad Al Thani announced his country's SWFs stood ready to invest €300 million in the troubled Spanish savings banks (*cajas de ahorro*).

GCC SWFs have long been investing in Europe, but the secrecy surrounding SWFs in general and GCC SWFs[14] in particular do not allow for a correct estimation of their assets under management in the continent. As an indication of SWFs' interest in Europe, between 1995 and 2010, 30 percent of their cross-border investment was made in the EU, and the total stocks acquired by GCC's private investors and SWFs in the EU is estimated at more than €400 billion, making them among the largest foreign stakeholders in Europe.[15] Their

10 According to International Monetary Fund's (IMF), "*[Foreign]Direct Investment is the category of international investment that reflects the objective of a resident entity in one economy in obtaining a lasting interest in a company located in another country*". Hence, depending on the stake acquired by the SWF, the investment might or not qualify as FDI. Usually, for an international investment to qualify as FDI, a 10 percent threshold is applied. See *Balance of Payments Manual*, cit.

11 SWFs are investment vehicles created by governments for macroeconomic purposes such as smoothing life income streams for future generations in countries dependent on commodities' exports or avoiding exchange rate appreciation in countries accumulating important exchange reserves.

12 The large amount of wealth proceeding from hydrocarbon exports has also encouraged GCC ruling families to create such investment vehicles. While they might not be considered as SWFs since they are not sovereign investors, the intricacy between GCC countries' ruling institutions and families allow assimilating such investment vehicles to SWFs.

13 International Institute for Strategic Studies (ISS), "Sovereign Funds Eye Opportunities in Europe", *Comment*, No. 39, November 2011.

14 In 2008, the IMF issued the Generally Accepted Principles and Practices (GAAP), a voluntary and non-binding code of conduct for SWFs aimed at stimulating disclosure of information and transparency, known as the Santiago Principles. Only Oman, Kuwait and the United Arab Emirates have adhered to the Principles and only two Omani and Emirati Funds have disclosed audited balance sheets in 2010. Ministers from OECD countries also undertook not to discriminate against SWFs' investments by signing the 2008 OECD Declaration on Sovereign Wealth Funds (SWFs) and Recipient Country Policies.

15 S. Hertog, "EU-GCC Relations in the Era of the Second Oil Boom", *CAP Working Paper*, December 2007, http://www.cap-lmu.de/publikationen/2007/hertog.php.

increased presence in the EU has stirred deep controversy among member states. France, Germany and Italy voiced open concerns about the lack of transparency in SWFs, suspecting their acquisitions to be backed by geopolitical objectives. However, the aggravation of the eurozone crisis makes such open comments less likely, as rating agencies cut eurozone countries' ratings and their banking systems need recapitalisation.

The high level of financial interdependence between the EU and the GCC contrasts with the shallowness of their diplomatic and political relations. Investment matters are neither part of the latest Joint EU-GCC Ministerial Meetings, nor of the 2010-13, Joint Action Programme, leaving these issues at an informal level of discussion. Nevertheless, as the eurozone crisis deepens, it remains to be seen whether EU-GCC investment linkages will be reinforced or not. Indeed, the financial turmoil has translated into some major losses for SWFs, which could induce them to focus their portfolios on emerging markets, while at the same time their long-term focus could on the contrary push them towards acquisitions in the EU. In addition, unrest in their own countries as well as neighbouring territories has prompted a general refocusing in the Arab region in a bid to appease unrest and avoid contagion.[16]

Conclusion

Since the signature of the 1988 EU-GCC Cooperation Agreement, EU and GCC relations have mostly revolved around bilateral trade and investment, with other European initiatives towards the region being of a limited nature. The GCC is an important export market to the EU as well as a hydrocarbon supplier and investor. While economic relations until now appear to have withstood the negative impact of the crisis, the eurozone's uncertainties cast doubts about future relations between the regions. These uncertainties have prompted more GCC activity in Arab and Southern Mediterranean countries. Following the outbreak of unrest in the region, the EU has announced an overhaul of its Neighbourhood Policy resting not only on increased commitments to the region, but also on a stricter conditionality, granting of trade concessions, and greater support to democracy promotion and civil society.

On the other hand some GCC countries were also affected by a growing unrest, driven by inequalities, stagnant socioeconomic development prospects and diverse forms of discrimination, prompting governments to respond by announcing benefit packages, creating public sector jobs and initiating modest political reform processes. What is more, in a bid to preserve stability within the regional grouping and avoid potential spill-over of unrest, the GCC invited Jordan and Morocco to join, leading to commitments to support both countries' development plans as well as cash transfers. As both the EU and the GCC have an interest in addressing the root causes of the unrest in the Southern Mediterranean, there exists a window of opportunity for engaging in a trilateral cooperation framework.
Such a cooperation framework could take the form of a platform involving private sector

16 D.A. Glancy, "Political Risk – An Important Issue for Sovereign Wealth Funds", The Sovereign Wealth Fund Initiative, *SWFI Paper*, February 2012, http://fletcher.tufts.edu/SWFI/SWFI-Research-and-Activities.

investors', Gulf SWFs', EU institutions', as well as GCC and Southern Mediterranean countries' representatives tasked with coordinating funding for development programs as well as mutually identified initiatives. Given the likelihood of increased political risk in the region and the subsequent rise in the cost of capital, involvement of international donors would be beneficial for engineering "blended" financial instruments, mixing grants and loans, as a means to reassure private sector investors. Such a framework, if implemented, could emerge as a valuable instrument for cooperation and socioeconomic development in the Southern Mediterranean while contributing to a renewal of bilateral EU-GCC relations.

ANNEX 1. EU AND GCC SOCIOECONOMIC INDICATORS (2010)

	GDP (€ bn)	GDP/ Capita (€)	GDP growth (%)	Population (mil)	Trade (% GDP)	Stocks traded (% GDP)	Inflation (%)	Literacy rate (%)	Life ex-pectancy (%)
EU	12,438	24,371	2	502.3	71	58	2.2	99	80
GCC	818	19,043	4.23	43.5	98 (2009)	27.06	2.42	90.5	75.21

Sources: World Bank, World Development Indicators and Eurostat for EU inflation. Regional averages except for GDP and population. Data are for 2010 unless otherwise indicated.

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ABOUT SHARAKA

Sharaka is a two-year project implemented by a consortium led by Istituto Affari Internazionali (IAI).

The project, partially funded by the European Commission, explores ways to promote relations between the EU and the Gulf Cooperation Council (GCC), through the implementation of policy-oriented research, outreach, training and dissemination activities. The overall project aim is to strengthen understanding and cooperation between the EU and the GCC, with particular attention to the strategic areas identified in the Joint Action Programme of 2010, such as trade and finance, energy, maritime security, media and higher education.

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Sharaka Commentaries is an ongoing series of opinion pieces on topical Gulf issues and EU-GCC relations written by experts and scholars in Europe, the Gulf countries and the North Africa and Middle Eastern region. The series complements the research conducted in the framework of the project Sharaka. The Sharaka Commentaries examine key questions surrounding the political, socio-economic and cultural evolution of the Gulf region as well as the challenges and opportunities in EU-GCC cooperation.