

# Bridging the Gulf: EU - GCC Relations at a Crossroads

IAI RESEARCH PAPERS

Edited by  
Silvia Colombo



Edizioni Nuova Cultura



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*Istituto Affari Internazionali*

# IAI Research Papers

# Bridging the Gulf: EU-GCC Relations at a Crossroads

*edited by Silvia Colombo*



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***Series Editor***

Natalino Ronzitti

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# List of authors

**Fatma Al-Araimi** is Correspondent at Thomson Reuters, Sultanate of Oman. She previously occupied the positions of Assistant Editor of *Alam al-Iktisad Wal A'mal* magazine and Editor in Chief of *Signature* magazine.

**Rym Ayadi** is Senior Research Fellow and Head of Research of the Financial Institutions, Prudential Policy and Tax Unit at the Center for European Policy Studies (CEPS), Brussels.

**Cinzia Bianco** holds an MA in Middle East and Mediterranean Studies from King's College, London. She was the Sharaka fellow at Tawasul, Oman, between October and December 2013.

**Silvia Colombo** is a Research Fellow at the Istituto Affari Internazionali (IAI), Rome, and coordinator of the Sharaka project.

**Camilla Committeri** holds an M.Sc. in International Relations from Sciences Po, Paris, and an M.Sc in International Political Economy at the London School of Economics and Political Science (LSE), London. She was a stagiaire at the Istituto Affari Internazionali (IAI), Rome, in the framework of the Sharaka project.

**Nicolas Cottret** was energy analyst at the Renewable Energy Division at the Observatoire Méditerranéen de l'Energie (OME), Nanterre.

**Salim Gadi** is Research Assistant at the Center for European Policy Studies (CEPS), Brussels.

**Willem Pieter de Groen** is Researcher at the Center for European Policy Studies (CEPS), Brussels.

**Emanuela Menichetti** is the Director of the Renewable Energy Division at the Observatoire Méditerranéen de l'Energie (OME), Nanterre.

**Ahmed Ali M. Al-Mukhaini** is an independent researcher in political developments, human rights and dialogue, and the former assistant secretary-general for the Shura Council in Oman.

**Natalino Ronzitti** is Emeritus Professor of International Law, LUISS University, Rome, and Scientific Advisor, Istituto Affari Internazionali (IAI), Rome.

**Abdulaziz Al-Shalabi** works as a mechanical engineer at the Industrial Department and the National Ozone Unit at the Environment Public Authority of Kuwait (KEPA). From February to May 2013 he held the position of Sharaka Fellow at the Observatoire Méditerranéen de l'Énergie (OME), Nanterre.

# List of abbreviations

ACRS	Arms Control and Regional Security Working Group
ADWEC	Abu Dhabi Water and Electricity Company (UAE)
AER	Authority for Electricity Regulation (Oman)
ASEAN	Association of South-East Asian Nations
AUE	Arab Union of Electricity
BCN weapons	Bacteriological, Chemical and Nuclear weapons
BOT	Build, Operate and Transfer
BP	British Petroleum
BRSS	Bank Regulation and Supervision Surveys
CAGR	Compound Average Growth Rate
CDM	Clean Development Mechanism
CPF	Country Program Framework
CPP	Competitive Procurement Process
CS	Continental Shelf
CSBM	Confidence and Security Building Measure
CSP	Concentrated Solar Power
CWC	Chemical Weapons Convention
DEWA	Dubai Electricity and Water Authority (UAE)
DFSA	Dubai Financial Services Authority
DLR	German Aerospace Centre
DNI	Direct Normal Irradiance
DPC	Dhofar Power Company (Oman)
DSM	Demand Side Management
EBRD	European Bank for Reconstruction and Development
ECRA	Electricity and Cogeneration Regulatory Authority (Saudi Arabia)
EEAS	European External Action Service
EEZ	Exclusive Economic Zone
EHC	Electricity Holding Company (Oman)
EIB	European Investment Bank
EIJJLPST	Egypt, Iraq, Jordan, Lebanon, Libya, Palestine, Syria, and Turkey
EMMS	Energy Market Management System
ENEC	Emirates Nuclear Energy Corporation (UAE)
ENP	European Neighbourhood Policy
ENTSO-E	European Network of Transmission System Operators for Electricity

EOR	Enhanced Oil Recovery
EPIA	European Photovoltaic Industry Association
ERRA	Energy Regulators Regional Association
ESMA	Emirates Authority for Standardization and Metrology (UAE)
EU	European Union
EWA	Electricity and Water Authority (Bahrain)
FANR	Federal Authority for Nuclear Regulation (UAE)
FDI	Foreign Direct Investment
FEWA	Federal Electricity and Water Authority (UAE)
FTA	Free Trade Agreement
GAPP	Generally Accepted Principles and Practices
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
GCCIA	Gulf Cooperation Council Interconnection Authority
GDP	Gross Domestic Product
GED	Global Education Digest
GHG	Greenhouse Gas
GHI	Global Horizontal Irradiance
GMP	Global Mediterranean Policy
GORD	Gulf Organization for Research and Development
GSP	Generalized System of Preferences
HCoC	Hague Code of Conduct against Ballistic Missile Proliferation
HDI	Human Development Index
HESR	Higher Education and Scientific Research
IAEA	International Atomic Energy Agency
IAIS	International Association of Insurance Supervisors
ICC	International Criminal Court
ICI	Istanbul Cooperation Initiative
ICJ	International Court of Justice
ICoC	International Code of Conduct for Security Companies
IEA	International Energy Agency
IFSB	Islamic Financial Services Board
ILO	International Labour Organization
IMF	International Monetary Fund
IMO	International Maritime Organization
IPP	Independent Power Producer
IPTA	International Parcel Tanker Association
IRENA	International Renewable Energy Agency
IWG	International Working Group on SWFs
IWPP	Independent Water and Power Producer
JICA	Japan International Cooperation Agency
JPA	Joint Action Programme
K.A.CARE	King Abdullah City for Atomic and Renewable Energy (Saudi Arabia)
KAHRAMAA	Qatar General Electricity and Water Corporation

LIST OF ABBREVIATIONS

KAUST	King Abdullah University of Science and Technology (Saudi Arabia)
KEPCO	Korea Electric Power Company
KIA	Kuwait Investment Authority
KISR	Kuwait Institute for Scientific Research
KNNEC	Kuwait National Nuclear Energy Committee
LEED	Leadership in Energy and Environmental Design
LNG	Liquefied Natural Gas
MARPOL	International Convention for the Prevention of Pollution from Ships
MBC	Middle East Broadcasting Centre
MD	Mediterranean Dialogue
MED	Multi-effect distillation
MEDENER	Mediterranean Association of National Agencies of Energy Conservation
MEDREG	Mediterranean Regulators for Electricity and Gas
MENA	Middle East and North Africa
MEPC	Marine Environment Protection Committee
MEW	Ministry of Electricity and Water
MIS	Main Interconnection System
MMOU	Multilateral Memorandum of Understanding
MOU	Memorandum Of Understanding
MOWE	Ministry of Water and Electricity
MSF	Multi-stage flash
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
NEEP	National Energy Efficiency Program
NPL	Non-Performing Loan
NPT	Non-proliferation Treaty
NREP	National Renewable Energy Plan
NWFZ	Nuclear Weapons Free Zone
OAPEC	Organization of Arab Petroleum Exporting Countries
OCMA	Oman Capital Market Authority
OETC	Oman Electricity Transmission Company
OLI	Ownership Location Internalisation
OME	Observatoire Méditerranéen de l'Énergie
OPEC	Organization of the Petroleum Exporting Countries
OPWP	Oman Power and Water Procurement Company
OTRI	Overall Trade Restrictiveness Index
PAEW	Public Authority for Electricity and Water (Oman)
PCASP	Privately Contracted Armed Security Personnel
PMSC	Private Military and Security Company
PPP	Public-Private Partnership
PSI	Proliferation Security Initiative
PST	Poly-Silicon Technology
PV	Photovoltaic

QEWC	Qatar Electricity and Water Company
QFCRA	Qatar Financial Center Regulatory Authority
QIA	Qatar Investment Authority
QNFSP	Qatar National Food Security Programme
QP	Qatar Petroleum
QPEERU	Qatar National Plan for Energy Efficiency, Optimization and Resource Utilization
QSAS	Qatar Sustainability Assessment System
QSTec	Qatar Solar Technologies
QSTP	Qatar Science and Technology Park
RAECO	Rural Areas Electricity Company (Oman)
RBS	Risk-Based Solvency
RE	Renewable Energy
RMP	Renovated Mediterranean Policy
RO	Reverse Osmosis
ROA	Return-On-Asset
ROE	Return-On-Equity
ROPME	Regional Organization for the Protection of the Marine Environment
SAMA	Saudi Arabian Monetary Agency
SEC	Saudi Electricity Company
SEEC	Saudi Energy Efficiency Center
SEPC	Sustainable Energy Procurement Company (Saudi Arabia)
SEWA	Sharjah Electricity and Water Authority (UAE)
SM	Social Media
SME	Small and Medium-sized Enterprise
SST	Swiss Solvency Test
STRI	Services Trade Restrictiveness Index
SUA	Convention for the Suppression of Unlawful Acts Against the Safety of Maritime Navigation
SWF	Sovereign Wealth Fund
TPES	Total Primary Energy Supply
TREC	Trans-Mediterranean Renewable Energy Cooperation
UAE	United Arab Emirates
UAE	United Arab Emirates
UNCLOS	United Nations Convention on the Law of the Sea
UN-ESCWA	United Nations Economic and Social Commission for Western Asia
UNFCCC	United Nations Framework Convention on Climate Change
UNODC	United Nations Office on Drugs and Crime
US	United States
VAT	Value-Added Tax
WMD	Weapons of Mass Destruction
WMDFZ	Weapons of Mass Destruction Free Zone
WTO	World Trade Organization

LIST OF UNITS

bcm	Billion standard cubic metres
bn b	Billion barrels
GW	Giga Watt
kWh	Kilo watt-hours
MCM	Million cubic metres
Mtoe	Million tonnes oil equivalent
MW	Megawatt
TWh	Tera watt-hours



# Foreword

*Silvia Colombo*

This volume collects the revised and updated versions of the technical reports produced in the framework of the project 'Sharaka – Enhancing Understanding and Cooperation in EU-GCC Relations' co-funded by the European Commission - Service for Foreign Policy Instruments between 2012 and 2013. The project and the book itself come at a timely moment in which relations between these two important regional blocs are at an all-time low and need to be revamped on new, more solid foundations. As such, not only does this book offer an important contribution to the scholarly debate on the evolution of the relations between the European Union (EU) and the Gulf Cooperation Council (GCC), but it also attempts to shed light on the potential future course of this strategic relation in the years ahead. In this light, it highlights the areas where greater room for manoeuvre exists in order to enhance EU-GCC relations, discusses the instruments available and sheds light on the features of the regional and international context that are likely to significantly influence the new phase in the mutual relation between the two blocs.

The chapters of the book have been drafted by some of the members of the Sharaka project research team that has worked for over two years to assess the past, present and future of EU-GCC relations from a multiplicity of perspectives. Some of the authors, indeed, combine a solid academic background with cross-cutting experiences as practitioners in different fields. The result is a book that sheds light on the complexity and the challenges embedded in EU-GCC cooperation as much as it highlights the hidden opportunities that could be grasped by reinvigorating this strategic partnership.

The first chapter sets the conceptual framework that has guided the research carried out by the project. It contextualises the current state of EU-GCC relations in the framework of the history of cooperation between the two regions. It then identifies the factors that have favoured cooperation and those that have hindered closer relations and led to unfulfilled potential. The following chapters are thematic in nature, covering some selected areas of cooperation among

those identified in the Joint Action Programme for 2010-2013 for the implementation of the Cooperation Agreement of 1988. These areas, ranging from trade and financial cooperation to higher education and media and communications, have been identified as the most promising ones to revamp the cooperation between the two blocs. Some of these areas of cooperation, such as trade and energy, have always featured rather high on the list of priorities of the EU *vis-à-vis* the GCC. As discussed by Ayadi and Gadi in the second chapter, at the time of the conclusion of the Cooperation Agreement, the motivations of the EU countries were quite straightforward. The GCC countries were important suppliers of hydrocarbons and no less important as an export market for European economies. This has created an imbalance between the economic objectives, on the one hand, and the political cooperation, on the other, which has remained dismally low. In addition to discussing the trade and investment flows between the two regions in the last decade and the growing competition to the European economies represented by Asia, the chapter focuses on the reasons for the derailment of the Free Trade Agreement (FTA) between the two regions, assessing the prospects for concluding it in the near future. Chapter three explores the financial sector (banking and insurance) in the GCC in comparison with the EU, assesses regulatory convergence and provides policy recommendations for future financial partnerships between the two regions. The banking and insurance sectors represent some of the most dynamic ones in the GCC countries and greater convergence with the EU could greatly benefit from an enhanced European Banking Union.

Chapters four and five are devoted to exploring the issues of energy cooperation and maritime security, respectively. In terms of energy cooperation, the EU has a well-founded interest to cooperate with the GCC countries and support them in addressing and successfully tackling energy issues. EU-GCC cooperation makes particular sense when one considers that the EU is, on the one hand, one of the world's major importers of hydrocarbons and, on the other, the leading global proponent of sustainable development. Before addressing these issues, the chapter provides an in-depth analysis of the energy sector in the GCC countries, examining issues ranging from the importance of fossil fuels to electrical interconnections, and focusing on the latest developments in relation to renewable energy and energy efficiency in the region. Talking about EU-GCC cooperation on maritime security, Prof. Ronzitti focuses on legal problems involved in sea use and management, with reference to the issues of particular relevance for the Gulf, i.e. piracy, the establishment of ad hoc tribunals for the punishment of pirates/terrorists, the maritime relevance of the proposed WMD Free Zone (WMDZF) in the Middle East, the settlement of current maritime controversies and other soft security threats such as drug trafficking and traffick-

ing in persons.

Finally, the last two chapters are original analyses carried out by researchers and practitioners on the topics of EU-GCC cooperation on higher education and research, on the one hand, and media and communications, on the other. On both topics, the authors underscore that the lack of effective cooperation in education, students' mobility and significant media exposure between the two regions has been identified already in the relevant literature as key factors at the root of several setbacks in the interregional dialogue. However, these chapters argue that even if a number of obstacles have been acknowledged, very little has been done to concretely overcome them and that under the current conjuncture, characterised by heightened turbulences in both regions, it becomes more urgent to take action.

This comprehensive analysis of EU-GCC relations stresses that little space has been devoted over the years to the strategic dialogue between the two partners on political and security issues. This absence appears even more remarkable if one takes into account the host of crises that have manifested themselves in the broader Middle Eastern region in the past three years. This is a region in which both the EU and the GCC clearly have important stakes. In this light, not only would greater coordination in the responses and continuous dialogue be an asset for both partners in tackling these crises, but they would also help ease tensions between Europe and the Gulf and lay the ground for renewed cooperation in other domains.

As the EU and the GCC chart their future course, two points need to be taken into account. The first is the difference between leverage and conditionality. While the EU has tried, quite unsuccessfully, to make use of conditionality mechanisms to entice its partners into following its preferred course of action, it has dramatically lost leverage in the Arab world, including in the GCC countries. The EU has to make a serious effort to regain its credibility and effectiveness when dealing with this part of the world, if it wants to re-launch its relations with the GCC. The second point concerns the prospect for a more prominent European role in the security of the Gulf region and the possibility to use this as a springboard to other confidence-building measures. This role should not be aimed at containing threats, e.g. directly dealing with the GCC countries' fear about Iran's nuclear programme, but at risk-management, something the EU has already proved to be able to do in other contexts, i.e., the Balkans. Potential fields of cooperation, in which a joint assessment and a common strategy could be developed, include migration, conflict and post-conflict management, cyber-security, border control, maritime security and humanitarian operations at sea. These areas of cooperation do not require the use of hard force and are located on the blurring division line between domestic and foreign policy issues. Among the

benefits that such issue-based and pragmatic cooperation could bring to both partners is the possibility to unlock the potential of EU-GCC cooperation that has so far been trapped in an under-performing strategic partnership dialogue. Most importantly, it could act as a catalyst of much-needed confidence-building measures between the Arab Gulf countries and the West in general.

# 1.

## Need to Rethink the EU-GCC Strategic Relation

*Silvia Colombo and Camilla Committeri*

### INTRODUCTION

The Gulf Cooperation Council (GCC) and the European Union (EU) are two important global players with an enormous potential for cooperation in a number of sectors.<sup>1</sup> This potential notwithstanding, relations have tended to ebb and flow over time and are now at an all-time low and need to be revamped and rebuilt on a new, more solid foundation. The aim of this chapter is to shed some light on the past, present and future of EU-GCC relations, assessing their strengths and weaknesses and putting forth ideas to foster mutual cooperation.

The first section contextualises the current state of EU-GCC relations in the framework of the history of cooperation between the two regions. It then identifies the factors that have favoured cooperation and those that have hindered closer relations and led to unfulfilled potential. It also dwells on the challenges and opportunities embedded in the future of EU-GCC relations, which was the main objective of the Sharaka project. The second section assesses the present state of cooperation and the way forward in a number of sectors, ranging from trade and finance to communications and higher education. Our conclusions lay out some ideas about how to overcome obstacles and maximize the potential for EU-GCC cooperation and how the Sharaka project will contribute to this goal.

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<sup>1</sup> The GCC is a political and economic union of six states bordering the Persian Gulf, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

## 1.1. THE EU-GCC COOPERATION BETWEEN STRATEGIC INTERESTS AND IDEATIONAL OBSTACLES

### 1.1.1. *The EU and the GCC: A long history of cooperation*

Relations between Europe and the GCC date back to the Cooperation Agreement signed in 1988, although intense bilateral relations based on historical and colonial ties preceded it. Contacts between the two sides started in 1983 as a direct consequence of the creation of the GCC in 1981.<sup>2</sup> The Cooperation Agreement, entered into force in 1989, was a fairly general document providing for the institutional framework in which cooperation should have been achieved in a number of fields of interest to both parties. These included the traditional sectors of the economy: energy, industry, trade, investment, agriculture, science, technology and the environment.<sup>3</sup> The principal aims were to improve economic relations between the two regions, intensify trade and investment exchange, strengthen interregional interdependence and initiate loose political dialogue. It also intended to encourage GCC regional integration, contribute to strengthening stability in a region of strategic importance to Europe, secure European energy supplies and strengthen the process of economic development and diversification of the GCC economies.

In spite of this comprehensive list of ambitious goals, EU-GCC relations have been largely confined to trade and economic issues for many years. One of the main goals of the Cooperation Agreement was the establishment of an EU-GCC free trade agreement (FTA). After the initial enthusiasm for the potentially positive repercussions on cooperation in political and security issues, negotiations gradually lost steam and were unilaterally interrupted by the GCC at the end of 2008. While the next section will discuss the factors that have prevented the establishment of the FTA, it is commonplace to argue that this issue has taken EU-GCC relations hostage. Talks have gone through many ups and downs and the scope and mandate often changed to accommodate new priorities by one or both sides. The agreement would provide for a progressive, reciprocal and region-to-region liberalisation of trade in goods and services, aiming at ensuring a comparable level of market access opportunities. Negotiations would also cover common rules and regulations for intellectual property rights, competition, dispute settlement and rules of origin. Although FTA talks were initiated

<sup>2</sup> Matteo Legrenzi *The GCC and the International Relations of the Gulf. Diplomacy, Security and Economic Coordination in a Changing Middle East*, London and New York, I.B. Tauris, 2011.

<sup>3</sup> European Union, *Cooperation Agreement between the European Economic Community, of the one part, and the countries parties to the Charter of the Cooperation Council for the Arab States of the Gulf...* (21989A0225(01)), 25 February 1989, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=celex:21989a0225%2801%29:en:not>.

in 1990, immediately after the signing of the Cooperation Agreement, the prospects of a region-to-region FTA only became realistic in 2003, when the GCC became a customs union. The pace of negotiations accelerated in 2007 and there was much expectation that a conclusion would be reached in 2008. This did not happen as the GCC, feeling that too many concessions had been made with no reward coming from the European side, decided to suspend the FTA talks. In the following years, the two regions have only maintained the institutional exchanges through the yearly Joint Council and Ministerial Meeting, a series of communiqués and some expert meetings aimed at advancing cooperation in the areas of environment, energy, education and combating criminal activities.

However, this list does not make justice to the strategic nature of the EU-GCC relations in a number of areas. Some issues are specific to the EU and the GCC, while there are also a number of global issues that have a particular relevance for the bilateral relationship. On the one hand, energy relations are clearly the main driver of EU-GCC relations and the sector in which fewer doubts exist about the necessity to increase cooperation: Europe needs to secure the procurement of its growing energy demand and the GCC countries seek to obtain access to technology and know-how. On the other hand, the current global financial crisis has raised important questions about the role of the Gulf Sovereign Wealth Funds and Gulf investments in general. Although EU-GCC relations may look asymmetrical in some respects, with Europe and its member states vying with other actors such as China and India for a special relationship with the GCC countries to cope with their financial and energy needs, reality on the ground tells a different story. Europe is and remains one of the most important strategic partners for the Gulf region as well as a sort of model for the latter's internal evolution in the direction of increased regional integration. Strategic interests notwithstanding, the two regions have grown increasingly apart, turning their dialogue and cooperation into a formal and fruitless exercise.

In 2010, the EU and the GCC agreed on a Joint Action Programme for 2010-2013 for the implementation of the Cooperation Agreement of 1988.<sup>4</sup> The Programme is once again a detailed but scarcely operational list of areas of cooperation ranging from trade and energy to culture and mutual understanding and higher education and scientific research. The Joint Action Programme has not contributed to resurrecting and putting the EU-GCC cooperation on a new track; relations need to be recast by trimming the number of areas, in order to avoid an all-encompassing list that could dilute the cooperation, and should focus instead on best practices (see the Conclusions for a more detailed elaboration on this issue).

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<sup>4</sup> Gulf Cooperation Council, *Joint Action Programme for Implementation of the GCC-EU Cooperation Agreement of 1988: 2010-2013*, June 2010, [http://eeas.europa.eu/gulf\\_cooperation/docs/joint\\_action\\_programme\\_en.pdf](http://eeas.europa.eu/gulf_cooperation/docs/joint_action_programme_en.pdf).

After more than 20 years since the 1988 EU-GCC Cooperation Agreement and many rounds of meetings, cooperation between the two sides remains dismally limited and does not live up to the potential and aspirations of both sides. The global financial and economic crisis has only increased the urgency to re-think the EU-GCC strategic relationship by addressing the lack of political will to settle some pending issues. Over the years, this situation has bred a certain degree of mistrust and lack of confidence, particularly regarding the intentions and the ability of the EU to pursue a sincere, non-preconditioned dialogue with the GCC to increase mutual cooperation.

More recently, the events of the so-called Arab Spring have highlighted the little leverage enjoyed by the EU in the Gulf region and the lack of instruments in the field of foreign policy cooperation. The fact that the EU has not engaged the GCC in its initiatives targeted to the Mediterranean and the Middle East tells a lot about the short-sightedness of the EU in relation to the GCC. The risk is that the new political and socio-economic regional developments will further dilute the European presence and influence in the Gulf region. The next paragraphs discuss how this situation has materialised, pinpointing some of the causes of the deficits in EU-GCC relations.

### *1.1.2. Explaining the relationship to date: structural factors*

Among the reasons for the disappointing performance and outstanding difficulties in developing EU-GCC relations, both structural and contingent factors can be mentioned. Generally speaking, EU-GCC cooperation was affected by the domestic, regional and international political and economic situation of the Gulf countries.

Starting from the structural factors, EU-GCC multilateral relations have suffered from the resilience of bilateral relations between individual European member states and particular Gulf states. Institutional deficiencies inside the GCC are partially responsible for this situation. While economic and financial regional integration is not yet complete (see Section 1.2. for more details on the current state of economic ties at the regional level), decision-making on strategic issues such as foreign policy is still taking place at the individual state level rather than within the framework of the multilateral GCC. This is also reflected in the contrasts and rivalries that sometimes emerge in the positions of the six GCC states in relation to some strategic decisions regarding both domestic and external domains. Evidence of contrasts within the GCC is, for example, the increased competition between Saudi Arabia and Qatar in the wake of the Arab Spring and the covert struggle related to the issue of monetary union. In March 2010, Saudi Arabia, Kuwait, Qatar and Bahrain set up a forerunner to the Gulf

central bank, a “monetary council”, but since then the institution has kept a low profile because of the lack of agreement on the whole issue. More in general, it is possible to speak of the GCC as a weak-integrated regional organisation, in which major disagreements exist among its member states about the form of cooperation to be pursued both in internal and external affairs.

The difficulties encountered in EU-GCC relations cannot be blamed on the Gulf partners alone. At the European level, EU member states have often developed an independent foreign policy, thus retaining as much freedom of manoeuvre as possible in terms of their bilateral relations with the GCC countries. This is the case, for example in relation to the United Kingdom, France and Germany, each of which has tried to cultivate a privileged relationship with individual GCC countries.<sup>5</sup> This has led to a certain degree of unease on the part of some member states with the way in which the Commission has recently sought to fashion a leading role for itself in EU-GCC relations. Furthermore, member state policies have also signalled to the GCC countries that it is not worth taking the EU seriously.

The development of relations between the two parties is also impacted by the structural difficulties of European foreign and security policy. Before the entry into force of the Lisbon Treaty, the rotating EU presidency played a significant role in advancing or hindering EU-GCC relations. Past research has shown that some presidencies have had the capacity and determination to focus on the development of EU-GCC relations, such as that of Germany in the first half of 2007 and France in the second half of 2008, while during other presidencies the EU-GCC field has lied fallow.<sup>6</sup> With the coming into force of the Lisbon Treaty in December 2009, EU-GCC relations have fallen into the competences of the European External Action Service (EEAS). From the reports and joint communiqués released in the aftermath of the EU-GCC Joint Council and Ministerial Meetings held in 2010, 2011 and 2012, it emerges that long discussions have been going on regarding a number of regional and international issues and the need to devise and implement “common solutions” to “common challenges”. In contrast, little information is available on the plans to advance cooperation between the EU and the GCC in the domains that go beyond foreign policy. This is a direct continuation of the trend inaugurated with 9/11 and characterising European foreign policy with regard to all Arab governments: Counterterrorism policies and the need to control the turbulence originating from Iraq and Iran have become the most urgent topics of discussion and consultation between the

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<sup>5</sup> Abdullah Baabood and Geoffrey Edwards, “Reinforcing Ambivalence: The Interaction of Gulf States and the European Union”, in *European Foreign Affairs Review*, Vol. 12, No 4 (Winter 2007), p. 537-554 at p. 548-550.

<sup>6</sup> Christian Koch, “Exploring Opportunities in the EU-GCC Relationship”, in *Al Jisr Policy Briefs*, October 2009, <http://www.aljisr.ae/?q=node/33>.

parties.

One of the main reasons for the “disappointing progress in EU-GCC relations”, writes Richard Youngs from FRIDE<sup>7</sup>, “is that the EU has been unable to resolve the tensions between the economic and political strategies in the Gulf”.<sup>8</sup> The main argument is that economic questions, and in particular the strong emphasis on the FTA, have interfered with political and governance issues, while neither track of the cooperation has actually reached the desired results. Although a certain mismatch between political and economic goals exist in any relation, in the Gulf such tensions have proven especially difficult to reconcile. Lack of flexibility on economic policies has been an obstacle to political objectives, while short-term thinking on strategic challenges has failed to advance economic cooperation.

On the economic side, integration of the GCC economies, from ways to improve the customs union, to implement the common market, and to prepare for the introduction of a common currency, has not yet reached the desired level. This hinders further cooperation and coordination with the EU on economic matters, as the EU sees these steps as a facilitating pre-condition for the FTA. At the international level, GCC countries often blame the EU for its scarce support for the integration of the GCC economies into global markets. For years EU governments have blocked duty-free access for petrochemicals from the Gulf. This is mainly the result of intense lobbying on the part of the Association of Petroleum Producers in Europe that has actively mobilised against trade liberalisation.<sup>9</sup> As we shall see below, it is clear that protectionists in the EU have used the issue of human rights as a cover to block the EU from offering a more generous package. Indeed, the GCC has never hidden the fact that it sees the signing of the FTA as a prerequisite for deepened political cooperation. This aspiration has always been turned down by the EU, which has dealt with the GCC, in particular with Saudi Arabia and Qatar, merely as energy suppliers rather than as important geostrategic actors in the broader Middle Eastern region. This may have started to change as a result of the Arab uprisings.

At the political level, the EU has made little impact. The EU’s focus on counter-terrorism, embedded in all its acts of foreign policy, has meant that EU efforts to promote governance reform in the GCC countries have largely been weak. On the one hand, conditionality with the GCC regimes has not been implemented because of the latter’s opposition to any form of external interference in domestic issues. On the other hand, the EU has not pursued a formal dialogue with civil society organisations in the region, and projects and aid programmes involving

<sup>7</sup> Fundación para las Relaciones Internacionales y el Diálogo Exterior, Madrid.

<sup>8</sup> Richard Youngs, “Impasse in Euro-Gulf Relations”, in *Al Jisr Policy Briefs*, April 2009, p. 9, <http://www.aljisr.ae/?q=node/33>.

<sup>9</sup> Richard Youngs, “Impasse in Euro-Gulf Relations”, cit., p. 2.

civil society have been dropped because they were creating tension with the regimes, whose cooperation was deemed a pillar of Western counter-terrorism strategy. The structural weakness of the EU's ability to initiate political dialogue with the GCC region has been compounded by the partial strategic reorientation of EU's efforts towards the eastern neighbourhood following the enlargement of 2004. According to some authors, one additional reason why the EU has partially lost momentum in developing its relations with the GCC stems from the attitudes of the eastern and central European countries. The enlargement to these countries has led to a more inward-looking approach on the part of the EU that has had to cope with the impact of this process on institutional and constitutional terms.<sup>10</sup>

The derailment of the FTA negotiations shows that the substance of the relationship itself has often been contested by one part or the other. The failure of the FTA negotiations has dominated the headlines and has been presented as a major obstacle to cooperation. On the one hand, top GCC officials have often lamented the attempt by the EU to include human rights issues into the FTA negotiations. This has been regarded as an unwarranted attempt to interfere with the domestic development of these countries. The rejection by the GCC to abide by EU conditionality on the grounds that these issues have nothing to do with economic cooperation and dialogue has dampened the prospects for achieving the FTA and with it the progress in EU-GCC relations. On the other hand, the European view is that to some extent the GCC's aversion to the human rights clause disguises a more deep-rooted opposition to genuine liberalisation, including in the service and investment sectors, and to the reduction of subsidies in their economies. Furthermore, for the EU the FTA had to be the umbrella under which other forms of cooperation could be initiated between the two blocs. In particular, the energy dialogue was high on the list of EU priorities in the Gulf region in light of its energy security preoccupations. Despite the marked complementarities existing in this field – with European know-how particularly in the renewable sector and climate change-related issues of crucial importance to the GCC countries – EU-GCC energy cooperation has not flourished.

With a view to re-launching EU-GCC relations based on new, stronger footing, it is important to circumscribe the problem and its impact. One way to overcome the paralysis in EU-GCC relations could be to conduct confidence-building measures, for example through concrete cooperation measures in foreign policy, education and training and other less controversial areas.

So far Gulf security has also remained outside of the EU-GCC framework and any cooperation has been limited to political declarations or to bilateral arrangements between individual members of each group. For the GCC coun-

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<sup>10</sup> Abdullah Baabood and Geoffrey Edwards, "Reinforcing Ambivalence", cit., p. 539.

tries, security plays a fundamental role in shaping their external relations. In this light, their heavy dependence on the United States for security reasons has impacted on their relations with the EU as well. Relations with the EU will never be seen as an alternative to the central role played by the United States in the region. While the U.S. military presence is a matter of necessity and something that cannot be substituted by the EU, the GCC countries have felt the need to diversify their relations with a view to avoiding an over-identification with the United States' superpower. However, faced with what they have sometimes referred to as "inflexible economic policies" and with inescapable human rights and governance-related clauses, the GCC has taken a step backward.

### *1.1.3. Contingent factors and the future of EU-GCC relations*

Profound changes have taken place at the level of the EU and of the GCC since 1988. EU-GCC relations have not lived up to the expectations of both parties. It seems that a frank dialogue has not even started between the two to try to redress their relations, which in the last few years have been overwhelmed by two major events, i.e., the so-called Arab Spring and the current global economic and financial crisis.

The Arab Spring has partially transformed the list of priorities of both the EU and the GCC, thus also impinging on their joint cooperation. The GCC countries', and in particular Saudi Arabia's and Qatar's, increasingly assertive role in relation to the events that have taken place in the Arab world since 2011 has increased the premium associated with a more structured and strategic European engagement with this region. At the same time, the Arab Spring has unveiled a number of inconsistencies in the GCC countries' response to the momentous transformations that are taking place in North Africa and the Middle East, which will put increased pressure on their ability to cope with the multi-faceted challenges they have to confront either domestically or externally. The short-term, anti-status quo impact of the Arab Spring has been offset with a bold programme of social spending and redistribution. As demonstrated elsewhere, however, the expansion of social welfare schemes is likely to be unsustainable, should oil prices decline.<sup>11</sup> Furthermore, the burden on the public sector created with the expansion of employment opportunities and wages is deemed to undermine rather than address the goal of stimulating private sector-led growth and its ability to create jobs outside the oil and gas sector.

Turning to the financial and economic crisis, it is not a coincidence that the negotiations for the FTA were unilaterally suspended by the GCC in December

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<sup>11</sup> Silvia Colombo, "Unpacking the GCC's Response to the Arab Spring", in *Sharaka Commentaries*, No. 1 (July 2012), <http://www.sharaka.eu/?p=700>.

2008. This was the moment in which the financial crisis started to grip Europe. Thus, this decision cannot be separated from the way in which the financial crisis has altered the balance of power in favour of the GCC. While Europe has been significantly weakened by the crisis, the Gulf has acquired a more assertive role and is now in a stronger position to negotiate better terms in its relations to Europe. At the same time, Brussels has had to reassess the rationale of its relations to the GCC. The Gulf, once seen solely as a key provider of energy and a market for EU goods, has emerged as a valuable source of investment capital for European banks and institutions at a time when Europe is having trouble financing itself. Changes in the global political economy have also increased the EU's appetite for a free trade deal with the GCC. As the balance of economic power is increasingly shifting towards Asia, the Gulf region appears to be extremely well positioned to act as bridge between European and Asian markets. At the same time, the competition coming from other regions, especially from Asian markets, is pushing the EU to appreciate the need to reinforce trade with the GCC.

Against this backdrop, the GCC seems to be keen on extending its clout onto geopolitical issues while asserting its independence, most significantly on the fast changing regional context. This becomes apparent as far as the response to the Arab Spring is concerned, in which the GCC and particularly some member states are willing to take the lead and are asking the EU to buy into their agenda. At the same time, the EU continues to view the GCC themselves as a potential strategic partner on a number of economic issues especially in light of the crisis.

Time may be ripe for a qualitatively different mutual engagement between the EU and the GCC. The EU seems to have understood that it cannot fail to develop its relations to this strategic partner any further and it is thus trying to engage more with the GCC. It is still too early to assess whether this will be a short-term strategic reassessment of relations in light of the need to respond to the challenges of the Arab Spring and the Eurozone crisis, or whether it will be a more in-depth attempt to strengthen the foundation for dialogue between these two important regions. During the latest Joint Council and Ministerial Meeting held in Luxembourg at the end of June 2012, HR Catherine Ashton talked about a "constructive and important" meeting to "help ensure that our relationship becomes even more strategic, even more dynamic".<sup>12</sup> Strengthening cooperation between the EU and the GCC at this point would be highly symbolic for the GCC, a sign of acknowledgement of its renewed and more assertive role on the global scene. This sign, while important, should be accompanied by a serious reassessment of the basis upon which the whole EU-GCC cooperation is built, including the issue of domestic reforms. The next section provides a comprehensive over-

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<sup>12</sup> Remarks by High Representative Catherine Ashton following the 22nd EU-GCC Joint Council and Ministerial Meeting, Luxembourg, 25 June 2012, [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/EN/foraff/131194.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/131194.pdf).

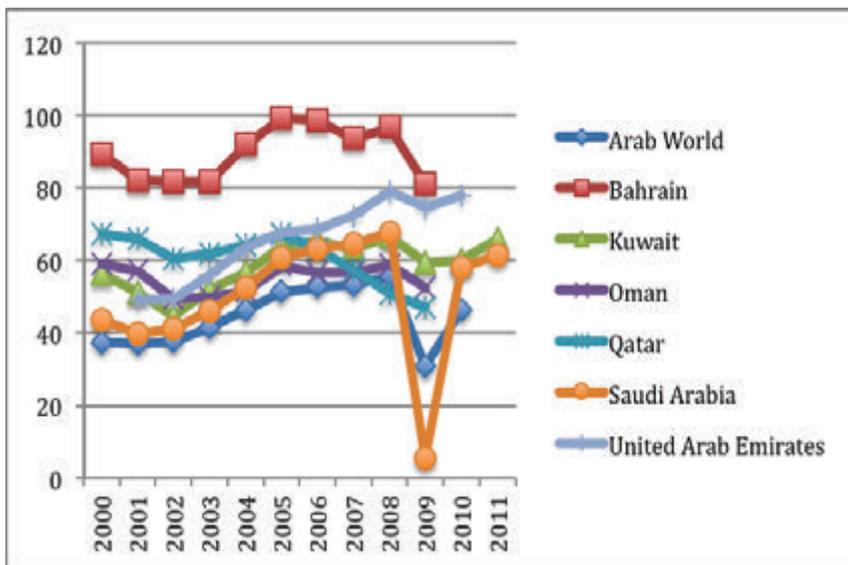
view of the main sectors of cooperation, assessing their strengths and weaknesses and the opportunities for better coordination between the EU and the GCC. This section provides the basis of the research that has been carried out by the Sharaka project.

## 1.2. SECTORAL COOPERATION: THE PRESENT STATE AND THE WAY FORWARD

### 1.2.1. Trade and economic integration

By observing the trends in GCC exports of goods and services between 2002 and 2012, on average, exports increased by 15,7 percent of GDP between 2002 and 2008. In 2009, all countries witnessed a decrease in exports; yet, the global financial crisis affected some countries more than others. For example, the UAE recovered quite rapidly and by 2010 exports were almost at the same level of the pre-crisis period; while, Saudi Arabia endured bigger losses and is recovering at a slower pace.

Fig. 1. GCC Exports of Goods and Services (%GDP)<sup>13</sup>

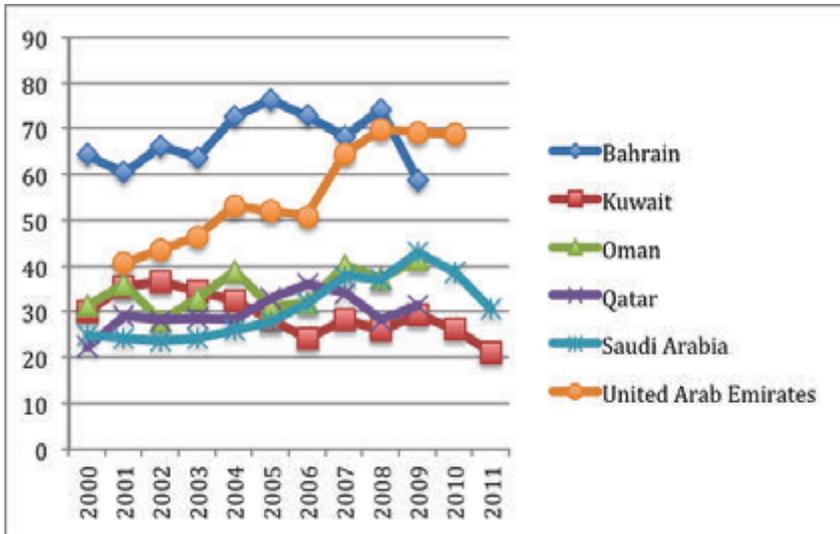


Conversely, in the same period, imports of goods and services increased on

<sup>13</sup> All the graphs are the authors' own elaboration of the data provided by the World Bank, <http://data.worldbank.org/indicator?display=graph>.

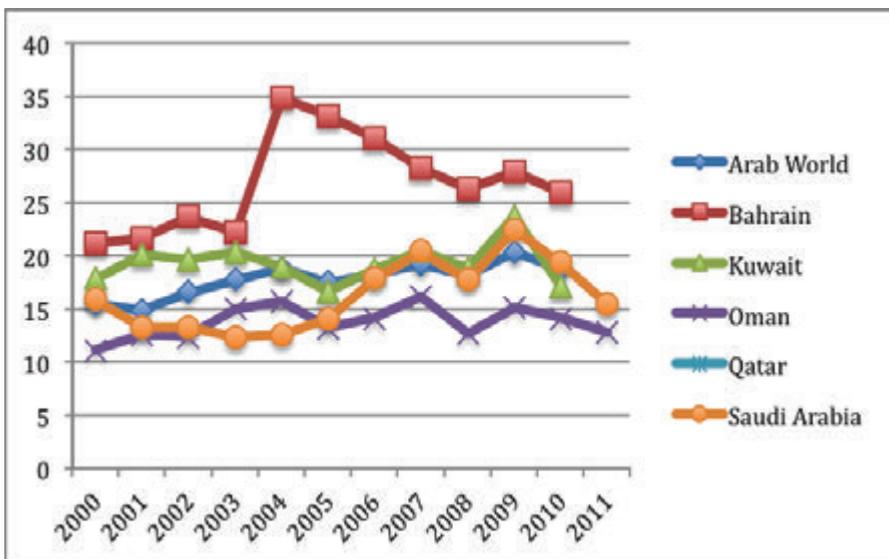
average by 7.8 percent compared to GDP. And, in the aftermath of the crisis, they did not plunge but remained rather stable or increased.

Fig. 2. GCC Imports of Goods and Services (%GDP)



In a similar manner, when focusing on the outflows and inflows of services in the same period, it emerges that these increased in a regular manner, regardless of the crisis.

Fig. 3. GCC Trade in Services (%GDP)



Furthermore, by observing the Ease of Business Index (provided by the World Bank Doing Business Project), which assesses the regulatory environment of conducting business operations, it comes as no surprise that, as of June 2011, the GCC countries ranked among the first in the Arab World, with Saudi Arabia leading the way. However, on a global scale variations between the GCC states are notable, with Saudi Arabia ranking 12<sup>th</sup>, the UAE 33<sup>rd</sup>, Qatar 36<sup>th</sup>, Bahrain 38<sup>th</sup>, Oman 49<sup>th</sup> and Kuwait 67<sup>th</sup>.

**Table 1. Doing Business World Bank Index – Ranking for GCC countries**

State	Ease of Doing Business	Starting a Business	Dealing with Construction Permits	Getting Electricity	Getting Credit	Protecting Investors	Paying Taxes	Trade Across Borders	Enforcing Contracts
<b>KSA</b>	12	10	4	18	48	17	10	18	138
<b>UAE</b>	33	42	12	10	78	122	7	5	134
<b>Qatar</b>	36	116	24	18	98	97	2	57	95
<b>Bahrain</b>	38	82	7	49	126	79	18	49	114
<b>Oman</b>	49	68	64	61	98	97	9	47	107
<b>Kuwait</b>	67	142	121	57	98	29	15	112	117

When the GCC was founded in May 1981, initial agreements among member states focused on the structure of the cooperation council and on the steps to be taken towards the creation of a single market. Projects currently underway or under study included a customs union, a joint value-added tax (VAT) and even the introduction of a single currency. But serious obstacles have hampered closer integration, including bureaucratic and administrative inefficiencies, as well as old rivalries and a desire among smaller Gulf States to retain their autonomy. Even the countries' wealth sometimes becomes an obstacle; with economies already growing robustly, there is less incentive to make radical changes to achieve faster growth.

In analysing how GCC countries interact with one another, a recent IMF paper underlines: "GCC countries show signs of convergence on many macroeconomic indicators, including: inflation rates, short-term interest rates, foreign exchange reserves, and public debt to GDP ratios. [...] This convergence, while important for the establishment of a monetary union, also reflects the vulnerability of these economies".<sup>14</sup> Indeed, the lack of diversification in GCC economies exposes them to the same types of shocks, including falls in oil prices and dollar depreciation.

Similarly, the World Bank emphasises that trends of economic integration through trade of commodities and services have yet to achieve their full poten-

<sup>14</sup> Raphael Espinoza, Ananthakrishnan Prasad and Oral Williams, "Regional Financial Integration in the GCC", in *IMF Working Papers*, No. 10/90, 2010, p. 4-10, <http://www.imf.org/external/pubs/cat/longres.aspx?sk=23780>.

tial. In fact, commodity trade in the region, excluding the non-oil or gas sectors, is far lower than trade flows in similar regional blocs (i.e., NAFTA, ASEAN and the EU-15). Nevertheless, the lowering of nontariff barriers to comply with WTO commitments<sup>15</sup> and the unified technical standards for a series of traded products are clear signs of progress. To further enhance this process, greater regional infrastructure and fewer border controls are necessary, together with deep economic reforms to increase economic complementarity among countries.

In addition, trade in services has advanced greatly, in particular thanks to the Common Market Agreement, which allows for the free-movement of GCC citizens, accompanied by the possibility of conducting business in other GCC countries. Yet, this openness has not been extended to foreign investors. Furthermore, the “mode of entry, level of tradability, and market contestability” of services remain diverse and in need of harmonisation.<sup>16</sup>

The GCC launched a customs union — a free trade area with a common external tariff — in 2003; this has largely been successful in removing overt trade barriers within the bloc. But the full functioning of the project has been delayed by disagreements over a formula on how to divide customs revenues between the governments. In June, the GCC set up a customs union authority to resolve the revenue-sharing dispute. Options include dividing customs revenues according to the level of imports, population or the share of gross domestic product of individual countries.

Other GCC projects have also run into headwinds. For six years, Gulf countries have been considering whether to introduce a VAT perhaps at a unified rate of 5 percent, in order to mitigate their reliance on oil income. The countries would need to launch the tax simultaneously to prevent a shift of consumer spending to untaxed areas. However, in light of the current buoyancy in the oil sector – according to recent data, combined Arab crude export earnings of the 11 members of the Kuwaiti-based Organization of Arab Petroleum Exporting Countries (OAPEC), grew by nearly \$174 billion and Saudi Arabia accounted for almost half the total – there is little immediate need for governments to raise more revenue. This could go on for some years, depending on oil prices.

The GCC’s most ambitious economic integration project, creating a single currency, looks unlikely to move ahead for the foreseeable future. In theory, a monetary union could encourage a fresh wave of trade and investment around the region. Although intra-GCC trade soared to \$65.4bn in 2010 from \$19.8bn in 2003, official data show that this is still a small fraction of the GCC’s total trade volume of nearly \$1.3tn last year. The single currency project suffered a major

<sup>15</sup> The Gulf countries entered the WTO in different moments: Kuwait and Bahrain joined in 1995; Qatar and the UAE in 1996; Oman in 2000; and Saudi Arabia in 2005.

<sup>16</sup> World Bank, *Economic Integration in the GCC*, October 2010, <http://siteresources.worldbank.org/INTMENA/Resources/GCCStudyweb.pdf>.

blow in 2009, when the UAE, the second biggest Arab economy, abandoned it over Riyadh's insistence that Saudi Arabia would host the joint central bank. Much smaller Oman had already dropped out of the project in 2006, saying it was not ready. The absence of the UAE, seen as an economic counterbalance to Saudi Arabia, is an obstacle to further progress towards a monetary union. Meanwhile, the Eurozone debt crisis, where the single currency system has proven deeply flawed, has dealt another blow to supporters of Gulf monetary union. The Eurozone's experience has suggested a single currency may not be viable if countries do not give up much of their fiscal independence, and Gulf States may not be willing to lose so much of their sovereignty.

Turning to EU-GCC cooperation in the trade sector, the Cooperation Agreement between the EU and the GCC establishes the "institutional and contractual framework" of economic and trade relations, among others, between these two regional institutions. Art. 3 states that both EU and GCC countries should "strive to encourage and facilitate" the latter's productive sector, its economic infrastructure and technology transfers and development through joint ventures. Specifically, art. 11 aims to promote "development and diversification of reciprocal commercial exchanges to the highest possible level".<sup>17</sup>

Economic and trade relations were further enhanced via a series of agreements and memoranda of understanding, the most important of which is the MOU of 2007 between the Federation of GCC Chambers and EUROCHAMBRES. Ten objectives were set, most notably: development of bilateral trade, information exchange, and institutional cooperation.<sup>18</sup>

In 2008, the chambers produced a joint statement on EU-GCC free-trade negotiations, emphasising the need for a comprehensive agreement, calling for "increased market access" for industrial goods, services, investment and public procurement; a definition of rules of origin; support for regional integration; and the establishment of a monitoring committee".<sup>19</sup>

Yet, these achievements represent only small steps towards full economic cooperation between the two regions, due to the stalled negotiations for the FTA. As of 2009, the EU exported approximately €57.8 billion worth of goods, mainly machinery and transport materials, material manufactured goods and chemical products towards GCC economies. Simultaneously, it imported roughly €21.8 billion from the GCC, predominantly in fuels and derivatives.<sup>20</sup>

<sup>17</sup> European Union, *Cooperation Agreement between the European Economic Community...*, cit.

<sup>18</sup> EUROCHAMBRES, *Memorandum of Understanding between FCCCG and EUROCHAMBRES*, October 2007, <http://www.eurochambres.eu/Content/Default.asp?PageID=1&DocID=519>.

<sup>19</sup> EUROCHAMBRES, *EU-GCC Business Statement on EU-GCC Free Trade Relations*, 29 October 2008, <http://www.eurochambres.eu/Content/Default.asp?PageID=1&DocID=1357>.

<sup>20</sup> European Commission, *EU-GCC Trade Relations*, <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/regions/gulf-region> (consulted on 19 November 2010).

In particular, EU goods exports to the GCC have steadily increased between 2009 and 2011 (from €57.1 billion to €72.2 billion); similarly, EU commercial services exports increased from €21.6 billion to €22.5 billion in the same period. To sum up, GCC products count for 3.3 percent of EU imports, while the GCC receives 4.7 percent of total EU exports.<sup>21</sup> The data reveal that until recently the GCC was commercially more dependent on the EU than vice versa. This situation may have started to change as a result of a stronger exposure and diversification of the GCC economies towards China, India, and Russia.<sup>22</sup>

EU-GCC exchanges are currently possible thanks to the Generalized System of Preferences (GSP) established by the EU in 1971, which promotes preferential duties for developing countries' exports to the EU. However, with the 2014 revision of the GSP, countries such as Saudi Arabia and Qatar will be excluded from this system, as the World Bank classifies their level of income per capita as high or upper middle. Nonetheless, if the FTA were to be reached in time, all GCC countries would enter a more favourable economic relation with the EU.<sup>23</sup>

From the above paragraphs, various elements emerge. It is clear that, although rather important in volume, trade between the GCC and the EU is not sufficiently diversified. In fact, oil products and machinery constitute the majority of traded goods. Furthermore, it transpires that full economic integration is yet to be achieved both among GCC countries and between the EU and the GCC. Deficiencies in the former are due to the delays in completing a single market and the difficulty in diversifying the Gulf economies. At the same time, numerous issues hinder the achievement of the FTA between the EU and the GCC. Among these, the aforementioned political demands set forward by the EU represent the most significant complication. Indeed, it appears clear that the

<sup>21</sup> European Commission, *EU-GCC Trade Data*, [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113482.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113482.pdf) (consulted on March 2012).

<sup>22</sup> Asia has become the most important destination for exports from countries such as Saudi Arabia, Kuwait and the UAE. While historically China has not developed strategic ties to the Gulf region, that relationship has witnessed a significant rise in relevance over the late 1990s and into the twenty-first century. Driven primarily by near exponential increases in energy requirements, China has begun to focus a lot of attention on regional Gulf affairs and is increasingly willing to commit political and security-related muscle to its burgeoning global national interests. The GCC is India's second largest trading partner and is expected to overtake the United States as number one. The GCC countries account for more than 12 percent of India's total global exports, supply nearly two-thirds of India's energy needs and host almost four million Indians who contribute to the region's economic development. There is also little dispute about the importance to the Indian economy of remittances sent by Indian expatriates and of the increasing Indian dependence on Gulf crude oil, which may grow to 91.6 percent by 2020. See "China, GCC agree to accelerate FTA negotiations", in *China Daily*, 16 January 2012, [http://www.chinadaily.com.cn/china/2012-01/16/content\\_14449569.htm](http://www.chinadaily.com.cn/china/2012-01/16/content_14449569.htm) and "Big Thrust to India-Gulf Economic Relations", in *Alibaba.com*, 9 August 2010, <http://news.alibaba.com/article/detail/international-trade-special/100375654-1-big-thrust-india-gulf-economic-relations.html>.

<sup>23</sup> European Commission, *Generalised Scheme of Preferences (GSP)*, <http://ec.europa.eu/trade/policy/countries-and-regions/development/generalised-scheme-of-preferences>.

GCC will not agree to continue FTA negotiations unless the EU abandons political conditionality to trade.

### 1.2.2. Finance and investment

Thanks to the elimination of formal barriers to free movement of goods and services, capital flows and financial integration increased among GCC countries. By looking at the structure of the financial system using interest rate and equity price data it is possible to assess the extent of financial integration among GCC countries. Both beta-convergence data on interest rate spreads and the analysis of prices of cross-listed stocks show that “equity markets are fairly efficient at removing price differentials and seem more integrated within the GCC than within global markets and that there is strong evidence of financial integration”.<sup>24</sup> Yet, commercial banks dominate the GCC financial system. Defined as “well capitalized” and “sound”, they reflect stability across the region. Still, only a small share of the balance sheet is composed of foreign assets and liabilities. Bahrain has the highest percentage of foreign assets (53.4 percent of total assets and 47 percent of total liabilities, respectively), followed by Qatar (24.7 and 22.2 percent) and Kuwait (22.4 and 14.5 percent), while Saudi Arabia’s banks are almost closed vis-à-vis the rest of the world (11.8 and 8.6 percent). In addition, important restrictions remain, such as the purchase of shares in local markets and inward FDI, which “hamper regional as well as global integration.”

The World Bank underlines similar features of the GCC financial sector, most notably that “the largest five banks are domestic and account for 50-80 percent of total banking sector assets”;<sup>25</sup> Islamic banking now controls 24 percent of the region’s banking system assets; and “mutual investment funds are bank-owned”. These elements result in shallow bond markets, with underdeveloped secondary bond markets, a surplus of bank assets over stock market capitalization and limited nonbank financial institutions. Further aspects hindering regional and global integration are the variations in “regulatory regimes and in the level of openness to foreign participation”. Nevertheless, important steps towards best practices in finance and corporate governance have been made and Central Banks have agreed to comply with Basel II standards, founding independent authorities dedicated to capital market regulation.<sup>26</sup>

However, the global financial crisis delayed the biggest step towards regional

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<sup>24</sup> Raphael Espinoza, Ananthkrishnan Prasad and Oral Williams, “Regional Financial Integration in the GCC”, cit., p. 4-10.

<sup>25</sup> World Bank, *Economic Integration in the GCC*, cit., p. 12-14.

<sup>26</sup> Basel II is the second version of the Basel Accords and it is composed of three pillars dealing with banking laws and capital regulation. Released in June 2004, it is now incorporated in Basel III.

integration. Originally scheduled for 2010, modelled after the European Monetary Union, and now indefinitely postponed, the GCC monetary union would have “lowered foreign exchange rate transaction costs and increased pricing transparency, competition and trade”. Furthermore, the crisis unveiled weaknesses in the regional financial sector. These were handled on a case-by-case basis, hence lacking clear “criteria for treatment,” which slows down further development of structured financial products. Finally, the crisis, which instigated the Dubai World debt problem, as well as the default of two major Saudi corporations and the overall Kuwaiti financial problems, led to an increase in risk aversion and a revision of lending practices on the banks’ side.<sup>27</sup>

Turning to EU-GCC cooperation on financial matters, art. 7 of the Cooperation Agreement affirms, “in the field of investments, the EU and the GCC shall strive to take steps for the mutual promotion and protection of investments, in particular through the extension of investments promotion and protection agreements with a view to improving reciprocal investment conditions”.<sup>28</sup>

Almost two decades later, in the context of the EU-GCC Al-Jisir project, which was developed between 2008 and 2010, the study *Europe and the Gulf Region – Towards a New Horizon* underscored common financial interests between the two regions. Especially in light of the global financial crisis, a particular area of cooperation would be to jointly identify best practices. This would increase both regions’ attractiveness for international investors. Moreover, similar “down-to-earth financial practices”, such as Islamic finance or German cooperative banks, are potential elements for further partnerships, as well as common support for small and medium-sized enterprises.<sup>29</sup> Recent EUROCHAMBRES has called for greater financial cooperation between the EU and the GCC, particularly concerning FDI. This led EUROCHAMBRES to launch “EU-GCC Invest: a project aimed at stimulating a policy debate on FDI and at creating a common virtual platform for EU business in the region”.<sup>30</sup> Regardless of these treaties and MOU, a recent European Central Bank report shows that bank exposure between the GCC and the EU remains relatively low, with the GCC claiming less than 2 percent of the euro area banks’ activities outside the euro-area. Hence, financial integration

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<sup>27</sup> May Khamis and Abdelhak Senhadji, “Impact of the Global Financial Crisis on the Gulf Cooperation Council Countries and Challenges Ahead: An update”, in *IMF Middle East and Central Asia Departmental Paper*, No. 10/02 (July 2010), p. 15, <http://www.imf.org/external/pubs/cat/longres.aspx?sk=24036>.

<sup>28</sup> European Union, *Cooperation Agreement between the European Economic Community...*, cit.

<sup>29</sup> Michael Bauer, Christian-Peter Hanelt, *Europe and the Gulf Region. Toward a New Horizon*, Gütersloh, Bertelsmann Stiftung, July 2009, [http://aljisr.ae/sites/default/files/Europe\\_and\\_Toward\\_Gulf\\_Region\\_kronberg.pdf](http://aljisr.ae/sites/default/files/Europe_and_Toward_Gulf_Region_kronberg.pdf).

<sup>30</sup> EUROCHAMBRES, *EU needs to increase its investment efforts into the Gulf Region*, 27 March 2012, <http://www.eurochambres.eu/Content/Default.asp?PageID=1&DocID=4269>.

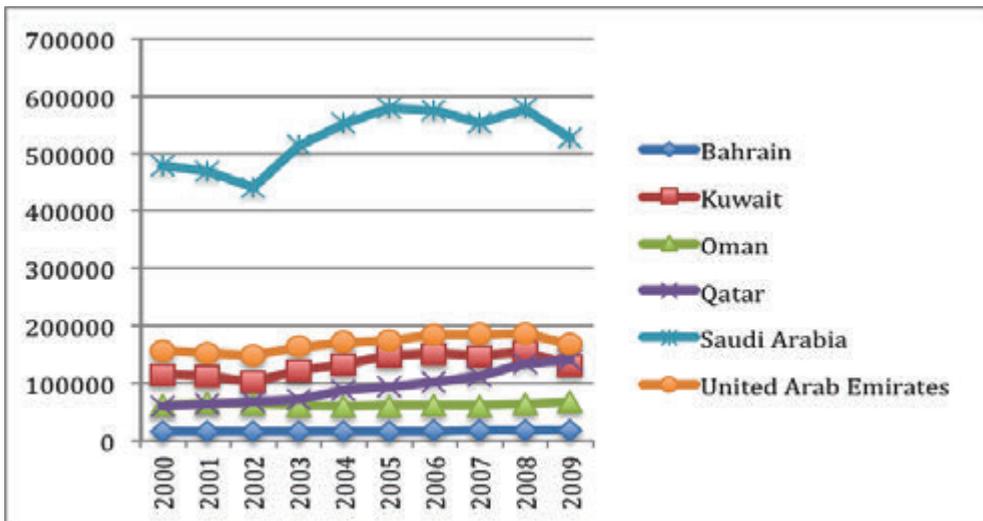
between the two regions still has a long way to go.<sup>31</sup>

In light of the above, it appears that further financial integration between the EU and the GCC, a step of great importance for the success of the FTA, will only be achieved once Gulf banks decide to become more exposed to global financial markets. While this might seem farfetched in light of the global financial crisis and the Eurozone crisis more specifically, it is important that both parts bear in mind the common aspects of their markets, to coordinate and harmonise best practices and overall standards.

### 1.2.3. Energy

In 2009, GCC countries produced more than 1 million kiloton of oil equivalents of energy, thanks to their reserves of crude oil and natural gas. More than half of this production was supplied by Saudi Arabia.

Fig. 4. GCC Energy production (kt of oil production)



According to the International Energy Agency (IEA)'s 2011 Key World Energy Statistics, Saudi Arabia supplies 11.9 percent of the world's total crude oil production and it is also the main exporter, with 313 megaton (Mt) exported in 2010. Yet, in 1973, the MENA area as a whole had a higher share of global crude oil production than it did in 2010. This is due to the increase in energy production in former Soviet space, China and Africa.<sup>32</sup>

<sup>31</sup> European Central Bank – Directorate General International and European Relations, *Recent Economic and Financial Developments in the GCC*, Division EU Neighbouring Regions, 2012.

<sup>32</sup> International Energy Agency (IEA), *Key World Energy Statistics 2011*, p. 10-11, <http://www.>

Also, World Bank data on energy use reflects an increase in local consumption, with fairly stable energy production. This point is also underpinned by the net imports data. Graph no. 6 shows that the GCC countries, albeit still among the biggest energy exporters, are slowly, yet steadily, increasing their imports.

Fig. 5. GCC Energy Use - kg of oil equivalent per capita

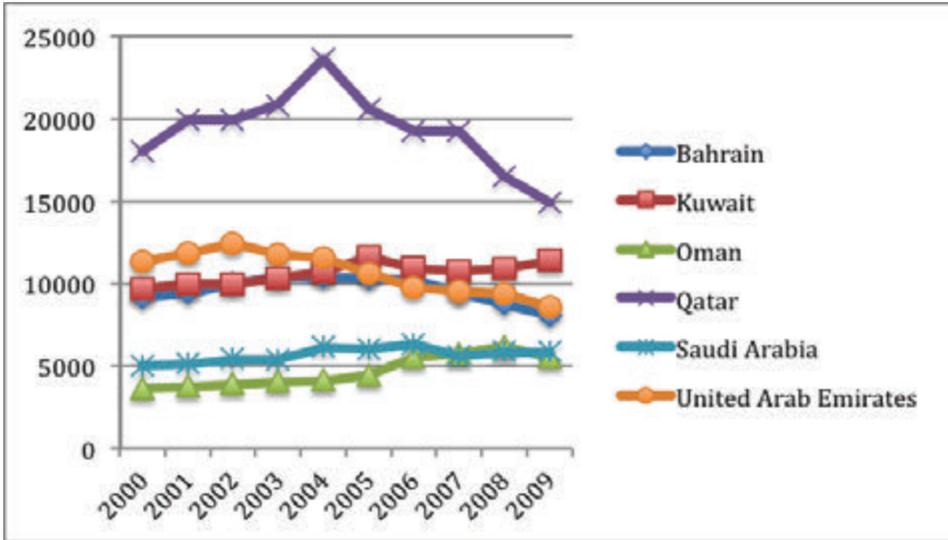
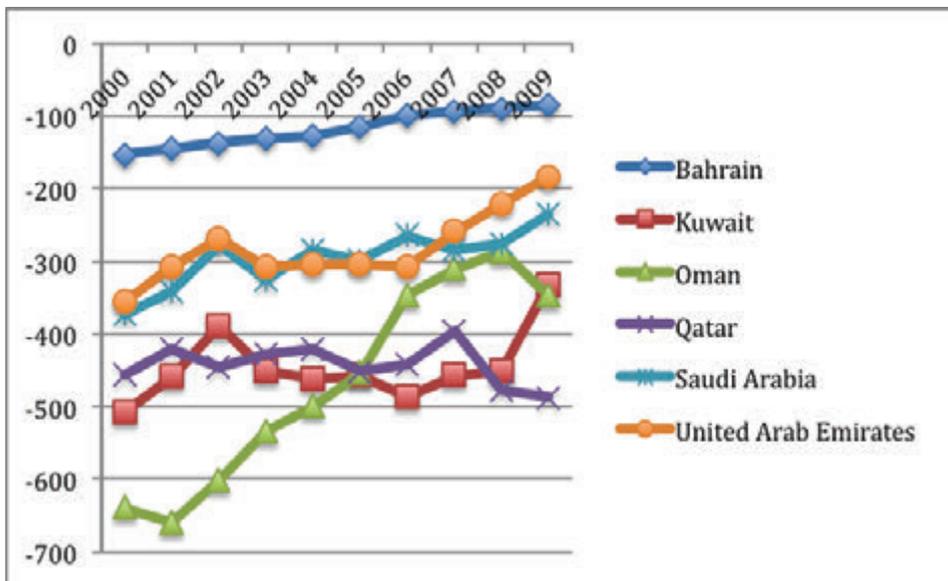


Fig. 6. GCC Energy Imports - net (% of energy use)



iea.org/publications/freepublications/publication/key\_world\_energy\_stats-1.pdf.

Today, energy is central to relations between the GCC and the EU. In fact, biofuels remain the most traded product between the two regions. This is mainly due to geographic proximity and the complementarity of the two regions' energy production and consumption patterns, which create favourable exchange conditions between the EU and the GCC. These exchanges are regulated chiefly through art. 6 of the Cooperation Agreement, which states that "in the field of energy, [the EU and the GCC] shall strive to encourage and facilitate: cooperation in the two regions by energy undertakings, [...] and exchanges of views and information on matters relating to energy in general and respective energy policies, without prejudice to the parties' international obligations".<sup>33</sup>

As previously mentioned, energy flows between the regions are still very much focused on biofuels, mainly petroleum and gas. The OPEC 2010 report underlines that Qatar exports towards Europe only 8.6 percent of its total export volume, Kuwait 7.7 percent of its total exports, Saudi Arabia 7.4 percent and the UAE merely 0.5 percent.<sup>34</sup> In this situation, the Kingdom of Saudi Arabia remains the biggest exporter toward Europe, with 3315 thousand metric tons of biofuels transferred only in 2011.<sup>35</sup>

When considering the EU's crude oil imports from 2005 to 2011, the privileged relationship with the former Soviet space remains unaltered. In fact, imports from this region increased steadily from 35.7 percent in 2005, to 41 percent in 2011. Another region providing major supplies is Africa, with Algeria and Libya in the lead. Imports from this region also grew from 18 percent in 2005 to 20.6 percent in 2010 – with a slight decrease in 2011 (down to 17.3 percent), due to the recent events of the Arab Spring. A similar trend is observable for the Middle East, which includes the Gulf and the Levant. In 2005, imports from these countries accounted for 20 percent of the total, they decreased until 2009, when imports were at 15.1 percent, and in 2011 they rose back to 18.3 percent.<sup>36</sup> The registered decrease is mainly due to the increase of imports from the Former Soviet Union area. Indeed, the downtrend reversed with the surge in gas prices set by Russia around the same time.<sup>37</sup>

To enhance cooperation in this field, the EU-GCC Joint Action Programme for 2010-2013 focuses on information exchanges on oil and gas markets; policies,

<sup>33</sup> European Union, Cooperation Agreement between the European Economic Community..., cit.

<sup>34</sup> OPEC, *Annual Statistical Bulletin 2010/2011*, [http://www.opec.org/opec\\_web/static\\_files\\_project/media/downloads/publications/ASB2010\\_2011.pdf](http://www.opec.org/opec_web/static_files_project/media/downloads/publications/ASB2010_2011.pdf).

<sup>35</sup> IEA, *Monthly Oil Survey*, March 2012, <http://www.iea.org/stats/surveys/oil/OIL0312.XLS>.

<sup>36</sup> European Commission, *EU Crude Oil Imports - Monthly and cumulated Crude Oil Imports (volumes and prices) by EU and non EU country*, 2011, [http://ec.europa.eu/energy/observatory/oil/import\\_export\\_en.htm](http://ec.europa.eu/energy/observatory/oil/import_export_en.htm).

<sup>37</sup> Russia pursued a policy aimed at making the country the sole energy supplier to the European Union. Said ambition was hindered by the notable budgetary expenditure first and by the global financial crisis and the consequent Eurozone crisis later.

frameworks and best practices; and techniques for upstream, midstream and downstream infrastructure. The Joint Action Programme provides that ad-hoc groups should address the various areas of cooperation, holding seminars and workshops, as well as training and capacity building exercises when appropriate.

Particular attention is devoted, in the Joint Action Programme, to the issue of renewable energy, specifically solar energy technology. While the European Union has started leaning towards eco-responsibility, the GCC still lacks a coherent framework for all six countries, since most governments have established different targets and timelines. Yet, this does not imply that the region is inactive in the field of renewables. In fact, all GCC countries promote national large-scale projects of this nature. Bahrain, for example, is investing in mobile solar water desalination units, although, as of today, the only renewable source project remains the installation of wind turbines in the Bahrain World Trade Centre. Kuwait is an exception, generally avoiding renewable energy large-scale projects, even though the government has repeatedly financed research in the field. Regardless, the Kuwaiti government set a 5 percent target for electricity produced by renewables – how this is to be achieved is yet to be determined. Similarly, the Omani government is currently promoting feasibility studies to enhance the development and use of solar energy, in particular large-scale grid-connected solar thermal plants. Qatar, on the other hand, has already processed its field studies and is now in the early stages of project implementation, both for solar and photovoltaic plants, which should be completed by 2014. The Saudi private sector has recently begun investing heavily in solar power plants, most notably in the city of Jubail II. Finally, the UAE, while investing in side projects in other emirates, is most famous for the Abu Dhabi-based Masdar City, entirely reliant on solar energy.<sup>38</sup>

Furthermore, numerous conferences on clean energy between the EU and the GCC have been held. Generally, the common interest in sustainable development is highlighted in the Gulf by the increase in local energy consumption and resulting growing strain put on biofuels, and in the EU because of the general focus on green growth. These elements led to the establishment of a “Clean Energy Network”, a framework in which GCC institutions can access European Commission partnerships and participate in discussion groups and pilot projects.<sup>39</sup>

To a large extent, energy relations between Europe and the Gulf are the backbone of economic or political ties. The benefits both parties accrue from these exchanges cannot be underestimated. The GCC is an important energy supplier

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<sup>38</sup> Imen Jeridi Bachelier, *Renewable Energy in the GCC Countries. Resources, Potentials, and Prospects*, Jeddah, Gulf Research Centre, March 2012, <http://library.fes.de/pdf-files/bueros/amman/09008.pdf>.

<sup>39</sup> EU-GCC Clean Energy Network, *Network Activities and Offering*, 2010, <http://www.eugcc-cleanenergy.net/TheNetwork/NetworkActivitiesOffering.aspx>.

to the EU, while the EU can help build consistent and sound frameworks for the ambitious energy diversification projects of the GCC as well as constitute a model in renewable energy technology and projects.

#### *1.2.4. Maritime security*

The notion of maritime security encloses different elements, ranging from freedom of navigation, to the ability of countering threats posed by piracy, terrorism, drug trafficking, irregular immigration and the proliferation of weapons of mass destruction.

The GCC is fully aware of the potential threats to maritime security present off the coasts of Yemen and Oman. In fact, recent developments in maritime security specifically concern the Gulf region, most notably due to piracy, drug trafficking, and to some extent, irregular migration. Alongside these non-state actor challenges, there are risks tied with state issues, in particular regarding the Strait of Hormuz and the territorial disputes over the islands of Abu Mousa, Greater Thumb and Lesser Thumb between the UAE and Iran. Consequently, the GCC has promoted a series of encounters and conferences to enhance coordination among member states. In particular, during the February 2012 Maritime Security and Surveillance Conference, the following critical areas were identified: piracy, drug-trafficking and maritime coordination. The first two are perceived as domains in which progress is being made, regardless of the lack of a complete body of international norms and regulations governing the issue of piracy. Regarding coordination, different methods of surveillance systems are currently being examined.

At the international level, an issue as global as this has led to the creation of specific instruments, in the form of treaties, instruments and initiatives attempting to deal with the multifaceted reality of maritime security. The greatest achievements in this area are the UN Convention on the Law of the Sea (UNCLOS) and the Convention for the Suppression of Unlawful Acts Against the Safety of Maritime Navigation (SUA). The former, finalized in 1982, regulates the use of international waters by state and non-state actors. The latter, entered into force in 1992, dictates provisions for bringing to justice persons suspected of unlawful acts against ships. The GCC and its neighbouring countries have ratified UNCLOS, with the exception of the UAE and Iran.

The aforementioned contention over the three islands between the UAE and Iran and the Strait of Hormuz are issues relevant for UNCLOS, in particular for the regime of navigation through international straits, the delimitation of Continental Shelf (CS) and Exclusive Economic Zone (EEZ) between adjacent and opposing States. Furthermore, art. 123 of UNCLOS regulating enclosed and

semi-enclosed seas is relevant. The Gulf countries – constituting a semi-enclosed area – may, via the GCC “invite, as appropriate, international organisations to cooperate with them.” This leaves room for manoeuvre for the European Union, namely in the areas envisaged by Article 123, i.e., exploration, conservation and exploitation of fisheries, preservation of marine environment and marine scientific research. The GCC actively participates in the Combined Task Force 151, which deals with piracy off the coast of Somalia, but it is yet to take part in the EU military programme, ATALANTA, which ensures safe-passage of ships in the same area. In the latter, non-EU member states can participate, either through an operational contribution (navy vessels, patrol aircrafts or vessel protection teams) or by providing military staff for the EU NAVFOR Headquarters in the UK. Clearly, the participation of Gulf countries in this programme, particularly as operational contributors, would symbolise an important step towards fighting piracy in the Gulf region.

### 1.2.5. *Media and communication*

Regional integration is not only measured by volumes of traded commodities or financial services among countries, but also via the harmonization of standards for public services. One of these services is clearly that of media and communication. For the latter, in particular, the GCC has asked its Communication and IT Steering Committee to produce a coherent legislation and regulation package. Furthermore, the Employment and Tariffs Committee recently proposed a revised roaming price standard, to be standardised throughout the GCC.

Also, to further enhance dissemination of the Council’s decisions, the GCC General Secretariat has approved the creation of a Twitter account, as well as a YouTube Channel. Both tools are deemed necessary to target younger generations and involve them in the objectives and scope of action of the GCC. This step clearly demonstrates that social networks are increasingly recognised in the region for their ability to connect and interconnect, for their appeal and power over specific segments of the population.<sup>40</sup>

It would be inadequate to speak of media and communication in this region without mentioning the noteworthy role played by Al Jazeera. Founded in 1996, thanks to a significant loan from the Emir of Qatar, and still expanding, Al Jazeera became the voice of the Arab world in the Middle East and beyond. In 1996, it filled the void left by the discontinuation of BBC Arabic, taking up most of its staff. However, it was only in 2000, when it started airing around the clock, that Al Jazeera surpassed Middle East Broadcasting Centre (MBC)’s view-

<sup>40</sup> GCC General Secretariat, *Communication and IT Steering Committee Meeting* [in Arabic], 20 May 2012, <http://www.gcc-sg.org/index898e.html?action=News&Sub=ShowOne&ID=2428&T=A>.

ership. The latter was the first “free-to-air, pan-Arab news and entertainment channel”;<sup>41</sup> initially stationed in London, it was later transferred to Dubai for the opening of the affiliated 24-hour news channel Al Arabiya, direct competitor of Al Jazeera. Though founded in London, MBC was the brain-child of King Fahd of Saudi Arabia. The late king’s brother-in-law, Waleed al Ibrahim, is still chairman of the channel. It is interesting to note that both channels are available online, though Al Jazeera developed a broader network. Finally, it is important to note that, since both channels are primarily state-founded, they follow, to a certain extent, the national and foreign concerns of their patrons. Hence, both the GCC and the region’s more or less independent media are undergoing important steps to complete the digital revolution.

Media and communication relations with the rest of the world developed thanks to Al Jazeera’s role in the aftermath of 9/11, airing video messages by Al-Qaeda. This marked the turning point at which the Western world acknowledged the growing importance of Al Jazeera and of Arab media in general. Furthermore, the coverage of the wars in Afghanistan and Iraq highlighted the added value of well-established offices in different regions of the world. In fact, after the successes of their broadcasts from these war zones, Al Jazeera opened new bureaus worldwide.

The entry of the GCC in the global arena of media and communication is also evident when observing the dissemination of specialised foreign magazines. For example, *TimeOut*, a well known weekly entertainment guide, publishes editions for Dubai, Doha and Bahrain.

The inauguration of Al Jazeera English and of its London office, in 2006, further enhanced media relations between the Gulf and Europe. This is today reflected in the solid efforts to renew common telecommunication policies and the role of governments in IT development. In fact, the aforementioned GCC Employment and Tariffs Committee approved, in February 2012, legislation to increase cooperation with EU countries “expressing readiness to provide consultation and share experiences in the field of ICT, contributing to the development of this sector in GCC countries.”<sup>42</sup>

### 1.2.6. Higher education and research

Recently, Gulf governments voiced their concern about the quality of education received by their nationals and they are now taking action to make improvements. In particular, a meeting of the Ministers of Education in May 2012

<sup>41</sup> Allied Media Corp., *MBC: Middle East Broadcasting Centre*, [http://www.allied-media.com/ARABTV/ana\\_tv\\_and\\_middle\\_east\\_broadcast.htm](http://www.allied-media.com/ARABTV/ana_tv_and_middle_east_broadcast.htm).

<sup>42</sup> UAE Telecommunication Regulatory Authority, *TRA participates in EU-GCC Meeting*, 9 July 2012, <http://www.tra.gov.ae/news429.php>.

underscored the region's priorities regarding training and education. It is clear that training in the security field remains a focal point and a prime concern, as it was the first element to be discussed. Yet, a complete education reform should involve all sectors concerned. In fact, fresh research underlining the importance of complementary skills courses to theoretical teachings suggests tackling the issue at the state, employer, professor, and student level to maximize results.<sup>43</sup>

In the aftermath of the Arab Spring, Gulf governments increased the amount of money allocated to social welfare. The increase of such spending also bore positive effects on the education system. In particular, it emerges that funds for scholarships to study abroad increased, while the national education reforms are yet to be defined in detail. Hence, it appears that the current strategy for increasing competitiveness is to send nationals to study abroad.

In this context, the EU has ample leeway for enhanced cooperation with GCC countries. As a matter of fact, it is specified in the EU-GCC Joint Action Programme that cooperation at the institutional level should be continued and enhanced, in particular by promoting relations between the European University Association and the GCC Committee of Heads of Universities. Furthermore, involved countries should strive to raise awareness among Gulf students of exchange programmes in Europe, such as ERASMUS MUNDUS. A specific partnership between some EU universities and seven Gulf universities already exists for MA, PhD and Post-Doc students, as well as staff members, under the patronage of ERASMUS MUNDUS. Yet, less than one hundred people participate in the programme on a yearly basis. Also an important objective is to raise the number of Gulf students studying full-time in the EU, something that necessitates an increase in the number of partnerships among GCC and EU universities. Finally, to assist in the education reform in the Gulf states, it is desirable for EU universities to share best practices regarding student and staff management, curricula redaction and research programmes.

With regards to research, GCC countries have distinguished themselves from other Arab countries for their availability to host foreign, mainly American, universities and centres. Hence, the EU, with the implementation of the Joint Action Programme, aims at achieving the highest degree of cooperation via the identification and implementation of relevant research partnerships and technology transfers.<sup>44</sup>

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<sup>43</sup> Michael Barber, Mona Mourshed and Fenton Whelon, "Improving Education in the Gulf", in *The McKinsey Quarterly*, March 2007, p. 39-47, <http://abujoori.files.wordpress.com/2007/04/improve-gulf-education.pdf>.

<sup>44</sup> Gulf Cooperation Council, *Joint Action Programme for Implementation of the GCC-EU Cooperation Agreement of 1988*, cit.

### 1.3. CHALLENGES AND OPPORTUNITIES TO REVAMPING EU-GCC RELATIONS

The difficulties encountered by EU-GCC relations are the result of a host of factors, ranging from structural inefficiencies on both the EU and the GCC sides and the lack of a frank dialogue on political and governance-related issues, to imbalances created by the global financial and economic crisis and the events of the Arab Spring. A number of obstacles need to be overcome with a view to making EU-GCC relations more vibrant and up to the challenges at the regional and international levels. A few concluding remarks are offered here concerning some of the most urgent issues that need to be tackled and the ways of doing so.

The new regional context characterised by the North African transitions, continuous instability in Syria and the confrontation with Iran on its nuclear programme call for a more concerted effort by the EU and the GCC to turn their cooperation into a progressive force with regard to these issues. The GCC and the EU have always shared similar points of view on all the main regional issues, from Iraq and Afghanistan to Iran's nuclear programme. Nevertheless, the political dialogue between the two regions has mostly remained declaratory and inconsequential on critical security issues. By capitalising on their common views on a number of regional issues, the EU and the GCC should start a more frequent and effective exchange of opinions with a view to developing a pro-active response to the different situations created by the Arab Spring. For example, financial cooperation to answer the tremendous socio-economic challenges facing the southern Mediterranean countries could be one avenue of cooperation between the GCC and the EU in light of the substantial surpluses enjoyed by the first group's economies. By cooperating with the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB), which have their own projects in the Mediterranean region, the GCC could contribute where it is most needed. Another way to promote political and security cooperation would be to invest in the existing instruments in the framework of the North Atlantic Treaty Organization (NATO)'s partnerships, i.e., the Mediterranean Dialogue (MD) and the Istanbul Cooperation Initiative (ICI).

Another way to promote EU-GCC relations would be to involve the youth on both sides. In this regard, there is a need to explore the causes of the low rate of participation of GCC students and faculty in EU higher education programmes. As evidenced in the previous section, cooperation in the field of higher education is still poor and this represents one of the main shortcomings in the effort to promote educational exchanges, increase mobility and reciprocal knowledge and even facilitate a greater convergence at the decision- and policy-making levels. Further cooperation in this sector could be facilitated by the liberalisa-

tion of visa requirements on both sides.

Cooperation at the political and the human levels could distinctly benefit from any progress in the removal of the roadblock to the conclusion of the FTA. As previously stressed, in many respects the GCC countries have tended to regard the FTA as a litmus test of the EU's seriousness in developing stronger relations between the two blocks. It is obvious that the FTA would represent an important step in the right direction as it would free up resources, rationalise economic relations, provide new incentives for the diversification of the GCC economies and allow political ties to be enhanced to a new level of engagement. To achieve this goal, a great deal of suspicion towards the EU's intentions needs to be dispelled and major efforts need to be made by both parties to lay the ground for such an achievement. Bearing the above in mind, the time may not be right to re-launch FTA negotiations, due to the difficulties that the EU economic and political integration is currently undergoing. In this light, putting too much emphasis (and expectations) on the conclusion of the FTA is not a good idea. Relations should go beyond the FTA and should not be overly dependent on it. This does not mean however that its effective pursuit could not have a positive spill-over effect on the whole confidence-building exercise and cooperation.

In conclusion, with a view to advancing its relations with the GCC the EU needs to be aware of the differences existing among the GCC countries. The GCC does not constitute a single block and disregarding these differences could negatively impinge on EU-GCC relations. The disproportionate weight of Saudi Arabia, economically and politically, is now matched by the other GCC countries' as they become significant players in their own right, either in foreign policy, i.e., Qatar, or in economic terms, i.e., the UAE.

In light of the above, efforts should be made to devise a more strategic relationship centred on a less comprehensive number of topical issues compared to the ones already included in the Joint Action Programme. The Sharaka project aimed to disentangle the complex web of EU-GCC relations, with a view to identifying and enlarging the latitude, by both actors to achieve mutual cooperation, provided that there is a will on both sides. By analysing the record of EU-GCC cooperation in a number of different sectors, identified as the most strategic and/or promising ones in the relations between the two groups of countries, the project strove to contribute to the rethinking of EU-GCC relations. We believe that there is a huge potential to develop EU-GCC relations, provided obstacles are overcome, challenges confronted and the potential for cooperation fulfilled.



## 2.

# EU-GCC Trade and Investment Relations: What Prospect of an FTA between the Two Regions?

*Rym Ayadi and Salim Gadi*

## 2.1. CREATION OF THE GCC AND ITS RELATIONS WITH THE EU

### *2.1.1. GCC integration: drivers, objectives and progress to date*

The Gulf Cooperation Council (GCC) is a regional grouping bringing together Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. Home to a population of 43 million people in 2012, the region exhibits high heterogeneity in socioeconomic development. With GDP per capita of between €34,000 and €54,000, Qatar, Kuwait and the United Arab Emirates are the wealthiest countries, whereas Saudi Arabia, Oman and Bahrain are less wealthy with GDP per capita ranging from €12,000 to €13,000. Human capital is highest in Bahrain, Kuwait and Qatar, with literacy rates of between 91% and 94%, whereas in the other countries literacy rates are lower (Annex 4). The GCC is well known for its hydrocarbons endowments, but since their discovery and the beginning of oil exploitation in the 1970s, reserves have decreased substantially in most countries, which has led governments to engage in economic diversification policies. The remaining hydrocarbons are concentrated in a few countries: in 2013, Saudi Arabia and Kuwait accounted for 16% and 6% of world's oil reserves, respectively, and Qatar for 13% of global natural gas reserves (Annex 5).

Security motives were the driving force behind the GCC's creation. In the aftermath of the first Gulf War between Iran and Iraq, the countries of the Arabian Peninsula decided to initiate a move towards regional integration with a view to dealing with possible security threats. Countries in the region share many characteristics, but notwithstanding their commonalities, some important dif-

ferences exist. For example, Bahrain and Kuwait have somewhat open political systems with parliamentary elections and a written constitution, whereas Saudi Arabia more closely resembles an absolute monarchy.

After the GCC's creation on 25 May 1985, besides reinforcing security cooperation, states in the region have initiated a move towards regional integration similar to that of the EU, with the objectives of creating a customs union and adopting a single currency by 2010. To do so, they established a Secretariat General in 1981, as well as a number of technical organisations subsequently: the GCC Patent Office (1992), the GCC Standardization Organisation (2001) and the Monetary Council (2009). Despite their willingness to become a unified regional grouping, progress has been slow and uneven. The GCC customs union was only established in 2005, Bahrain and Oman signed free trade agreements (FTAs) with the US in 2004 and 2006 respectively, and, after numerous postponements, talks on the creation of the common currency have been frozen after Oman and the United Arab Emirates decided to opt out. Nevertheless, the process of regional integration advanced, and in 2008 member countries established a common market with the creation of the Gulf Customs Union.

Several factors can be put forward to explain why progress in regional integration has been slow. As oil and hydrocarbons producers, the GCC countries are competitors, which renders the necessary coordination of industrial policies in the region difficult. This similarity in production structures translates into very low rates of intra-regional trade; intra-GCC trade (imports and exports) averaged 7% between 1995 and 2011, compared to 63% for the EU and 23% for ASEAN countries (Figure 7). In the same vein, the region's exposure to oil price volatility and the imperative of income diversification makes coordination of monetary policies difficult. GCC economies appear to be highly state-dominated, with governments holding important shares in the industrial and services sectors. For example, GCC governments retain significant ownership stakes in the country's hydrocarbon sectors,<sup>45</sup> and state-owned banks accounted for an average of 22% of total banking assets in the region between 2003 and 2011, compared to 12% in the EU15.<sup>46</sup> Combined with the high degree of similarity in production structures, the state's presence in their respective economies is likely to complicate diversification and regional integration efforts, as governments might be reluctant to conduct important privatisation<sup>47</sup> programmes, despite their willingness

<sup>45</sup> Raed Kombargi et al., *Governance in the GCC Hydrocarbon Sector. The Right Time to Act*, Booz & Company, 21 June 2011, <http://www.booz.com/global/home/what-we-think/reports-white-papers/article-display/governance-hydrocarbon-sector-right-time>.

<sup>46</sup> Rym Ayadi and Willem Pieter de Groen, "Banking and Insurance in the GCC Countries: Is there Regulatory Convergence with the EU?", in *Sharaka Research Reports*, No. 4 (July 2013), <http://www.sharaka.eu/?p=1292>.

<sup>47</sup> Here, privatisation refers to the transfer of ownership of property or a business from a government to a privately-owned entity.

to support the development of the private sector.

With reducing hydrocarbons dependence a key challenge for the GCC countries, governments in the region have undertaken different strategies to meet this objective. The region's biggest oil producer, Saudi Arabia, has chosen for example to develop manufacturing activities close to the oil sector, such as plastics, polymers and fertilisers, via the state-owned SABIC company. Bahrain and the United Arab Emirates have chosen to develop tourism, manufacturing and financial activities, while Qatar has opted to strengthen its gas and financial sector.<sup>48</sup> These efforts seem to have yielded some results, as recent evidence shows that countries in the region are reducing their dependence on commodities and are less vulnerable than before to fluctuations in the price thereof.<sup>49</sup> More precisely, the Kuwaiti and Saudi Arabian manufacturing sectors appear to have "decoupled" from the oil sector, while the Qatari economy is still affected by oil price swings (with the exception of its manufacturing sector).

As far as the patterns of GCC international trade in goods are concerned, exports show a high degree of concentration. Compared to other economies, the GCC countries appear to be the most dependent on oil and gas. This suggests that their recent efforts to move away from oil dependence have failed to achieve meaningful results (Figure 8, Annex 1).

Trade protection, measured by the Overall Trade Restrictiveness Index (OTRI) developed by Kee et al.,<sup>50</sup> is low by international standards (Figure 9). Given that GCC tariffs averaged 5% in 2009, the low value of the index suggests that countries in the region do not resort excessively to non-tariff barriers for protectionist purposes. The low values of the OTRI could also be a reflection of the GCC countries' specialisation in hydrocarbons. Since the countries in the region are locked into the production of oil and its derivatives, overly high levels of trade protection can be detrimental to diversification efforts since inputs would cost more, re-

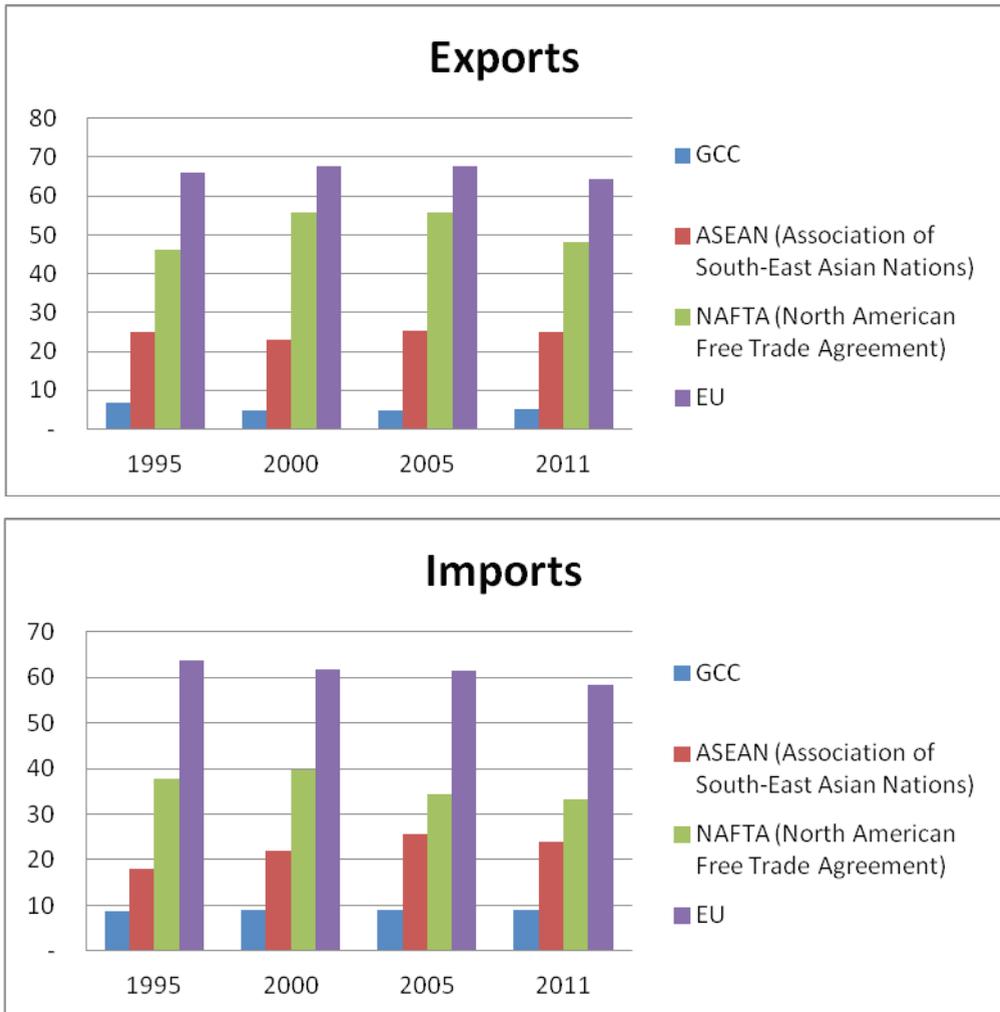
<sup>48</sup> Michael Sturm et al., "The Gulf Cooperation Council Countries. Economic Structures, Recent Developments and Role in the Global Economy", in *ECB Occasional Paper Series*, No. 92 (July 2008), <http://www.ecb.europa.eu/pub/pdf/scpops/ecbocp92.pdf>.

<sup>49</sup> To assess whether the GCC countries have diversified, Basher uses as a measure the degree of business cycle synchronicity between different economic sectors. Syed Abul Basher, "Has the non-oil sector decoupled from oil sector? A case study of Gulf Cooperation Council Countries", in *MPRA Papers*, 2 March 2010, <http://mpra.ub.uni-muenchen.de/21059>.

<sup>50</sup> The OTRI measures the uniform tariff equivalent of the tariff and non-tariff barriers (NTB) that would generate the same level of import value for a country in a given year. Tariffs can be based on Most Favored Nation (MFN) tariffs, which apply to all trading partners, or applied tariffs, which take into account bilateral trade preferences. The *ad valorem* equivalents of NTBs have been estimated by Kee et al. See Hiau Looi Kee, Alessandro Nicita and Marcelo Olarreaga, "Estimating Trade Restrictiveness Indices", in *The Economic Journal*, Vol. 119, No. 534 (January 2009), p. 172-199, [http://siteresources.worldbank.org/INTRES/Resources/469232-1107449512766/eco\\_j\\_2209.pdf](http://siteresources.worldbank.org/INTRES/Resources/469232-1107449512766/eco_j_2209.pdf). For a brief technical summary of the methodology see Annex 2 and World Bank, *Overall Trade Restrictiveness Indices and Import Demand Elasticities*, 2012, <http://go.worldbank.org/FG1KHXP30>.

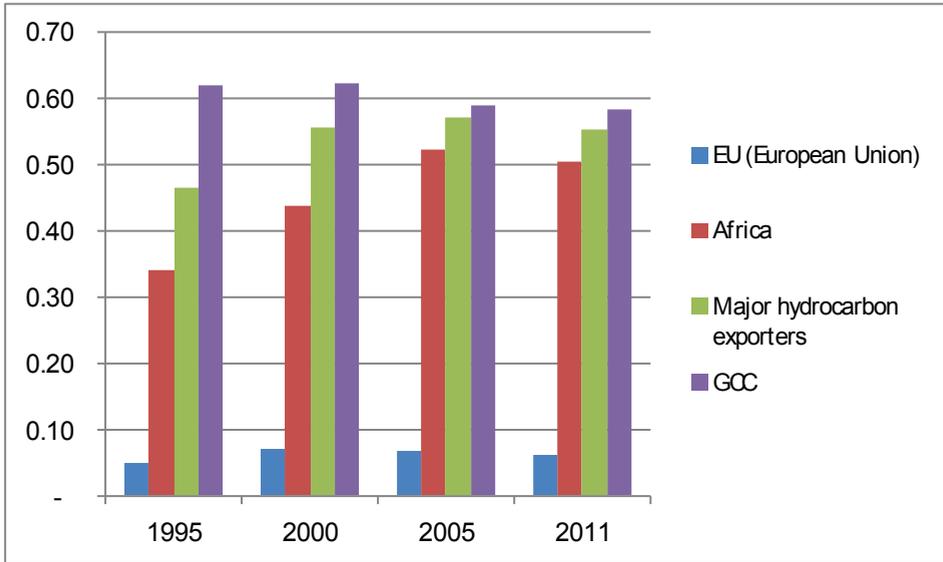
moving incentives for companies and governments to foster the development of alternative production. Also, high tariff levels can lead to inflationary pressures in oil-producing countries, thus complicating macroeconomic management while running a risk of social unrest.

**Fig. 7. Intra-regional exports and imports of selected trading blocs, 1995-2011 (% total trade in goods)**



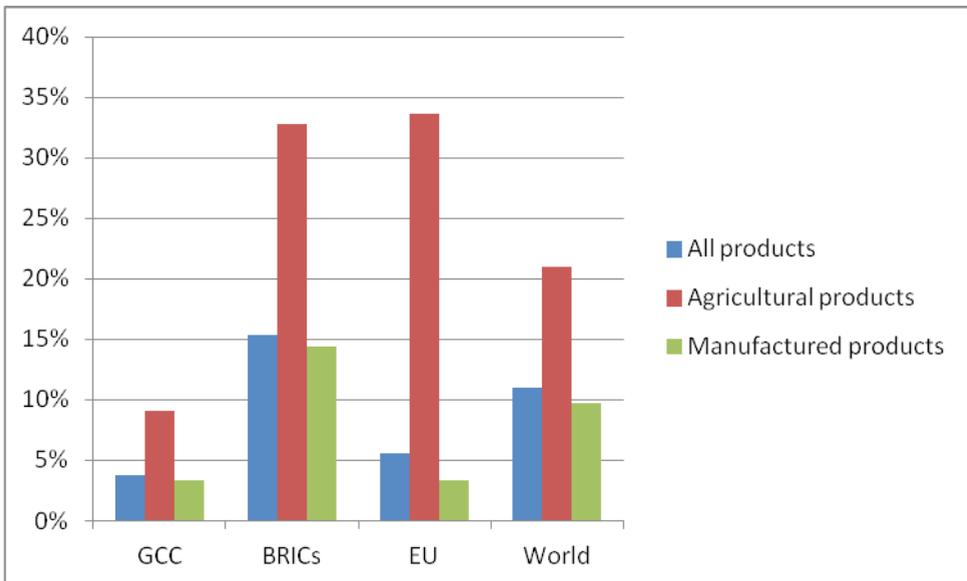
Note: see Annex 6 for country groupings used in this chapter.  
 Source: UNCTADstat.

**Fig. 8. Concentration index of GCC and other economies' exports, 1995-2011**



Source: UNCTADstat.

**Fig. 9. GCC countries' OTRI, 2009 (average tariff equivalent of tariff and non-tariff barriers across agricultural and manufactured products)**



Source: World Bank, *Overall Trade Restrictiveness Indices and Import Demand Elasticities*, cit.

In addition to structural economic factors rendering regional integration difficult, geopolitical factors can also explain why the GCC countries fail somewhat to behave as a unified bloc, despite their many common institutional characteristics. In 2004, for example, before the establishment of the customs union in 2005, Bahrain sidelined its other partners and signed an FTA with the US while reinforcing the US military presence in its territory in a bid to contain Iranian influence.

The GCC region's resource endowments, the weaknesses in its economic integration and its growing importance in the Arab world have resulted in the development of important commercial and political links with other countries, chiefly with the US, which established itself as the guarantor of regional security against the threats to the region represented by Iran and Iraq. As a result of their international clout and their importance in their neighbourhood, GCC countries have concluded a number of international agreements, and participate in regular international summits and negotiations.

### *2.1.2. GCC relations with the EU: drivers, objectives and progress to date*

While the GCC has privileged the US as an international partner thanks to the latter's engagement in the region since the discovery of hydrocarbons, the region has attracted the attention of EU policymakers since the 1970s as a result of a mix of geopolitical and commercial interests. The first initiative structuring relations between EU countries and the GCC countries dates back to 1974, when France pushed for the launch of the Euro-Arab Dialogue, following the Arab-Israeli War of 1973 and the first oil crisis. The initiative did not target the GCC countries exclusively, but sought to establish a permanent dialogue between European countries and members of the Arab League. Eventually, the initiative collapsed in 1989 without any significant achievement in terms of deepened or comprehensive cooperation.<sup>51</sup>

Between the end of the 1970s and the middle of the 1980s, European countries sought to strengthen relations with the Arabian Peninsula and, in 1983, both sides reached a framework agreement aimed at freeing and increasing commercial exchanges between the two regions. Over the 1980s, the scope of the framework agreement was gradually extended and, as trade relations grew between the two regions, negotiations for a Cooperation Agreement concluded in 1988. This multilateral agreement sought to "promote overall coopera-

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<sup>51</sup>The initiative collapsed for two reasons. First, Arab countries withdrew after the signature of the Camp David Accords in 1979. Second, despite French tentative attempts to revive the process, the Gulf War and inter-Arab divisions *de facto* collapsed it.

tion between equal partners on mutually advantageous terms in all spheres between the two regions and further their economic development, taking into consideration the differences in levels of development of the parties".<sup>52</sup>

At the time of the conclusion of the Cooperation Agreement, the motivations of the EU countries were quite straightforward. The GCC countries were important suppliers of hydrocarbons and no less important as an export market for European economies. Besides its economic dimension, the Agreement also had a minor political dimension in which the EU saw the GCC grouping as an important actor for the promotion of stability in the region. To achieve this aim, cooperation was established in a wide range of fields: economy and trade, agriculture and fisheries, industry, energy, science and technology, investment and the environment. Nowadays, the rationale for having close relations with the GCC countries is different and perhaps stronger, as trade and investment relations have grown due to the region housing the biggest sovereign investment vehicles, which have emerged since 2008 as important purveyors of emergency finance for distressed EU financial institutions.

However, despite its ambitious framework and the underlying motives for strong relations, little has been achieved in any of the fields covered by the Agreement. In fact, the Gulf countries were not included in the EU's external cooperation programmes until 2007, when the Council adopted Regulation (EC) No 1934/2006 establishing a financing instrument for cooperation with industrialised and other high-income countries and territories (ICIHI) for the years 2007-2013. The instrument is allocated a small envelope of €172 million and targets, besides the GCC countries, other industrialised nations such as Australia, Canada, Japan, and the United States. The fields of intervention of the ICIHI are broadly the same as those envisaged in the Cooperation Agreement.<sup>53</sup>

In the field of political dialogue, the Cooperation Agreement created the Joint Cooperation Council, comprising representatives of both sides who meet at least once a year. The Joint Cooperation Council's aim is to achieve the objec-

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<sup>52</sup> Quoted from the preamble to the EU-GCC Cooperation Agreement. See European Union, *Cooperation Agreement between the European Economic Community, of the one part, and the countries parties to the Charter of the Cooperation Council for the Arab States of the Gulf...* (21989A0225(01)), 25 February 1989, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=celex:21989a0225%2801%29:en:not>.

<sup>53</sup> The activities covered by the ICIHI are: promotion of cooperation, partnership and joint undertakings between economic, academic and scientific actors in the EU and the partner countries; stimulation of bilateral trade, investment flows and economic partnership; promotion of dialogue between political, economic and social actors and NGOs; promotion of people-to-people links, education and training programs, intellectual exchanges and the enhancement of mutual understanding between cultures and civilizations; promotion of co-operative projects in the areas of research, science and technology, energy, transportation and environmental matters; raising awareness about and understanding of the European Union and its operations in partner countries; and support for specific initiatives, including research work, studies, pilot schemes and joint projects.

tives set out in the Cooperation Agreement and to ensure it operates smoothly. In practice, the bulk of communiqués made by the Joint Cooperation Council have only been political statements on international stability and terrorism, on which both parties share the same views. As regards technical cooperation, besides some support in the form of technical assistance provided by the EU for the regional integration process of the GCC, very little has been achieved, mostly due to the numerous hesitations on the part of the Gulf countries in their regional integration process.<sup>54</sup>

## 2.2. TRADE AND INVESTMENT PATTERNS BETWEEN THE EU AND THE GCC: WHAT DIAGNOSIS?

### 2.2.1. EU-GCC trade in goods

If political dialogue and technical cooperation have failed to achieve meaningful results, trade and investment relations have flourished, driven by high oil prices and the Gulf countries' development imperatives. However, the economic and financial crisis of 2008 put a halt to the development of EU-GCC trade relations; as the emerging economies of Brazil, Russia, China, and India (the BRICs) proved more resilient to the financial turmoil, they outperformed the EU and in 2009-10 became the Gulf's top suppliers and primary export market (Figure 10). The emerging markets' immunity to the financial turmoil has influenced the figures on trade growth; between 1995 and 2011, the compound average growth rate (CAGR) of GCC exports to the BRICs amounted to 21%, compared to 12% for the EU and 14% for the entire world.

Despite the important growth in GCC-BRICs trade, the region has maintained a structural trade deficit with the EU. Trade patterns between the two regions are stable and show that GCC exports to the EU are mainly oil, gas, and related petrochemical products, while the region imports chiefly manufactured products and transport equipment from the EU.<sup>55</sup> While EU-GCC trade patterns have a strong resemblance to those of other GCC trading partners, GCC imports from the EU have a significantly higher value added and technological content. On average over the period 1995-2011, 28% of EU exports to the GCC were knowledge-intensive manufactured products (see Annex 7 for the product classification). In contrast, the BRICs, and chiefly China, continue to export mostly low- and medi-

<sup>54</sup> Abdullah Baabood, "EU-Gulf Political and Economic Relations, Assessment and Policy Recommendations", in *Gulf Papers*, 25 October 2006.

<sup>55</sup> France, Germany and the UK account for approximately 70% of EU exports to the GCC countries.

um-technology goods to the GCC region, although Chinese knowledge-intensive exports averaged a growth rate of approximately 10% over the period.

These patterns are evolving rapidly, however. Knowledge-intensive<sup>56</sup> exports from China to the GCC recently increased by 5%, moving from 15% to 20% of total exports between 2004 and 2011. The increase in high-tech imports from China, and the concomitant narrowing of the GCC region's trade balance with the EU, suggest that bilateral flows between China and the Gulf countries are going up in the value chain. This preliminary evidence notwithstanding, a definite assessment of whether imports from China are taking over the EU's position in the region would require more in-depth analysis.

The shifting trade patterns of the GCC region have translated into a narrowing of the trade balance with the EU of €27 billion, moving from €40 billion in 2009 to €15 billion in 2008 (Figure 11). Besides the upward move in the value chain of China's exports to the region, the narrowing of the GCC region's trade balance with the EU could be explained by the financial crisis. Between 2008 and 2009, the financial crisis resulted in a lower demand for hydrocarbons from the EU, while GCC countries' demand for European goods remained stable.

The figures for EU-GCC trade notwithstanding, from a European perspective the Gulf countries are minor trading partners. Between 2000 and 2011, their share of total EU exports amounted to approximately 3%, and their share of total imports averaged 2%. Also, reflecting the diversification of the EU's hydrocarbon supplies, the GCC countries' share of total hydrocarbons imports averaged 8%. Within the machinery and transport equipment category, the GCC countries accounted for a small share of total exports (3% between 2000 and 2011).

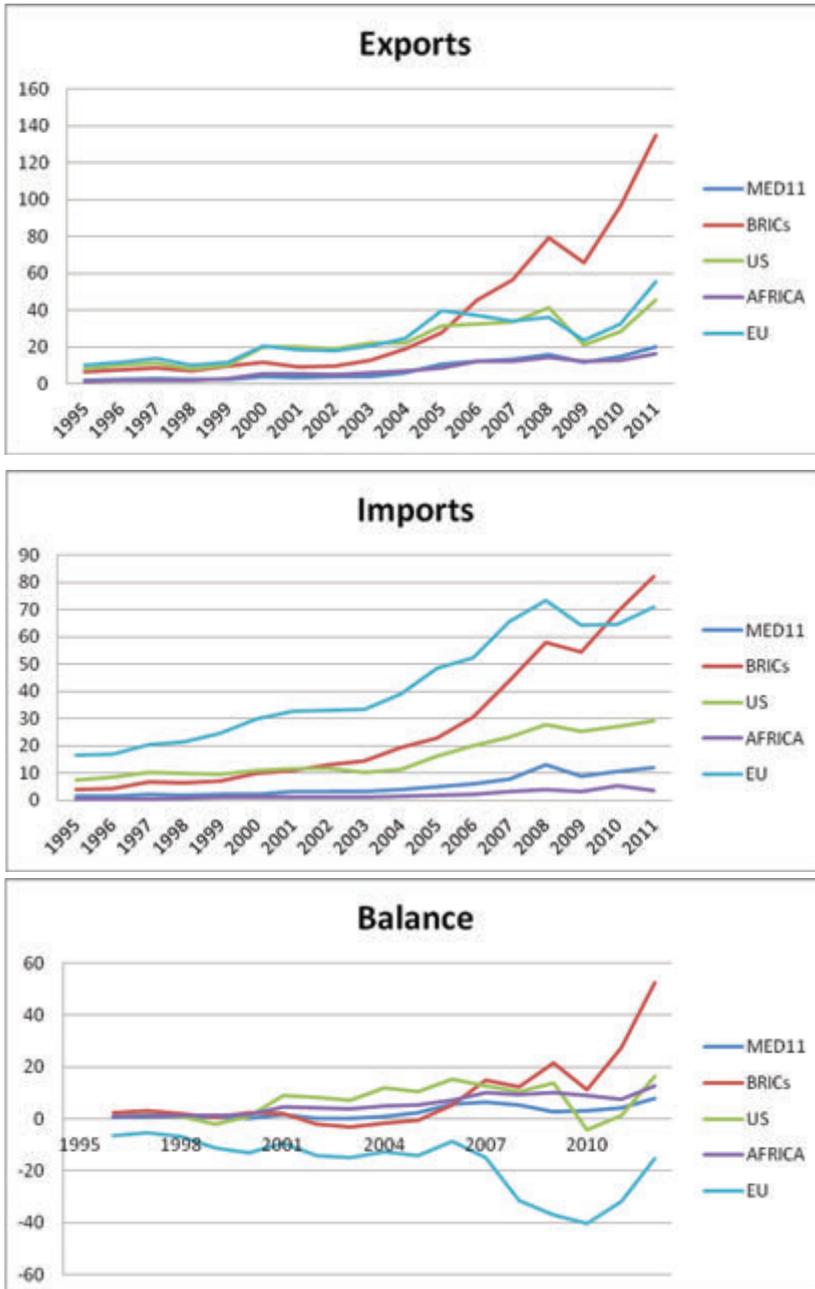
Looking at the figures at the country level, EU-GCC trade relations are concentrated among a small group of countries: France, Germany and the UK trade mainly with Qatar, Saudi Arabia and the United Arab Emirates, and these countries accounted for 70% of bilateral trade flows over the period 1995-2011. The close relations between these countries are further underscored by the number of defence contracts they have concluded since the 1990s. For example, the UK supplied significant quantities of military equipment to Saudi Arabia through a series of Al Yamamah deals, and the French defense consortium EADS built an air fence system along the Saud-Yemeni border.<sup>57</sup> Although a latecomer compared to France and the UK, Germany has sold military planes to the region and deepened its engagement with the GCC.<sup>58</sup>

<sup>56</sup> This classification is based on the OECD's definition of technological intensity in manufacturing products. High technology goods are produced by industries with the highest share of R&D spending in the manufacturing sector. For more information see OECD, *ISIC Rev. 3 Technology Intensity Definition*, 7 July 2011, <http://www.oecd.org/sti/ind/48350231.pdf>. See also Annex 7 for a classification of knowledge-intensive manufactured products.

<sup>57</sup> "World's Barriers: Saudi Arabia", *BBC News*, 5 November 2009, [http://news.bbc.co.uk/2/hi/middle\\_east/8342890.stm](http://news.bbc.co.uk/2/hi/middle_east/8342890.stm).

<sup>58</sup> Germany did not get involved in the Gulf wars, but agreed to participate in military oper-

**Fig. 10. GCC exports and imports to selected regions (€ bn)<sup>59</sup>**



Source: UNCTADstat.

ations involving GCC countries in the Middle East as long as they complied with United Nations resolutions.

<sup>59</sup> GCC exports to China consist mainly of oil and related products.

In recent years, trade between the GCC countries and China has soared, driven by Beijing's need for hydrocarbon resources and an increase in its exports' value added. Despite this rise, the EU still remains an important partner for the GCC but, looking to the future, Chinese exports are likely to compete increasingly with those from the EU.

### 2.2.2. EU-GCC trade in services

While bilateral flows of trade in goods have been explained by a country's comparative advantage, its factor endowments,<sup>60</sup> product differentiation,<sup>61</sup> trade costs<sup>62</sup> and, more recently, by productivity differentials among firms,<sup>63</sup> these theories seem somewhat ill-suited to explaining patterns of trade in services, due to the latter's inherent non-storability. As a result, theories explaining trade in services patterns emphasise the fragmentation of companies' production networks, demand, and total factor productivity.<sup>64</sup> The non-tradability of services has led authors to develop a typology of services based on the four modes of services supply<sup>65</sup>:

- Mode 1: Cross-border supply refers to services for which supply does not require the seller or buyer to meet physically to conclude a transaction. Telecommunications enter into this category.
- Mode 2: Consumption abroad applies to services for which the consumer or the supplier must move the other's physical location to supply the service. This is the case for tourism.
- Mode 3: Commercial presence concerns those services requiring either persons or firms to move to the location where consumers reside. Retail services are illustrative of this category.

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<sup>60</sup> Wolfgang F. Stolper and Paul A. Samuelson, "Protection and Real Wages", in *The Review of Economic Studies*, Vol. 9, No. 1 (November 1941), p. 58-73.

<sup>61</sup> Paul R. Krugman, "Increasing Returns, Monopolistic Competition, and International Trade", in *Journal of International Economics*, Vol. 9, No. 4 (November 1979), p. 469-479, [http://www.princeton.edu/pr/pictures/g-k/krugman/krugman-increasing\\_returns\\_1978.pdf](http://www.princeton.edu/pr/pictures/g-k/krugman/krugman-increasing_returns_1978.pdf).

<sup>62</sup> Paul R. Krugman, "Scale Economies, Product Differentiation, and the Pattern of Trade", in *The American Economic Review*, Vol. 70, No. 5 (December 1980), p. 950-959, [http://www.princeton.edu/pr/pictures/g-k/krugman/krugman-scale\\_economies\\_1980.pdf](http://www.princeton.edu/pr/pictures/g-k/krugman/krugman-scale_economies_1980.pdf).

<sup>63</sup> Marc J. Melitz, "The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity", in *Econometrica*, Vol. 71, No. 6 (November 2003), p. 1695-1725, <http://scholar.harvard.edu/melitz/publications/impact-trade-intra-industry-reallocations-and-aggregate-industry-productivity>.

<sup>64</sup> For a review see Bernard Hoekman, "Liberalizing Trade in Services: A Survey", in *World Bank Policy Research Working Papers*, No. WPS 4030 (October 2006), <http://dx.doi.org/10.1596/1813-9450-4030>.

<sup>65</sup> Gary P. Sampson and Richard H. Snape, "Identifying the Issues in Trade in Services", in *The World Economy*, Vol. 8, No. 2 (June 1985), p. 171-182.

- Mode 4: Movement of natural persons brings together services for which persons need to move to supply the service. This is the case for education and professional business services, for example.

This standard international classification was integrated in the WTO General Agreement on Trade in Services (GATS) but to analyse the characteristics of a country or region's trade in services, services categories are more illustrative. Also, from a liberalisation perspective, focusing on services categories rather than on modes of supply is more relevant since some different services under the same mode of supply might be subject to different regulations. For example, retail sales and banking services fall both under Mode 3, as they require opening a branch in the country. However, the regulations affecting these two activities are different, as banking and financial regulations have a prudential nature and, as a result, regulations affecting the entry of foreign suppliers in the host economy are likely to be different.

Partly as a reflection of the difficulties experienced in moving away from oil- and hydrocarbon-based economies, the performance of GCC countries on exports of services is poor, but their imports are substantial. The 1995-2011 cumulative value of GCC exports of services amounted to €2.3 billion, compared to €2.3 trillion for the BRICs and €20 trillion for the EU. On the import side, the cumulative value of services imports by GCC countries was €0.75 trillion between 1995 and 2011. Since the GCC imports substantially more services than it exports, figures on the share of trade in services over GDP give a blurred picture of the region's performance in global services markets. Indeed, the GCC region's total trade in services over GDP represented a share of between 15 and 19%, on a par with the EU.

Turning to the sector composition of the GCC region's trade in services, the region's exports mainly consist of construction, financial services and insurance (Figure 11). Given the region's surpluses and the willingness to diversify sources of income, the GCC's relative specialisation in the export of capital-intensive activities sustained by financial services is not surprising. It is also very likely that a significant share of these exports has fuelled real estate projects, acquisitions and investments in other Arab countries and the EU.<sup>66</sup> On the import side, the region is an important importer of transport, travel and government services, with these three categories accounting for a total of €731 billion over the 2000-2011 period (Figure 12).

The magnitude of transport activities' share of total imports of services is likely to be closely linked to the region's imports of goods, as importers might pay for the shipments of goods.

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<sup>66</sup> Examples include Qatari Diar, a company specialized in real estate projects with projects developed in the UK, Morocco, Tunisia, and Egypt among others.

Also, data on imports of travel services are very likely to reflect both the region's diversification efforts, which seek among other goals to create a vigorous tourist hub and become a bridge between Europe and Asia. The data may also reflect the importance of the yearly Hajj pilgrimage to Saudi Arabia, which brought 1.7 million people to the country in 2012. What is most striking in services imports, however, is the importance of government services. According to the Extended Balance of Payments Classification, this category encompasses expenses for embassies and consulates, military units and agencies, as well as other miscellaneous government services. Given the importance of security deals in the region and of this market for arms exporters in the EU, the significant share of this category is very likely a reflection of payments for items such as training of military staff in the region, costs related to the maintenance of military bases in the region, etc.<sup>67</sup>

In as far as EU-GCC trade in services is concerned, the Gulf region does not rank highly among the EU's trading partners, either in terms of exports or imports. However, as with trade in goods, the EU maintained a surplus with the GCC of €63 billion between 2006 and 2011 (Figure 13).<sup>68</sup>

In addition to the region's comparative advantage in hydrocarbon industries, other factors can explain the modest performance of GCC economies in trade in services. On the export side, the relatively low level of human capital in the region due to past neglect of education systems and trade in services policies that restrict the movement of persons prevents a vigorous service-driven economy from emerging. For example, on average, only 6% of GCC citizens aged over 25 have completed tertiary education, compared to 18% for Cyprus, 20% for Belgium and 24% for Japan. In addition, restrictive migration policies in the region prevent skilled workers from entering the GCC countries, limiting knowledge spillovers and the potential for increasing human capital in the region.<sup>69</sup>

On the import side, based on an index of services trade restrictiveness,<sup>70</sup> Gulf

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<sup>67</sup> Unfortunately, UNCTADstat provides neither a detailed breakup of services imports by sub category, nor a breakup by category and partner.

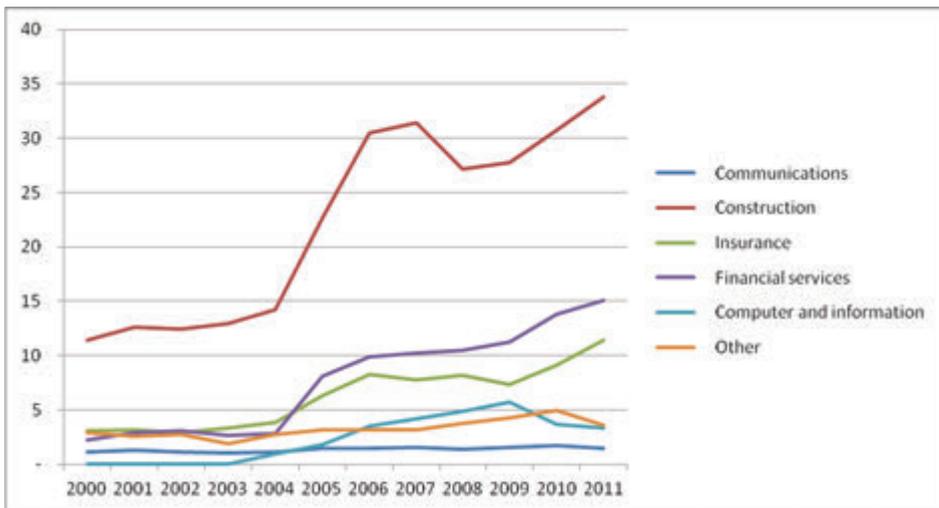
<sup>68</sup> Sectoral breakup of trade in services is not available.

<sup>69</sup> Figures quoted originate in the Barro and Lee Educational Attainment Dataset, <http://www.barrolee.com>.

<sup>70</sup> See Ingo Borchert, Batshur Gootiiz and Aaditya Mattoo, "Policy Barriers to International Trade in Services. Evidence from a New Database", in *World Bank Policy Research Working Papers*, No. WPS 6109 (June 2012), <http://dx.doi.org/10.1596/1813-9450-6109>. The STRI was developed by Borchert et al. and the World Bank with the view to propose a comparable measure of policy barriers affecting international trade in services. It is based on an inventory of regulations affecting the mode of entry of foreign companies completed with a questionnaire administered to local law officials on laws affecting foreign service suppliers and when possible on their scope of implementation. After verification, the questionnaire proceeds were then treated to create an index measuring the degree of services trade restrictiveness for each country and sector. The STRI database covers a total of 103 countries and 5 sectors: financial services (banking and insurance);

countries' markets appear to be the most protected in the world relative to their level of income across almost all services categories (Figure 14).<sup>71</sup> Widespread restrictions are found to apply such as minority ownership requirements for foreign suppliers willing to enter some segments of GCC telecommunications markets. It is likely that these restrictions play a significant role in the level of entry of foreign investors in the region.<sup>72</sup> Also, restrictions on foreign suppliers of services and discriminatory treatment are likely to hinder the GCC region's diversification efforts as strong, competitive, and open services sectors have been found to be essential in supporting such endeavours.<sup>73</sup>

**Fig. 11. GCC exports of services to the world by category, 2000-2011 (€ bn)**



Note: "Other" services refers to: travel; personal, cultural and recreational services; and other business services.

Source: UNCTADstat.

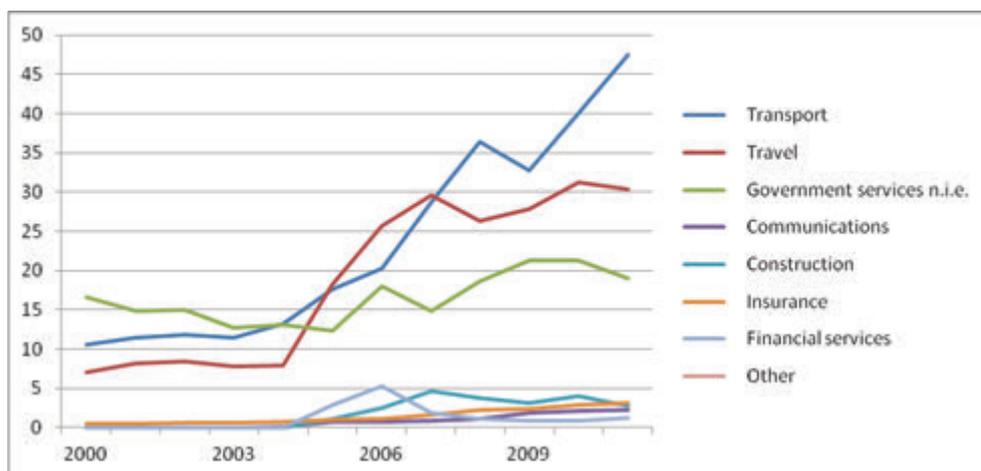
telecommunications' retail distribution; transportation; and professional services. With a view to providing the most detailed information possible, these sectors were further disaggregated into subsectors, the results of which are not reported here for simplicity purposes. The higher the value of the index in a particular sector, the more closed a country is in this sector. See Annex 3 for a brief methodological summary of the STRI.

<sup>71</sup> Ingo Borchert, Batshur Gootiiz and Aaditya Mattoo, "Policy Barriers to International Trade in Services", cit.

<sup>72</sup> Using a small panel of mergers and acquisitions over the period 2003-2009 in the communications, construction, insurance, financial services, computer and information services, travel, cultural, and other business services, services sectors, Borchert et al. find that restrictions on the entry of foreign services' suppliers exert a negative and significant impact on inflows of direct investment.

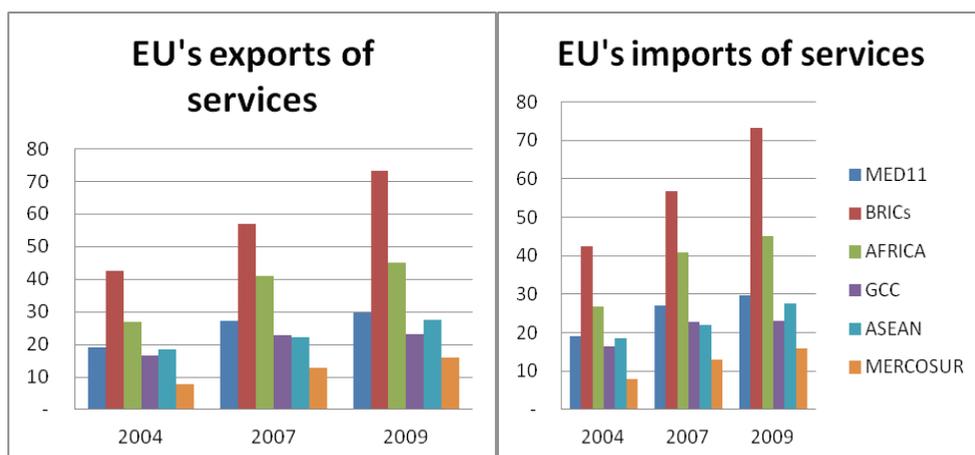
<sup>73</sup> Elena Ianchovichina, Julien Gourdon and Hiau Looi Kee, "Anatomy of nonoil export growth in the Middle East and North Africa region", in *GTAP Resources*, No. 3532 (2011), [https://www.gtap.agecon.purdue.edu/resources/res\\_display.asp?RecordID=3532](https://www.gtap.agecon.purdue.edu/resources/res_display.asp?RecordID=3532).

**Fig. 12. GCC imports of services by category, 2000-2011 (€ bn)**



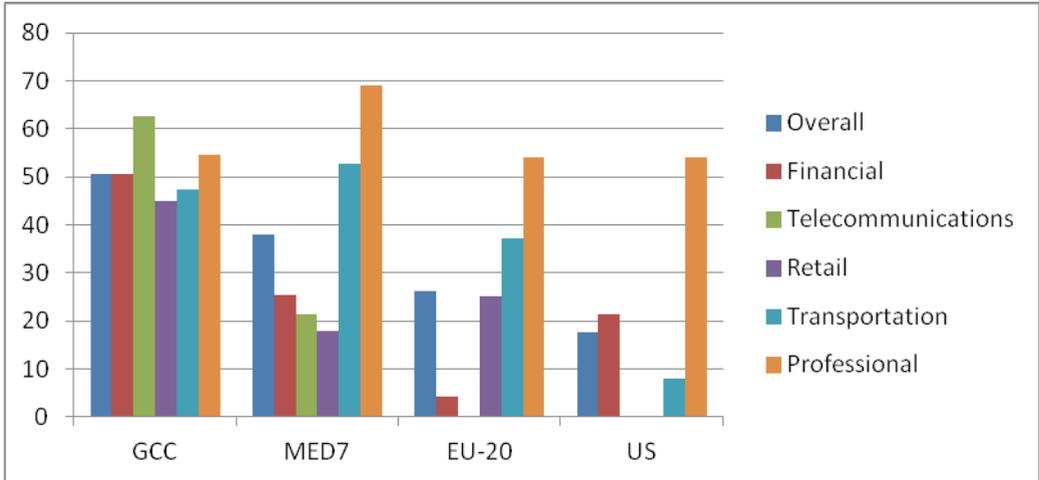
Note: "Other" services refers to: computer and information services; royalties and license fees; other business services; cultural and recreational services; other business services; and government services.  
Source: UNCTADstat.

**Fig. 13. EU-GCC trade in services with selected regions and trading blocs, 2000-2011 (€ bn)**



Source: EuroStat.

**Fig. 14. Values of the Services Trade Restrictiveness Index (STRI) across regions and services sectors, 2009**



Source: World Bank, *Services Trade Restrictions Database*, 2012, <http://iresearch.worldbank.org/servicetrade>.

GCC countries' exports of services are low, and consist mainly of construction activities, a result of their significant foreign exchange reserves. On the import side, the region is a significant importer of government services, the amounts of which are likely explained by the number of defense contracts the region has concluded with the US and EU member states. The GCC appears to be among the least open regions to trade in services, which can be explained by the governments' eagerness to diversify and favour the emergence of non-oil activities. However, the high level of restriction applied in some sectors can hinder this objective, preventing knowledge spillovers and negatively affecting the entry of foreign investors in these economies.

### 2.2.3. FDI between the EU and the GCC

The *Balance of Payments Manual* 5th edition, published by the International Monetary Fund (IMF), gives the following definition of foreign direct investment (FDI) flows: “Direct investment is the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy”.<sup>74</sup> Direct investment implies the right to vote in a company’s general assembly of shareholders and comprises flows of capital related to the initial transaction and all subsequent transactions between the affiliated companies, both incorporated and unincorporated. According to the recipient country’s legislation and the preferences of the investing company, the investment in the host country can result in a joint venture, a wholly owned subsidiary, a branch, and so on. The foreign investor also has the choice of entering the host country either via the establishment of production facilities or via the acquisition of existing structures. Although no consensus exists regarding these definitions, the former is generally qualified as “greenfield” investment, whereas the latter is referred to as “brownfield” investment. The IMF definition of FDI does not focus on the entry mode of the investor and adopts as a sole criterion the voice in management with data on inflows from international sources (from, for example, the IMF, World Bank or UNCTAD) comprising both greenfield and brownfield FDI (realised direct investments, reinvested earnings, etc.).

In addition to FDI flows, FDI stocks are also important in assessing the attractiveness of a country. According to UNCTAD, FDI stocks are the value of the share of companies resulting from the investment “capital and reserves (including retained profits) attributable to the parent enterprise (this is equal to total assets minus total liabilities), plus the net indebtedness of the associate or subsidiary to the parent firm. For branches, it is the value of fixed assets and the value of current assets and investments, excluding amounts due from the parent, less liabilities to third parties”<sup>75</sup>. Consequently, a rising stock of FDI is a signal of increased profitability of already established companies in the host market and/or increased investment activity.

In the economic literature, industrial organisation theories emphasise microeconomic characteristics as the main motivation for a company to engage in FDI, which is seen as an alternative mode of internationalisation to exporting. For a company to engage in FDI, it must first possess a specific asset (for example, knowledge), direct investment must be the cheapest way to internationalise,

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<sup>74</sup> IMF, *Balance of Payments Manual*, 5th ed., Washington, International Monetary Fund, 1993, p. 86, <http://www.imf.org/external/pubs/ft/bopman/bopman.pdf>.

<sup>75</sup> UNCTAD FDI Stock definition at <http://unctad.org/en/Pages/DIAE/FDI%20Statistics/Sources-and-Definitions.aspx>.

and economies of scale should exist in the host market.<sup>76</sup> Other theories posit that internationalisation through FDI will only take place for companies producing highly standardised goods, since for such goods transaction costs are lower.<sup>77</sup> While the theories derived from microeconomic approaches succeed in explaining why and when a company internationalises through direct investment abroad, they fail to explain a firm's localisation choice. Dunning encompasses previous explanations of direct investment in the ownership location internalisation (OLI) or "eclectic" paradigm.<sup>78</sup> For a firm to invest abroad, it must possess a competitive advantage (a patent, for example), it must have an incentive to invest in a particular location (significant market size, fiscal incentives, etc.), and there must be a market failure translating into positive transaction costs inducing the firm to internationalise and produce abroad. While companies engage in FDI for different reasons, these three reasons need to be simultaneously satisfied for FDI to occur. A corollary of the OLI paradigm is that there can be three sources of FDI - resource seeking, market seeking and efficiency<sup>79</sup> seeking (for the rationalisation of the production process through business process outsourcing, for example).

In the Gulf region, inward FDI is most likely to be motivated by resource-seeking and, to some extent, market-seeking motivations due to the region's endowment in natural resources and the high levels of per capita GDP. Efficiency-seeking FDI is likely to be a minor phenomenon, since it requires either a cheap or educated labour force, both of which are rather scarce in the GCC countries.

Between 1995 and 2011, GCC countries attracted a total of €237 billion in FDI inflows, compared to €3.8 trillion for the EU and €792 billion for the world's major oil and gas exporters (Figure 15). Saudi Arabia, the United Arab Emirates and, to some extent, Qatar are the most attractive countries for foreign investors and have between them attracted 90% of total inflows to the region since 2004. The GCC countries' share in world inward FDI inflows is negli-

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<sup>76</sup> For Caves, these three conditions must be fulfilled at the same time for a company to invest abroad. Richard E. Caves, "International Corporations: The Industrial. Economics of Foreign Investment", in *Economica*, Vol. 38, No. 149 (February 1971), p. 1-27.

<sup>77</sup> Peter J. Buckley and Mark Casson, "The Optimal Timing of a Foreign Direct Investment", in *The Economic Journal*, Vol. 91, No. 361 (March 1981), p. 75-87. This theory of international investment departs from Vernon's product cycle theory.

<sup>78</sup> A paradigm is defined as a set of assumptions, concepts, values, and practices that constitutes a way of viewing reality for the community that shares them, especially in an intellectual discipline. John H. Dunning, "The Eclectic Paradigm of International Production: a Restatement and Some Possible Extensions", in *Journal of International Business Studies*, Vol. 19, No. 1 (March 1988), p. 1-31, <http://dx.doi.org/10.1057/palgrave.jibs.8490372>; John H. Dunning, "The Eclectic Paradigm as an Envelope for Economic and Business Theories of MNE Activity", in *International Business Review*, Vol. 9, No. 2 (April 2000), p. 163-190, [http://www.exeter.ac.uk/media/universityofexeter/internationalexeter/documents/iss/Dunning\\_IBR\\_2000.pdf](http://www.exeter.ac.uk/media/universityofexeter/internationalexeter/documents/iss/Dunning_IBR_2000.pdf).

<sup>79</sup> Efficiency is defined as the accomplishment of or ability to accomplish a job with a minimum expenditure of time and effort.

ble; on average over the period 1995-2011 they accounted for a mere 1.7%, compared to 5% for the major oil and gas exporters and 26% for the EU. This modest performance notwithstanding, the 2000s and the creation of the customs union seem to have had a positive impact on the region's ability to attract FDI relative to the rest of the world. By creating a customs union and abolishing tariffs between themselves while enacting a common external tariff, the GCC countries are likely to have reduced transaction costs for foreign investors, thus exerting a positive influence on foreign capital inflows. At the same time, the rise in FDI observed in the early 2000s is likely to have been influenced by the privatisation programmes conducted in the region, and especially in Saudi Arabia's hydrocarbon sector. However, considering the share of inward direct investment relative to their size, the GCC countries significantly outperform the EU and other economies; inward inflows for the period 1995-2011 accounted, on average, for 17% of GDP, compared to 2% and 3% for the EU and hydrocarbons exporters, respectively. Inward investments in these countries represent approximately 50% of trade in goods and services, compared to levels close to 10% for the EU and hydrocarbons exporters. The region does not appear to be particularly dependent on foreign investment, as inflows account for an average of 10% of gross domestic fixed capital formation, a figure in line with hydrocarbon exporters and the EU.

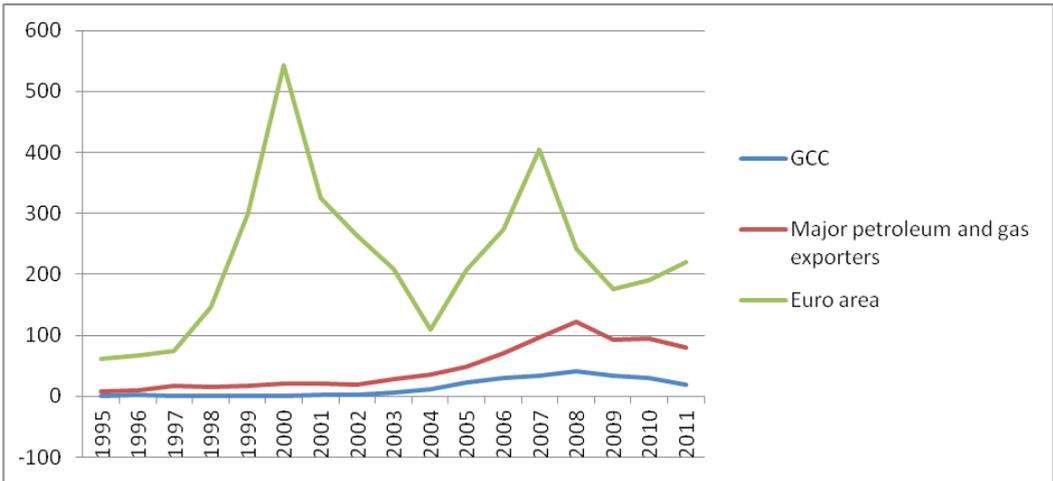
The small amounts of FDI in the region can be explained by the resource-seeking nature of direct investment in the GCC region, as well as the importance of the public sector in hydrocarbons. Despite moves towards privatisation in the 2000s, the GCC governments maintain significant ownership in their hydrocarbons sectors, restricting the entry of foreign investors to only minor ownership. For example, Saudi Arabia, the country which attracted the most FDI with €126 billion over 1995-2011, imposes equity restrictions on foreign participation allowing foreign investors to hold only minority ownership and ranks fourth among the countries least open to FDI after China, Russia, and Iceland.<sup>80</sup>

The same broad trends can be observed in the region's inward FDI stocks (Figure 16). Over 1995-2011, inward FDI stocks totalled €1.4 trillion, compared to €6.3 trillion for oil and gas exporters and €40 trillion for the EU. These amounts represented an average of 134% of the GCC region's GDP, compared to 14% and

<sup>80</sup> The ranking is based on the FDI restrictiveness index, developed by Kalinova et al. and maintained under the OECD. See Blanka Kalinova, Angel Palerm and Stephen Thomsen, "OECD's FDI Restrictiveness Index: 2010 Update", in *OECD Working Papers on International Investment*, No. 2010/3 (June 2010), <http://www.oecd.org/daf/inv/internationalinvestmentagreements/45563285.pdf>. Based on a surveys and desk research, the index ranks countries' openness to FDI along 4 criteria: equity restrictions, screening, key personnel, and operational restrictions. From a 0 to 1 score, 1 being completely open, Saudi Arabia is the only GCC country represented and obtained an overall score of 0.35 in 2012. See OECD, *FDI Regulatory Restrictiveness Index*, <http://www.oecd.org/investment/fdiindex.htm>.

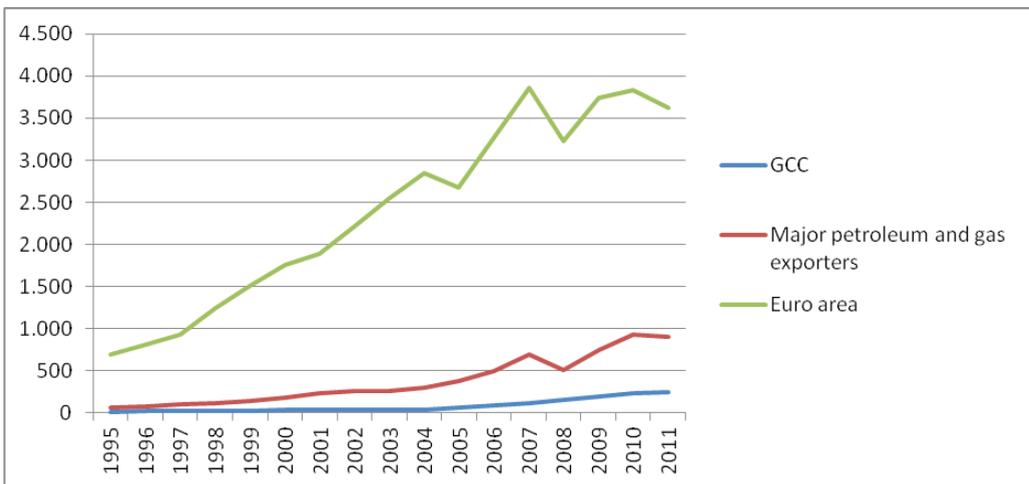
17% for oil and gas exporters and the EU, respectively. The high profitability of companies investing in the region illustrates the resource- and market-seeking opportunities from direct investment in the GCC countries, as the increase in companies' profitability could be a consequence of higher oil prices and a vigorous internal demand.

**Fig. 15. Inward FDI inflows in the GCC, major hydrocarbons exporters and the eurozone (€ bn)**



Source: UNCTADstat.

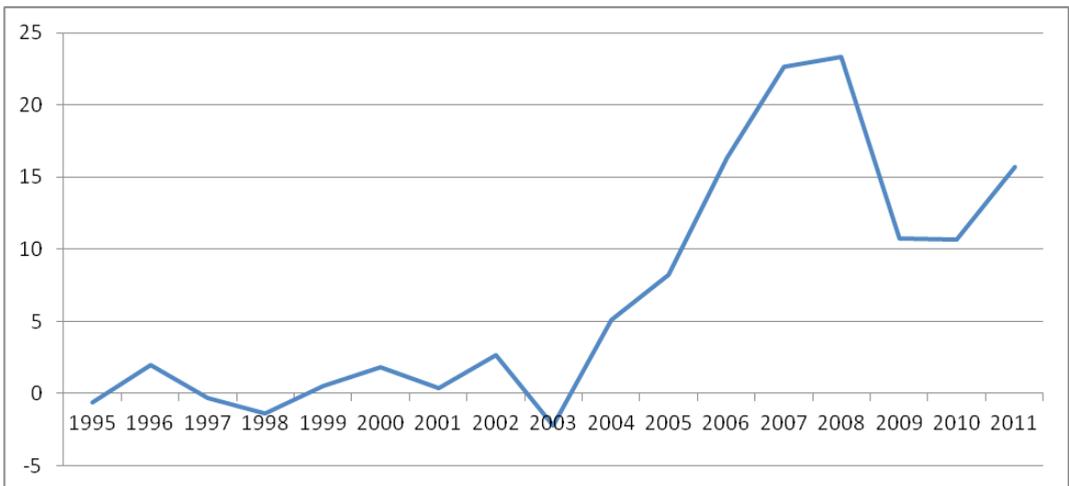
**Fig. 16. Inward FDI stocks in the GCC, major hydrocarbons exporters and the eurozone (€ bn)**



Source: UNCTADstat.

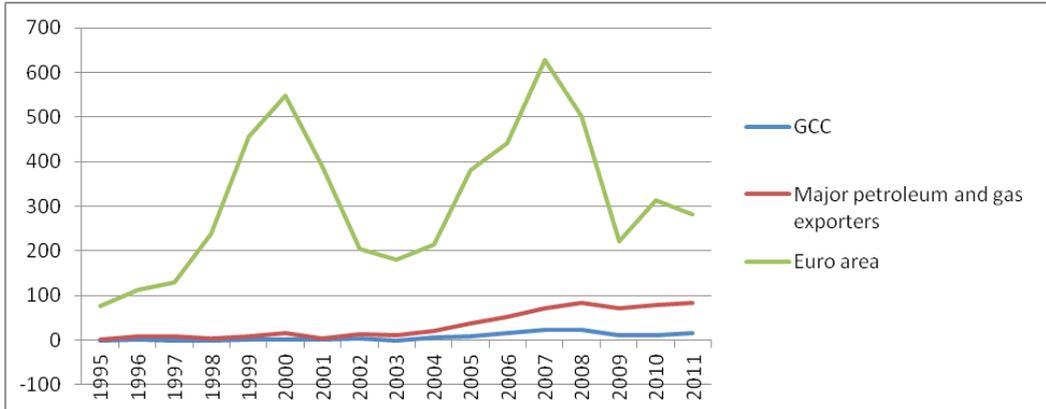
Turning to the GCC region's outward direct investment, the data show that Gulf countries were passive foreign investors until 2006. After that, yearly direct investments from the region were above the €15 billion mark and reached a peak of €26 billion in 2008. In the following years, foreign investment decreased to its 2006 levels, very likely as a consequence of both the international financial crisis and the Dubai crisis. Outward investments are on the rise again, however (Figure 17). At the country level, it appears that Saudi Arabia and the United Arab Emirates are the most significant exporters of capital in the region; their outward FDI flows have amounted to 50% of total outward FDI from the GCC countries. Compared to other countries, the performance of the GCC region in terms of foreign investment was modest over the 1995-2011 period, and EU countries significantly outperformed the region (Figure 18). As with direct investment inflows, GCC countries appear to be high exporters of foreign capital relative to their income and trade levels.

**Fig. 17. GCC outward FDI flows, 1995-2011 (€ bn)**



Source: UNCTADstat.

**Fig. 18. Outward FDI flows from the GCC, major hydrocarbons exporters and the euro-zone, 1995-2011 (€ bn)**



Source: UNCTADstat.

Outward FDI from the GCC region is the result of several motivations, chiefly the need for economic diversification. As major hydrocarbons producers and exporters, GCC countries need to protect themselves from the “Dutch disease”<sup>81</sup> syndrome by “recycling” their large surpluses through the diversification of their sources of income, which can be accomplished through the acquisition of foreign assets. While data on the sectoral and geographic distribution of foreign investments are not available, it is very likely that a significant share of Gulf countries’ investments is directed towards highly profitable markets and companies since their total outward FDI stocks have represented an average of 58% of their GDP, a significantly higher proportion than in hydrocarbon exporters and the EU (at 10% and 38%, respectively).

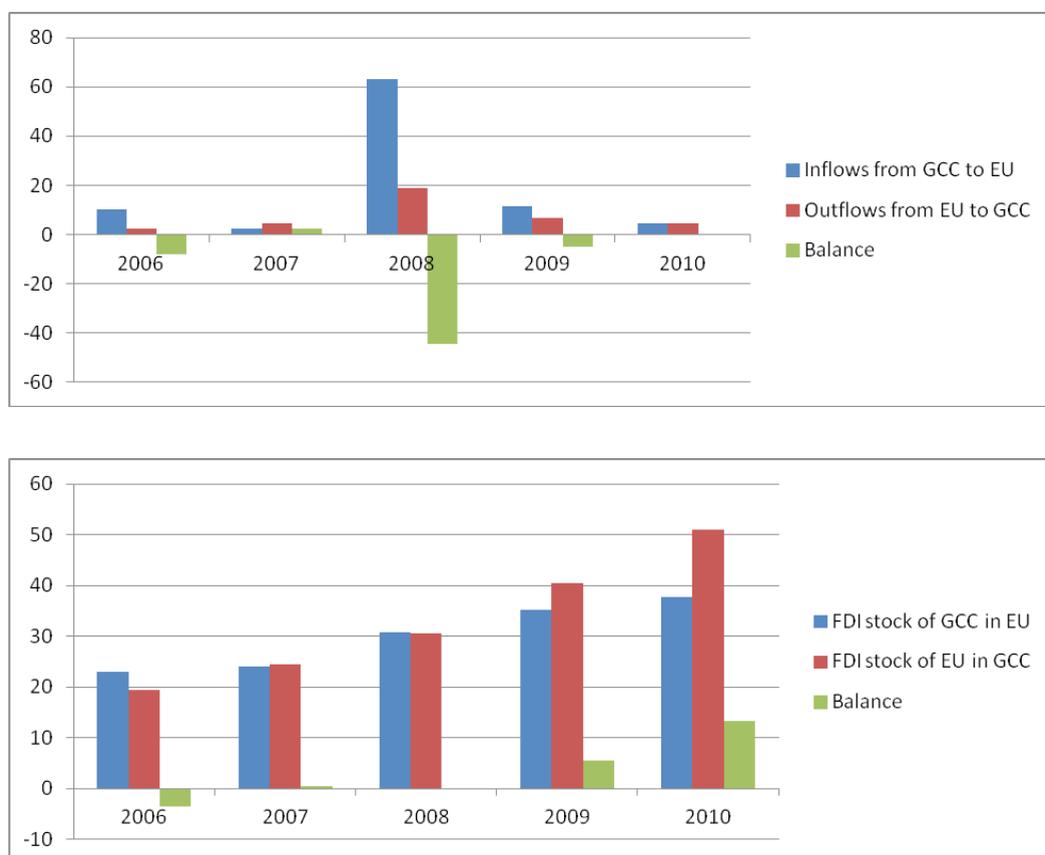
Turning to EU-GCC FDI,<sup>82</sup> data on inflows show that the EU invests less in

<sup>81</sup> In economics, the Dutch disease is the apparent relationship between the increase in exploitation of natural resources and a decline in the manufacturing sector (or agriculture). The mechanism is that an increase in revenues from natural resources will make a given nation’s currency stronger compared to that of other nations, resulting in the nation’s other exports becoming more expensive for other countries to buy, making the manufacturing sector less competitive.

<sup>82</sup> Aggregate FDI data used in this chapter originate from UNCTAD, whereas bilateral EU-GCC FDI data come from Eurostat. Both organisations compile data according to the guidelines of the IMF’s *Balance of Payments Manual*, but the European statistical office complies with the OECD Benchmark Definition of Foreign Direct Investment, Third Definition. The OECD’s methodology, meanwhile, allows for dissecting inflows and outflows between the various components of inward and outward FDI (equity investment, intra company loans, retained earnings) and gives the sectoral breakup of international investments, coverage of GCC countries in the database is low. Hence, in what follows, we chose to rely on aggregate figures released earlier by the European Commission Directorate General for Trade (DG Trade) in order to provide the reader with an idea of the magnitude of bilateral FDI inflows. Since European sources use EU member states’ balance of payments statistics and UNCTAD reporting economies’ data, there are discrepancies between data sources.

the GCC than the Gulf countries invest in Europe (Figure 19). While a direct comparison with total amounts of direct investment received by Gulf countries is not possible, the EU's investments in the region are likely to represent an important share of total investment. On the other hand, GCC countries' FDI in the EU represents a minor share of direct investment inflows. Turning to stocks, it appears that both destinations are lucrative for foreign investors as magnitudes of FDI stocks are close, and appreciated over the period 2006-2010. The FDI balance between the EU and the GCC region appears to be close to zero, meaning that the investment inflows of both regions are on a par. Turning to stocks, however, the balance is positive in favour of the EU, suggesting that companies located in that region are increasingly profitable.

**Fig. 19. Bilateral FDI flows and stocks in EU from GCC countries (€ bn)**



Source: European Commission DG Trade, *GCC-EU Bilateral Trade and Trade with the World*, September 2010, and *GCC-EU Bilateral Trade and Trade with the World*, October 2012.

Relative to their size, the GCC countries have attracted significant amounts of foreign capital, although the absolute magnitude of inflows has been low and probably below its potential level. Outward capital flows from the Gulf economies were also very low until the beginning of the 2000s, when the region dramatically increased its exports of capital. The picture of this rise of the GCC region as a foreign investor in the EU and in other regions can be misleading, however, as outflows from the region could be more significant than depicted in the statistics from international institutions.

#### *2.2.4. Sovereign wealth fund investments*

Due to statistical definitions and the presence of sovereign wealth funds (SWFs), the levels of GCC countries' FDI in the EU may underestimate the real magnitude of their investments. While there is no widely accepted definition of SWFs, economists agree on a number of characteristics distinguishing them from other investment vehicles. SWFs are investment vehicles created by governments and financed by transfers of foreign exchange reserves proceeding from balance of payments surpluses, commodity exports, privatisation receipts, fiscal surpluses and foreign currency operations. They are generally, though not always, managed by government authorities or related entities. Their objectives can be manifold – SWFs can be used as mechanisms for smoothing the negative effects of volatile revenues on the economy, for promoting transparency in public spending, for fiscal discipline or for pursuing economic diversification objectives.

The establishment of SWFs in the GCC countries is not a new phenomenon, as some were set up as early as the 1970s. However, the majority were set up in the beginning of the 2000s as oil prices and subsequent foreign exchange reserves increased, and governments in the region created funds to invest in assets overseas and to diversify the region's sources of income beyond hydrocarbons. Growing foreign exchange reserves and the establishment of these sovereign vehicles coincided with the implementation of development plans in the region as well as important investments in infrastructure, financial services, education, tourism and petrochemicals.<sup>83</sup>

EU countries have been important destinations for overseas investment by the GCC regions' SWFs, although it is virtually impossible to quantify their investment due to the high level of secrecy surrounding the SWFs and their lack of transparency. It is nevertheless estimated that their total assets range between

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<sup>83</sup> Gawdat Bahgat, "Sovereign Wealth Funds in the Gulf: An Assessment", in *LSE Kuwait Programme Research Papers*, No. 16 (July 2011), <http://www.lse.ac.uk/government/research/research-groups/kuwait/research/papers/sovereignwealth.aspx>.

\$800 billion and \$1 trillion (between €600 billion and €1 trillion in 2008),<sup>84</sup> and that over the period 2000-2006, approximately €76 billion of their €490 billion total surplus was invested in EU markets with an important focus on the financial sector (Table 2).

**Table 2. Selected examples of GCC SWF acquisitions in the EU**

<b>Target</b>	<b>Fund</b>	<b>Value (\$ mn)</b>
OMX (Sweden)	Dubai Investment Financial Corporation	3,551.4
Paris Saint Germain Football Club (France)	Qatar Investment Authority	193.6
British Petroleum (UK)	Kuwait Investment Authority	2,800
ACWA (UK)	Public Investment Fund (Saudi Arabia)	undisclosed

Source: Gugler and Chaisse<sup>85</sup>; Quintin<sup>86</sup>; Rasooldeen<sup>87</sup>; SWF Institute, *Linaburg-Maduell Transparency Index*, <http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index>.

Their significant participation in the marketplace raised concerns among EU policy-makers after GCC SWFs acquired stakes in strategic industries such as aerospace, defence, utilities, and electrical engineering companies. As SWFs are non-transparent actors (Table 3) that do not disclose information on their investment strategies, assets under management, governance or mandates, policy-makers feared their acquisitions could be backed by political agendas and result in the transfer of strategic assets. Fears were renewed when unofficial estimates put their investment stock in the EU at €400 billion, making them among the largest foreign stakeholders in Europe.<sup>88</sup>

<sup>84</sup> Ibidem.

<sup>85</sup> Philippe Gugler and Julien Chaisse, "Sovereign Wealth Funds in the European Union: General Trust Despite Concerns", in *NCCR Working Papers*, No. 2009/4 (January 2009).

<sup>86</sup> Emmanuel Quintin, "Le PSG est vendu!", in *Le Figaro*, 31 May 2011, <http://www.lefigaro.fr/football-ligue-1-et-2/2011/05/31/02013-20110531ARTSPO00510-le-psg-est-venu.php>.

<sup>87</sup> M.D. Rasooldeen, "PPA, "Sanabil acquire 19.4% stake in ACWA Power", in *Arab News*, 13 January 2013, <http://www.arabnews.com/ppa-sanabil-acquire-194-stake-acwa-power>.

<sup>88</sup> Steffen Hertog, "EU-GCC Relations in the Era of the Second Oil Boom", in *CAP Working Papers*, December 2007, <http://www.cap-lmu.de/publikationen/2007/hertog.php>.

**Table 3. GCC SWF characteristics**

Country	Fund name	Assets under management (\$ bn, 2013)	Inception	Origin	LM index*
UAE - Abu Dhabi	Abu Dhabi Investment Authority	627.0	1976	Oil	5
Saudi Arabia	SAMA Foreign Holdings	675.9	n/a	Oil	4
Kuwait	Kuwait Investment Authority	386.0	1953	Oil	6
Qatar	Qatar Investment Authority	115.0	2005	Oil	5
UAE - Dubai	Investment Corporation of Dubai	70.0	2006	Oil	4
UAE - Abu Dhabi	International Petroleum Investment Company	65.3	1984	Oil	9
UAE - Abu Dhabi	Mubadala Development Company	55.5	2002	Oil	10
Oman	State General Reserve Fund	8.2	1980	Oil & Gas	4
Bahrain	Mumtalakat Holding Company	7.1	2006	Non-commodity	9
Oman	Oman Investment Fund	6.0	2006	Oil	n/a
Saudi Arabia	Public Investment Fund	5.3	2008	Oil	4
UAE - Ras Al Khaimah	RAK Investment Authority	1.2	2005	Oil	3
UAE - Federal	Emirates Investment Authority	n/a	2007	Oil	3
UAE - Abu Dhabi	Abu Dhabi Investment Council	n/a	2007	Oil	n/a

\* The Linaburg Maduell index has been developed to score SWFs' transparency performance. The more information the fund provides, the higher the score. For more information see SWF Institute, *Linaburg-Maduell Transparency Index*, <http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index>.

Source: SWF Institute, *Fund Rankings*, updated September 2013, <http://www.swfinstitute.org/fund-rankings>.

As Gulf SWFs' investments in the EU grew, EU member states adopted protectionist stances against them, especially due to national security concerns. As early as 2005, France issued a decree listing 11 sectors in which foreign investment would be subject to approval due to concerns over "national defence interests". German Chancellor Angela Merkel pushed for similar legislation in April 2008, allowing policy-makers to scrutinise foreign investments, most notably those emanating from SWFs, irrespective of their origin. At the multilateral level, the growing role of SWFs was addressed in 2008 by the creation of the International Working Group on SWFs (IWG)<sup>89</sup>. Most notably, the IWG established 23 Generally Accepted Principles and Practices (GAPP) in the form of

<sup>89</sup>The IWG was established as an autonomous entity following a meeting at the IMF with representatives from SWFs, the OECD, recipient countries and the European Commission.

a Code of Conduct – the Santiago Principles – to foster understanding on SWF practices and dismiss fears over politically motivated investments. While the initial proposal for such a document was frowned upon by several GCC SWFs such as the Kuwait Investment Authority (KIA), which argued that with over 50 years in existence its investments were by no means politically motivated, recipient countries were also integrated into an OECD initiative to ensure non-discrimination and reciprocity to foreign investors – the Guidelines for Recipient Country Investment Policies Relating to National Security<sup>90</sup>.

However, the worldwide crisis dampened EU concerns, as GCC SWFs emerged as important purveyors of emergency financing to distressed banks. For example, in 2008 the Abu Dhabi Investment Authority, an Emirati SWF, invested \$6 billion in the British Barclays Bank. In 2011, 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 ahorros*). Dismissing arguments over politically motivated investments after buying important equity stakes in Citigroup, the KIA sold a significant proportion of its initial acquisition in 2009.<sup>91</sup> Illustrating the profit-driven nature of SWF investments, in November 2012, Italy and the Qatar Holding Company LLC, a subsidiary of the Qatar Investment Authority (QIA), announced the creation of a jointly owned fund mandated with investing in the Italian luxury and tourism industries, with investment commitments that could be beyond the €2 billion mark.<sup>92</sup> Similarly, the Qatari ruler committed to creating a joint fund with Greece endowed with €1 billion to invest in Greek small and medium-sized enterprises (SMEs).

The previous cases notwithstanding, the secrecy surrounding SWF investment and their strategy renders substantiating claims over politically motivated investments difficult. Occasional examples of SWF investments are sometimes interpreted as being illustrative of SWFs' willingness to acquire strategic assets.

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<sup>90</sup> At the EU level, the Commission communication on a common European approach to SWFs highlights the response to member states' concerns over strategically motivated SWF investments. While stressing the commitment to capital mobility, the document notes that member states can take legal action against SWF investments in cases where public security, plurality of the media or prudential regulations are compromised in accordance with the EU Treaty. In other cases, the Communication notes that the Commission shall inform member states of their right to restrict direct investments from SWFs on a case-by-case basis. Also, it notes that the EU can take unilateral measures affecting direct investments by qualified majority, and that restrictive measures on direct investment can be taken by unanimity within the Council. European Commission, *A common European approach to Sovereign Wealth Funds* (COM(2008) 115 final), 27 February 2008, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=celex:52008dc0115:en:not>

<sup>91</sup> Gawdat Bahgat, "Sovereign Wealth Funds in the Gulf: An Assessment", cit.

<sup>92</sup> Fondo strategico italiano, *FSI and Qatar Holding sign JV to invest up to € 2 billion in "Made in Italy"*, 19 November 2012, <http://www.fondostrategico.it/en/news/fsi-and-qatar-holding-sign-jv-to-invest-up-to-2-billion-in-made-in-italy.html>.

In 2008, for example, the QIA bought a French electrical engineering company, Cegelec, raising fears that such an acquisition would provide Qatar with a competitive advantage in strategic industries such as transport, communications, and utilities<sup>93</sup>. However, a few months later the Gulf SWF concluded a deal with Vinci, a French utility company, under which the Qatari fund swapped Cegelec shares for Vinci equity, realising a loss of 17% on the initial investment value. Analysts interpreted the move as illustrative of both the willingness of GCC countries to use their SWFs as a tool for industrial diversification and their incapacity to play an active role in knowledge-intensive target companies. Yet, it is not clear whether allegations of the SWF's lack of human capital are founded. Due to their significant size, it is likely that these funds can hire top-level managers able to play an active role in the management of investment companies. Moreover, by being an important shareholder of Vinci, the fund is still close to Cegelec since it is owned by Vinci.<sup>94</sup>

In the near future, the role of GCC SWFs in EU markets could increase for two reasons. First, oil prices are set to remain above \$100/barrel, generating important surpluses that will increase the capacity of the region's investment arms. Second, as the economic and financial crisis worsens, investment opportunities are likely to emerge, as shown by the Citigroup example. Whether their investments will be backed more than before by political agendas remains an open question, since countries in the region will be increasingly under pressure to diversify their economies and provide employment prospects to their populations to contain the potential of social unrest while, at the same time, their SWFs are likely to gain the capacity to manage increasingly complex portfolios.<sup>95</sup>

As a matter of fact, France provides an illustration of an increase in a country's capabilities to manage new types of investment. At the beginning of September 2012, Qatari investment arms announced their willingness to fund a project in France's neglected urban suburbs and the Ambassador to France announced his country stood ready to invest up to €10 billion in French listed companies with a view to developing partnerships in the country and overseas. The Ambassa-

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<sup>93</sup>The French company is a major actor in the infrastructure and utilities industries. It has operations in Latin America, West Africa, North Africa, the Middle East and South Asia, and employs more than 20,000 workers. Since it has activities in the energy industry and infrastructures, the QIA's investment was interpreted as illustrative of the Sheikhdome's willingness to use its financial muscle to strengthen its international position in the energy and infrastructure sectors. These concerns have been further strengthened as the country is set to host the World Cup in 2020 and will have to engage in important infrastructure works.

<sup>94</sup>François-Aïssa Touazi, "Sovereign Wealth Funds and European companies: What partnership to tackle the financial crisis?", in *CAPmena*, March 2010, [http://www.capnouveau monde.org/capmena/pdf/20100305%20Touazi%20\(eng\).pdf](http://www.capnouveau monde.org/capmena/pdf/20100305%20Touazi%20(eng).pdf).

<sup>95</sup>Sven Behrendt, "When Money Talks: Arab Sovereign Wealth Funds in the Global Public Policy Discourse", in *Carnegie Papers*, No. 12 (October 2008), <http://carnegie-mec.org/2008/10/15/when-money-talks-arab-sovereign-wealth-funds-in-global-public-policy-discourse/bezf>.

dor added that the countries would create a joint fund endowed with €300 million to invest in French small and medium-sized enterprises (SMEs)<sup>96</sup>.

These examples show that GCC SWF interest in the EU is growing, and that the crisis is likely to further increase their presence in the region. EU member states have consistently deplored the lack of transparency of these investment vehicles and fears about politically motivated investments have often been raised. However, as the region's surpluses are expected to grow in the coming decades and the interest of these funds in the EU is expected to grow, the two regions could launch a bilateral dialogue seeking to reinforce mutual confidence by devising measures to enhance the transparency of SWF investments and avoid protectionist reactions, for example, by creating an EU-GCC code of conduct for international investment.

## 2.3. THE EU-GCC FTA: MOTIVATIONS AND EXPECTED IMPACT

The EU and the GCC have limited political relations and rather stable bilateral trade and investment patterns, although emerging countries – chiefly China – are increasingly competing with the EU in the region. At the end of the 1980s, the EU and the GCC initiated negotiations for an FTA that would have been the first region-to-region trade deal ever concluded. The agreement sought to reinforce integration between both regions and went beyond shallow integration and tariff dismantlement to address issues such as trade in services liberalisation, investment regulations and government procurement rules. Despite the wide scope of the agreement, the parties failed to reach a consensus, resulting in the failure of the negotiations. This calls for an assessment of EU and GCC motivations for and potential benefits from the proposed agreement.

### 2.3.1. EU and GCC interests in the FTA

Economic theory emphasises mutual gains from reciprocal trade liberalisation as a sufficient condition for engaging in tariff dismantlement, but it seems that non-economic motivations likely play a more prominent role in EU-GCC relations than in other trade talks, mostly due to the Gulf's importance as a hydrocarbons supplier and to its economic and political influence in the Arab world.<sup>97</sup>

<sup>96</sup>“Le Qatar veut investir 10 milliards dans les entreprises françaises”, *Le Monde*, 6 November 2012, [http://www.lemonde.fr/economie/article/2012/11/06/le-qatar-veut-investir-dans-les-entreprises-francaises\\_1786620\\_3234.html](http://www.lemonde.fr/economie/article/2012/11/06/le-qatar-veut-investir-dans-les-entreprises-francaises_1786620_3234.html).

<sup>97</sup>Mustapha Rouis et al., *Arab Development Assistance. Four Decades of Cooperation*, Washington, World Bank, June 2010, <http://documents.worldbank.org/curated/en/2010/06/12821257/arab-development-assistance-four-decades-cooperation>.

For the EU, these geopolitical considerations are likely to take precedence over economic interests, and trade negotiations with the GCC should rather be seen as part of a wider effort aimed at reinforcing its policies towards the Arab world. Until the end of the 1980s and the beginning of the 1990s, the EU's policy frameworks towards the Arab world had neglected the Gulf and the wider Middle East<sup>98</sup>, centring *de facto* on former colonies in the Arab Mediterranean region. The different policy frameworks for relations with the latter rested on the idea that trade liberalisation, regional integration and the promotion of a set of good governance standards were the keys to achieving peace and stability. As a result, under the Global Mediterranean Policy (GMP) and the Renovated Mediterranean policy (RMP), the EU offered assistance to partner countries in exchange for the implementation of economic reforms and trade liberalisation. Relations with the southern Mediterranean<sup>99</sup> were further deepened in 1995 with the creation of the Barcelona Process and in 2003 with the European Neighbourhood Policy (ENP).<sup>100</sup> Meanwhile, the GCC countries' relations with the EU were structured around the 1988 Cooperation Agreement, of narrower scope than Association Agreements between the EU and southern Mediterranean countries. As a result of these different policy frameworks, the extent of the EU's presence and influence in the Arab world is based around the GCC/ENP divide, even though the southern Mediterranean and the Gulf share some common characteristics. Concluding an FTA with the region would thus be the first step towards a more unified presence in the Arab world while allowing the EU to potentially gain more influence in the region.

Another related motivation is referred to as "ideational". Since the EU-GCC FTA would be the first region-to-region FTA<sup>101</sup>, its conclusion would be a strong signal of the effectiveness of EU external policies, as it would underscore the success of the EU's regional integration and trade liberalisation strategy.<sup>102</sup>

On the economic side, while the GCC is a growing high-income market, the region has consistently represented a minor portion of EU international trade,

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<sup>98</sup> Wider Middle East refers here to Iran and Iraq.

<sup>99</sup> Southern Mediterranean countries are: Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria, Tunisia and Turkey, alternatively referred to as MED11.

<sup>100</sup> Rym Ayadi and Salim Gadi, "The Euro-Mediterranean Partnership and Development Assistance: Past Trends and Future Scenarios", in *MEDPRO Technical Reports*, No. 32 (March 2013), <http://www.ceps.eu/node/7934>.

<sup>101</sup> One exception is the association agreement with the Andean Community (Bolivia, Colombia, Ecuador and Peru). However, Colombia and Peru retired from negotiations before they concluded. See a list of concluded FTA in the European Commission Enterprise and Industry website: <http://ec.europa.eu/enterprise/policies/international/facilitating-trade/free-trade/#h2-1>.

<sup>102</sup> Agata Antikiewicz and Bessma Momani, "Pursuing Geopolitical Stability through Inter-regional Trade: The EU's Motives for Negotiating with the Gulf Cooperation Council", in *Journal of European Integration*, Vol. 31, No. 2 (March 2009), p. 217-235, <http://www.arts.uwaterloo.ca/~bmomani/documents/JEI-EUandGCC.pdf>.

well behind the US, other developed economies and, increasingly, emerging economies such as China. Concluding an agreement with the region would only be beneficial for certain industries such as machinery, transport equipment, and manufactured goods, since these are the EU's main exports to the region. For the EU, the main economic motivation to conclude a wide-ranging free trade deal with the GCC would be trade in services, as this remains closed and the GCC relies heavily on services imports to meet its needs.

For GCC countries, on the other hand economic drivers seem to play the prominent role in explaining the motivations for an FTA with the EU. Abdul Rahman Al-Attiyah, the former GCC secretary general, summarised in 2002 the region's interests in developing closer relations with Europe: "GCC countries are a historical partner of Europe. Europe needs us and we need them. We need their technical know-how. They need our resources. We have a mutual interest".<sup>103</sup> However, it is not clear whether a trade structure based on oil supplies against knowledge transfer still holds as EU hydrocarbon supplies are increasingly diversified and GCC-China trade grows and moves up the value chain. Within the scope of the FTA, GCC countries would benefit from enhanced market access for their petrochemical industries, thus supporting their vertical diversification efforts. In turn, better market access for EU goods and some degree of opening up in the services sector could generate spillovers and technology transfers supporting GCC economies' objectives of diversifying beyond oil and related products.

To reach the diversification objective, governments have engaged in economic planning exercises whose outcomes are highlighted in their respective development plans and "visions", in varying degrees of detail<sup>104</sup>. Gulf countries have enjoyed substantial oil rents in the preceding decades, and states in the region have predominantly redistributed the ensuing wealth to their population through generous welfare policies, while locking their production systems in the oil industry. Hence, diversification for GCC countries entails not only the development of activities decoupled from oil prices, but also an institutional shift from states redistributing rents to states providing incentives for the development of private sector activities.<sup>105</sup>

<sup>103</sup> Abdullah Baabood and Geoffrey Edwards, "Reinforcing Ambivalence: The Interaction of Gulf States and the European Union", in *European Foreign Affairs Review*, Vol. 12, No 4 (Winter 2007), p. p. 539.

<sup>104</sup> Due to the lack of information on the methodologies used in GCC's development plans, this section omits quantitative information for comparability purposes and relies instead on a general qualitative assessment. Interested readers can refer to national documents. See bibliography for national plans of Bahrain (2008), Kuwait (2010), Oman (2011), Qatar (2008), Saudi Arabia (2010), UAE (2010).

<sup>105</sup> Martin Hvidt, "Economic diversification in GCC countries: Past record and future trends, Research Paper", in *LSE Kuwait Programme Research Papers*, No. 27 (January 2013), <http://www.lse.ac.uk/government/research/resgroups/kuwait/research/papers/economicdiversification>.

If countries in the region vary regarding the degree of detail of their economic planning exercises, they all share common objectives in their diversification strategies and consider similar pathways towards reaching their goals. Increasing participation by GCC nationals in the labour force and human capital are the overarching objectives of the countries in the region. Each GCC country has created a vast public sector to employ its workforce in high-wage positions, leaving the private sector to an expatriate workforce and, as hydrocarbon resources deplete, it will prove increasingly difficult to maintain the current living standards of the population, eventually threatening the long-term sustainability of the GCC states. Favouring the emergence of a local, competitive workforce will be difficult, as recognised in the development plans themselves, since GCC citizens have been accustomed to almost guaranteed high-pay jobs in the public sector.

Two main channels are envisaged to boost both the development of non-oil activities and local labour force participation. First, all GCC countries seek to attract more FDI to foster economic diversification as this is seen as the preferred way to gain knowledge, foster innovation and align with international best practices. In this regard, several countries, including the United Arab Emirates and Saudi Arabia, have relaxed foreign ownership regulations and allowed for more foreign participation in local companies. However, as evidenced by the STRI and by the significant presence of the state in the region's productive systems, there seems to be a lot of room for manoeuvre for greater foreign participation in these economies. Second, almost all countries in the region seek to encourage the development of locally owned and globally competitive SMEs. The high-technology services sector is singled out in the region's development plans, as creating a competitive advantage in the small-scale non-oil manufacturing sector will prove impossible to achieve due to the region's reliance on hydrocarbons. Also, well aware of the negative environmental impacts of specialisation in hydrocarbons, GCC countries have added an environmental layer to their development plans, vowing to preserve natural resources, chiefly water and air quality.

While the objective of economic diversification has been high on GCC countries' agendas since the 1970s, progress towards meeting it has been slow and uneven. For example, progress in Saudi Arabia, where economic planning has been in place for several decades, has been very slow compared to that in Qatar and the UAE.<sup>106</sup>

GCC countries have ambitious development objectives and, as hydrocarbon resources deplete, the pressure on them to accomplish these goals will be high-

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aspx.

<sup>106</sup> *Ibidem*.

er. However, it is not clear whether the EU-GCC FTA could prove to be a strong supportive factor in their diversification strategies, as studies have failed to reach concluding evidence on its impact.

### 2.3.2. Studies on the impact of an EU-GCC FTA

Conventional wisdom derived from international trade theories suggested that trade liberalisation always had superior welfare effects to protectionism. However, by the 1950s and the subsequent conclusion of multilateral and preferential trade agreements, economists cast doubt on the validity of such a prescription, demonstrating that the welfare enhancing effects of trade liberalisation between two partners would depend on the extent of trade creation and trade diversion.<sup>107</sup> Trade creation refers to the sourcing of imports of a given good from the most efficient country, whereas trade diversion refers to the opposite, i.e. the sourcing of imports of a given good from a less efficient location. Intuitively, the net effect of an FTA between two partners is given by the difference between trade creation, trade diversion and forgone tariff revenue. This theoretical framework has inspired empirical studies quantifying the effects of trade integration via partial equilibrium analyses, which seek to calculate the equilibrium in terms of quantities and prices of goods between two partner countries given different assumptions of trade liberalisation. The use of partial equilibrium analyses, while practical due to their minor data requirements compared to other approaches, falls short in addressing the interactions between different goods and trading partners other than those engaging in trade liberalisation.

In another stream of the literature, researchers resort to general equilibrium modelling in a bid to overcome these shortfalls and provide a more comprehensive picture of the impacts of trade liberalisation. General equilibrium analyses consider interactions between liberalisation of different goods as well as between different trading partners and directly derive estimations of changes in welfare, as opposed to partial equilibrium ones. The main difficulty in using these models for trade analysis lies in their significant data requirements, generally constraining this type of analysis to developed countries. Moreover, as with partial equilibrium approaches, they are static and do not provide indications of the dynamic gains of trade liberalisation.<sup>108</sup>

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<sup>107</sup> Jacob Viner, *The Customs Union Issue*, New York, Carnegie Endowment for International Peace, 1950.

<sup>108</sup> Ahmed Farouk Ghoneim et al., "Shallow vs. Deep Integration in the Southern Mediterranean: Scenarios for the Region up to 2030", in *MEDPRO Technical Reports*, No. 13 (March 2012), <http://www.ceps.eu/node/6795>.

A third approach lies in the use of gravity models of trade. While these were initially used to conduct *ex post* analysis of the impacts of trade policy, they are increasingly used by economists to provide *ex ante*<sup>109</sup> analysis of trade liberalisation. Gravity models assume that bilateral trade flows are determined by a set of variables such as distance, the existence of a common language and borders between trading partners, and institutional characteristics, in addition to a number of economic variables. While these types of models have been criticised for lacking theoretical foundations, their important explanatory power compared to other approaches has fuelled their use in trade policy analysis.

Despite the relative strengths of these three types of models, statistically based approaches all fail to address qualitative aspects of the conclusion of an FTA between trading partners, especially as the recent waves of preferential trade agreements move beyond reciprocal trade liberalisation to integrating clauses on legislative approximation and the removal of “behind-the-border” obstacles to trade. As a result, to guide policy-makers and negotiating authorities in the process of FTA negotiations, quantitative modelling approaches are complemented by qualitative information gathered through consultations between stakeholders to add expert judgement.<sup>110</sup>

As far as EU-GCC trade is concerned, only three studies have been conducted to assess the impact of an FTA between the two regions. While their figures vary according to the methodology adopted, all three conclude that the GCC countries would be the main beneficiaries from trade liberalisation with the EU. In a first study using partial equilibrium techniques, DeRosa and Kernohan<sup>111</sup> found that the proposed FTA would benefit the GCC countries in two ways: first, by expanding their exports of petroleum and mineral products due to exchange rate depreciation; and second, by making a higher number of manufactured products available to GCC consumers at a lower price. On the other hand, this study finds negative results on a very small scale for the EU resulting from trade diversion and the loss of tariff revenue. While the authors had conjectured that the EU-GCC FTA would provide a boost to the Gulf’s non-oil sectors, the evidence shows that such an agreement would not allow the countries to meaningfully overcome their reliance on oil.

Using a gravity equation augmented with trade costs, Baier and Bergstrand again found that the proposed FTA would entail net trade creation for the GCC

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<sup>109</sup> *Ex ante* refers to “beforehand”. *Ex post* refers to “after the fact”.

<sup>110</sup> Michael G. Plummer, David Cheong and Shintaro Hamanaka, *Methodology for Impact Assessment of Free Trade Agreements*, Manila, Asian Development Bank (ADB), 2010, <http://www.adb.org/publications/methodology-impact-assessment-free-trade-agreements>.

<sup>111</sup> Dean A. DeRosa and David Kernohan, “Measuring the Economic Impact of an EU-GCC Free Trade Agreement”, in *CEPS Working Documents*, No. 206 (July 2004), <http://www.ceps.eu/node/986>.

countries, but also for the EU.<sup>112</sup> This result is explained by the authors' methodology that includes a term to proxy for trade costs between the two regions (the "multilateral trade resistance term"). In their specification, the gains experienced from the conclusion of the FTA result from the elimination of behind-the-border obstacles to trade and the possibility to benefit from more information flows between both regions' governments, producers and consumers.

The third study, undertaken by PricewaterhouseCoopers, used the European Commission's methodology for trade impact assessments.<sup>113</sup> It relied on a partial equilibrium analysis supplemented with qualitative information to assess the impact of an EU-GCC FTA. The results show that the GCC countries would be the main beneficiaries from the FTA with net welfare gains of 3% of GDP per annum, and a small welfare loss for the EU. In addition to tariff dismantlement simulations, the study undertook two sector-specific assessments on the GCC region's petrochemical and aluminum industries, given their importance in the region's exports to the EU and their potential for expansion. These two case studies provided more details on the mechanisms at play behind GCC countries' projected increase of welfare and highlighted that both industries would be the main beneficiaries of the agreement. Driven by the availability of inputs and economic diversification policies, the petrochemical industry in the GCC region is expected to expand massively in the next years. Within the GCC states, Saudi Arabia has the biggest potential in petrochemicals. The national petrochemical firm SABIC is the regional leader in the industry and the FTA would foster its activity in Europe, whereas other GCC countries would enjoy only minor gains. For the regional industry in general, and for the Saudi petrochemical company in particular, the conclusion of the FTA would result in the rapid acquisition of world-class technology potentially challenging the EU's competitive advantage and global market power.<sup>114</sup> As regards aluminium, also a strategic sector for the region, GCC exporters demand duty-free access to the European markets. The region's aluminum industries are expanding, supported by national investment programmes and low energy prices. Trade liberalisation effects for aluminum

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<sup>112</sup> Scott L. Baier and Jeffrey H. Bergstrand, "Trade Agreements and Trade Flows: Estimating the Effect of Free Trade Agreements on Trade Flows with an Application to the European Union - Gulf Cooperation Council Free Trade Agreement", in *European Economy. Economic Papers*, No. 214 (September 2004), [http://ec.europa.eu/economy\\_finance/publications/publication\\_summary592\\_en.htm](http://ec.europa.eu/economy_finance/publications/publication_summary592_en.htm).

<sup>113</sup> PricewaterhouseCoopers (PwC), *Sustainability Impact Assessment (SIA) of the negotiations of the trade agreement between the European Community and the Countries of the Cooperation Council for the Arab States of the Gulf (GCC)*, Final Report for the European Commission, 30 May 2004, <http://trade.ec.europa.eu/doclib/html/121208.htm>. For more information about the European Commission's methodology for sustainability and impact assessments of trade negotiations, see European Commission DG Trade, *Handbook for Trade Sustainability Impact Assessment*, March 2006, [http://trade.ec.europa.eu/doclib/docs/2006/march/tradoc\\_127974.pdf](http://trade.ec.europa.eu/doclib/docs/2006/march/tradoc_127974.pdf).

<sup>114</sup> PricewaterhouseCoopers (PwC), *Sustainability Impact Assessment (SIA) ...*, cit.

have to be assessed on the basis of their short- and long-term benefits. In the short run, profit margins of GCC producers will increase due to tariff reduction, and in the long run, the market power of GCC producers will increase. At the country level, United Arab Emirates and Bahrain are the countries most likely to benefit from the FTA. The projected expansion of these two industries was among the reasons for the negotiations failing (see Box 1).

### **Box 1. Insights on the failure of the EU-GCC FTA**

Three reasons can be put forward to explain the failure to conclude the FTA after 20 years of negotiations. First, the EU's petrochemical lobby forcefully fought against trade liberalisation, resulting in European governments blocking duty-free access for petrochemicals from the Gulf for many years. The reason behind this protectionist stance was that the EU's petrochemical suppliers argued that the double pricing policy of raw materials by GCC countries constituted an implicit subsidy which would result in dumped imports entering the EU. This policy allowed GCC producers to enjoy input prices 30% lower than export prices, with GCC governments arguing this was due to added costs to exports (pipeline transportation, refrigeration, storage and terminal facilities).<sup>115</sup> Second, the human rights and illegal migration clauses embedded in the FTA were rejected by the GCC states, which claimed that Brussels was bringing issues to the table that had nothing to do with trade.<sup>116</sup> However, according to other research, the rejection of such clauses is only a "smokescreen", as noted by a former EU diplomat in the region. Instead, it was the reluctance of the GCC countries to abandon subsidising their energy industry that was responsible for the stalemate in negotiations.<sup>117</sup> Third, the GCC countries were reluctant to meet the EU's demands to liberalise services and government procurement. As a result, the GCC suspended negotiations unilaterally in 2008, but informal contacts between negotiators continue to take place.

The impact assessment study also projected wider environmental and socioeconomic effects of the FTA for GCC countries. First, the expansion of heavy

<sup>115</sup> Agata Antkiewicz and Bessma Momani, "Pursuing Geopolitical Stability through Inter-regional Trade...", cit.

<sup>116</sup> Ana Echagüe, "The European Union and the Gulf Cooperation Council", in FRIDE Working Papers, No. 39 (May 2007), <http://www.fride.org/publication/43/>.

<sup>117</sup> Richard Youngs, "Impasse in Euro-Gulf Relations", in FRIDE Working Papers, No. 80 (April 2009), <http://www.fride.org/publication/596/>; Raed Kombargi et al., Governance in the GCC Hydrocarbon Sector, cit.

industries, such as petrochemicals and aluminum, is expected to drive a rural exodus and urbanisation that, if left uncontrolled, would exert a toll chiefly on the region's air and water quality. As regards the agreement's socioeconomic impacts, the study notes that the expansion of the petrochemical and aluminum industries could lead to a small number of additional jobs for high-skilled GCC workers, but that overall the FTA's impact on labour is expected to be at best marginal.

Finally, the authors note that the detrimental side effects of the agreement on the GCC countries could be mitigated through some level of opening up of the services sector. In the area of environmental management, for example, the negative effects of polluting industries could be mitigated by a strong regulatory framework as well as by the opening up to international competition of environmental and business services.

These prospective outcomes for the GCC economies need to be taken with caution, however, for a number of reasons. First, the lack of available data on the region's countries forced the studies to resort to partial equilibrium and gravity analysis, therefore not accounting for the interaction between productive sectors. Along the same lines, the lack of robust statistics on the services sectors – a constraint relevant to other economies as well – results in an underestimation of the agreement's impact in this area and its contribution to the diversification objectives of the region's economies. Also, due to the different modes of entry highlighted above, available studies fail to address the potential for increased investment flows in the region as well as their impact on the balance of payments and exchange rate, two subjects of great importance for the region. Second, the validity of these results should also be re-examined in light of the international economic and political context after the 2008 financial crisis and the 2011 political upheavals in the Arab world. All three studies cited here were conducted in 2004 and used 2003 data; it is probable that more recent statistics would yield different results. For example, when the previous studies were conducted, GCC's trade with China was lower than with the EU by some 50% and the unrest experienced in the region has since radically changed some countries economic policies, as witnessed in Saudi Arabia. After several episodes of social discontent in 2011, the kingdom announced it would implement a benefit package of \$130 billion (€100 billion), roughly equivalent to the GCC's total exports to the BRICs in 2010.

Despite negotiations for an FTA having been frozen, prospective studies seeking to quantify such gains should be undertaken in order to provide up-to-date information on its potential impact. Given the importance of services for the region, such studies should build on state-of-the-art methodologies, and also aim to explore the wider socioeconomic implications of a deeper commer-

cial integration between the region and the EU.

## 2.4. PROSPECTS AND RECOMMENDATIONS FOR IMPROVING EU-GCC TRADE AND INVESTMENT RELATIONS

### *2.4.1. Prospects for concluding the EU-GCC FTA*

As previously shown, the EU has geopolitical motivations for signing an FTA, whereas the GCC countries see the FTA as a supportive factor in their economic diversification strategies. Divergences over the content of the FTA and the 2008 financial crisis have frozen EU-GCC trade talks while, at the same time, GCC-China trade has soared and moved up the value chain. The outbreak of the Arab Spring and the unrest spilling over from Egypt and Tunisia to the Gulf region further complicates the prospects for concluding trade negotiations with the EU.

Countries in the region have responded to demonstrations by their populations demanding political opening up and better socioeconomic development prospects with significant welfare packages, especially those where the potential for protracted unrest and destabilisation is the highest, namely Bahrain, Oman and Saudi Arabia. The Bahraini ruler, King Hamad al Khalifa, announced in 2011 that each family would be granted a \$3,000 subsidy (approximately €1,800) to cover their needs and promised to create 20,000 jobs in the public sector for citizens. In Oman, Sultan Qaboos promised to create an unemployment benefit scheme, while increasing financial support for the country's students and increasing the minimum wage by 40%. Saudi Arabia's response to the unrest within its borders has resulted in a welfare package estimated at \$130 billion (approximately €100 billion), in addition to the construction of 500,000 new houses and the creation of 60,000 jobs in the public sector for Saudi nationals. Other countries proved no exception to this trend of state patronage, though their welfare packages were comparatively smaller; in Qatar, they have amounted to \$8 billion (approximately €6 billion) and in Abu Dhabi to \$2 billion, mainly covering pay rises in the public sector and the construction of new houses.<sup>118</sup>

Several reasons can be put forward to explain why the Arab Spring is likely to have a negative impact on the prospects of improving EU-GCC trade and investment relations. From an economic point of view, the upsurge in public spending is likely to divert public funds away from policies fostering economic diver-

<sup>118</sup> Silvia Colombo, "The GCC Countries and the Arab Spring. Between Outreach, Patronage and Repression", in *IAI Working Papers*, No. 1209 (March 2012), <http://www.iai.it/pdf/DocIAI/iaiw1209.pdf>.

sification and the emergence of a strong private sector. Indeed, the countries' various responses show that the public sector will retain a major role in their economies, compromising the governments' efforts to create incentives for the population to work outside of public administration or publicly owned companies. At the same time, liberalisation of trade in services and foreign investment regimes, two long-standing demands of the EU, stand little chance of happening. As the GCC countries increase public spending, any far-reaching reforms that could result in substantial inflows of capital are likely to be delayed, since they could result in currency appreciation and inflationary pressures, which could fuel unrest in the region, especially in the absence of effective inflation targeting monetary policy regimes<sup>119</sup>.

Also, the EU has insisted on GCC countries' economic integration as a condition for concluding the FTA, but such deeper integration is unlikely in the near future, not only because the countries are set to remain competitors due to similar specialisations, but also because reaching common negotiating positions regarding tariff revenue-sharing mechanisms will be more challenging. In addition, as the countries have enacted significant public spending packages to calm public discontent, they will all have an incentive for maximising their allocation, thus raising the likelihood of non-cooperative strategies.

Furthermore, the EU's standard clauses on respect for human rights, democracy, counter-terrorism and the like will continue to be rejected by the GCC countries, especially in the context of socioeconomic instability in the region. The 2011 protests in the Gulf were due not only to economic grievances, but also to political demands for more democratic societies. Given the GCC countries' repression of protests, any attempts by international agents to tie the signature of trade agreements to such clauses are very likely to be rejected.

To sum up, several factors rule out the prospect of concluding an FTA with the EU in the medium term. First, China is an increasingly important commercial partner for the Gulf, decreasing the likelihood of a reinforcement of trade links with the EU. Second, domestic instabilities spilling over from the unrest in the southern Mediterranean compromise the ability of the Gulf countries to achieve their diversification objectives, since public spending has been diverted towards large-scale benefits packages. Third, research on the prospective impact of an EU-GCC FTA is out-dated and does not provide either region's authorities with an incentive to explore further negotiating options. Nevertheless, given the increase in investment linkages between the regions and the diversification needs of the GCC countries, there is a need for more knowledge of both sides in order to appreciate the respective benefits of a region-to-region FTA.

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<sup>119</sup> Monetary policies in the GCC region resort to pegged exchange rate regimes combined with a variety of instruments such as loan-to-deposit ratios and reserve requirements.

### *2.4.2. Recommendations for improving EU-GCC trade and investment relations*

Despite the low likelihood of concluding the EU-GCC FTA in the near future, the EU and the GCC can nevertheless undertake joint actions to reinforce their trade, investment and overall economic links. Such actions are mainly concerned with supporting the diversification efforts and economic planning capabilities of the Gulf countries, updating the evidence regarding the impact of a possible FTA, and facilitating travel of GCC business people to the EU.

First, as shown by their development plans, most GCC countries have rather limited economic planning capacities. Some countries (such as Qatar and the United Arab Emirates) do conduct in-depth studies on the socioeconomic development challenges they face and the policies foreseen to meet them, but the others rely on rather general documents spelling out policy directions to support their diversification efforts. To move forward in its objective of reinforcing its policies towards the Arab world, the EU could support these countries in improving their economic planning capabilities, given its own and its member states' experiences in such activities. Such support could take two forms. First, EU institutions and GCC countries could create a programme of study visits and exchanges between EU, member state and GCC officials from relevant ministries to foster economic planning best practices. Second, both parties could also jointly fund long-term prospective studies on the diversification options, costs, benefits, and mitigation measures for adverse effects in order to guide policy-making in this area.

Along the same lines, both regions could develop a series of targeted programmes assessing the contribution of liberalisation of trade in services to economic diversification. Most GCC countries see the services sector as a key contributor supporting their diversification efforts. Data also show that, despite being important, trade in services is below its potential in the region, possibly due to overly restrictive policies. While a fully-fledged opening up of the sector is neither realistic nor suitable for balance of payments reasons, a gradual opening up of targeted services could prove beneficial for the GCC countries. In this regard, both regions should launch a study programme assessing the benefits and costs of liberalisation of selected services. The programme should devote particular attention to regulatory aspects, as services regulation is in part prudential. A particular aim of this programme should be to identify, in the services considered, the potential for regulatory enhancements and openness to foreign trade.

Third, while the conclusion of an FTA is not a likely future prospect and its conclusion should not be a precondition for deepening relations between the

two regions, studies on its prospective impact should be updated. Previous research was conducted between 2003 and 2004 and is now out of date, as the financial crisis and the Arab Spring have significantly changed the world's economic and geopolitical outlook. The new impact assessment should also pay attention to the services sector and its contribution to the GCC economies. The study should devote particular attention to the issue of data availability, as the lack of statistical evidence on services hinders robust analysis of the service sector's impact on the region's economic performance.

Last but not least, and beyond trade and investment considerations, the Arab Spring and the responses of both actors have shown a shared interest in preserving security and sustainable socioeconomic development in their neighbourhood, the southern Mediterranean. The improvement in commercial relations between the two regions could go hand-in-hand with an open dialogue between the EU and GCC countries on the means for supporting socioeconomic transition in the Mediterranean region.

## CONCLUSION

The EU and the GCC formalized their relations in 1988 with the conclusion of a Cooperation Agreement which aimed at deepening cooperation between the two regions in a number of areas and conclude a free trade agreement (FTA). The process was driven by the EU's willingness to expand its policy frameworks in the Arab world and by Gulf countries' needs to secure access to foreign technologies in order to diversify their production structures. However, many years of negotiations for this region-to-region FTA have failed to lead to an agreement, due to divergent stances on market access of GCC exports to the EU and Gulf countries' reluctance to open their services sectors to European companies. Meanwhile, EU-GCC trade and investment patterns have remained stable, but data show that emerging countries, and chiefly China, are increasingly important trading partners of Gulf countries. While previous analyses have showed that the GCC would stand as the main beneficiary of an FTA with the EU, the prospects of deepening EU-GCC trade and investment relations beyond the current frameworks are low: as GCC countries are increasingly confronted by the risks of social unrest stemming from the Arab Spring, governments in the region are unlikely to commit to an opening of their economies. The low likelihood of an EU-GCC FTA notwithstanding, each partner should nevertheless reassess the costs and benefits of an economic rapprochement. Indeed, previous analyses have failed to take into account the importance of the services sector for Gulf countries and this sector's potential contribution to their diversification

efforts. At the same time, both regions would gain from exploring cooperation possibilities in the Southern Mediterranean, as they have both a major interest in ensuring sustainability in their neighbourhood.

### 3.

## Banking and Insurance in the GCC Countries: Is there Regulatory Convergence with the EU?

*Rym Ayadi and Willem Pieter de Groen\**

### INTRODUCTION

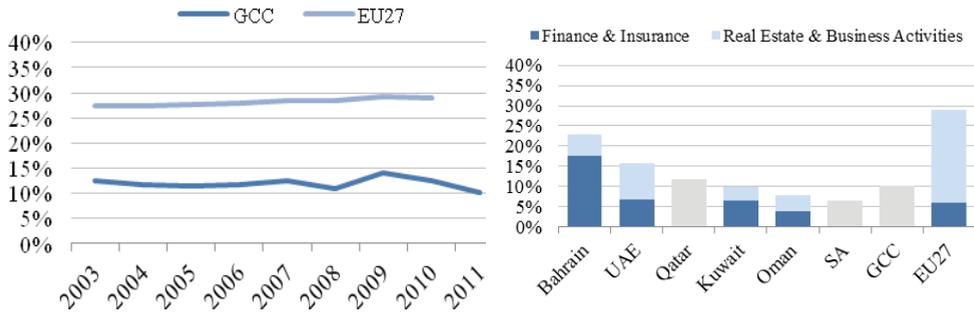
The GCC countries exhibit very similar economic structures, with strong reliance on the hydrocarbon sectors, foreign workers and pegged exchange rates. To reduce their dependency on natural resources that are in the process of being depleted, the GCC countries have made diversification of economic activities their principal long-term policy objective. The GCC countries are therefore trying to develop activities that are closely related to the hydrocarbon sectors or in which they have, or could have, a competitive advantage.

The financial sector has a pivotal role in this strategy of economic diversification. The benefits of financial sector development in the GCC area are twofold. First, the financial sector forms an intermediary that contributes to the collection and efficient allocation of financial resources. Second, the sector itself contributes to the economic development of the GCC countries by means of profits and the creation of employment. To tap this economic potential, the GCC countries have taken the initiative to develop their financial sectors by strengthening the domestic regulatory and supervisory framework, participating directly in financial institutions, and providing grants, subsidies and guarantees.

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\* The authors would like to thank Elina Pyykko and Ales Chmelar, Research Fellow and Research Assistant at CEPS respectively, for their contributions to this chapter.

**Fig. 20. Finance, insurance, real estate and business activities (% of GDP)**

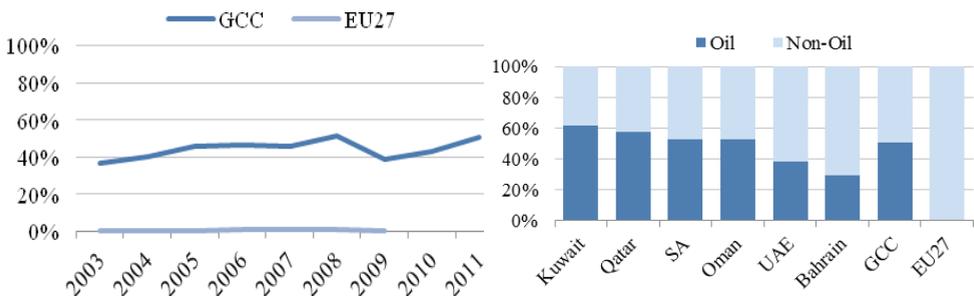


Note: These figures are for the whole GCC region and the EU27 from 2003 to 2011, and by country for 2011. There was no disaggregated data available for Qatar and Saudi Arabia.

Sources: Gulf Investment Cooperation, Central Bank of Bahrain, Central Bank of Kuwait, Ministry of National Economy Oman, Qatar Central Bank, Saudi Arabian Monetary Agency, UAE National Bureau of Statistics, EUROSTAT.

The financial services industry already plays a significant role in the GCC economies. However, its contribution varies substantially between the different countries. Figure 20 shows, for instance, that the financial sector contributes 17.7% to the Bahraini economy, but only 3.9% in Oman. On average, the share of GDP of the financial sectors in the GCC in 2011 was similar to the figure of 5.9% in the 27 Member States of the European Union (the EU27).<sup>120</sup> Since then, the absolute size of the financial sector has remained constant, while the relative size as a percentage of GDP has fluctuated between 10% and 15%. It is important to note that this fluctuation is attributable to variations in total GDP over the past few years. The size of GDP, in turn, follows developments in crude oil and natural gas exploration (see Figure 21).

**Fig. 21. Oil exploration**



Note: These figures show the contributions of crude oil and natural gas exploration to GDP for the whole GCC region and the EU27 from 2003 to 2011, and by country for 2011.

<sup>120</sup> With the accession of Croatia to the European Union at 1 July 2013 the number of Member States has increased to 28. Since the accession took place after the period covered in this paper Croatia has not been included in the analyses.

Sources: Gulf Investment Cooperation, Central Bank of Bahrain, Central Bank of Kuwait, Ministry of National Economy Oman, Qatar Central Bank, Saudi Arabian Monetary Agency, UAE National Bureau of Statistics, EUROSTAT.

The financial sectors in the GCC are dominated by commercial banking. Non-bank financial institutions have a rather limited presence in these countries.

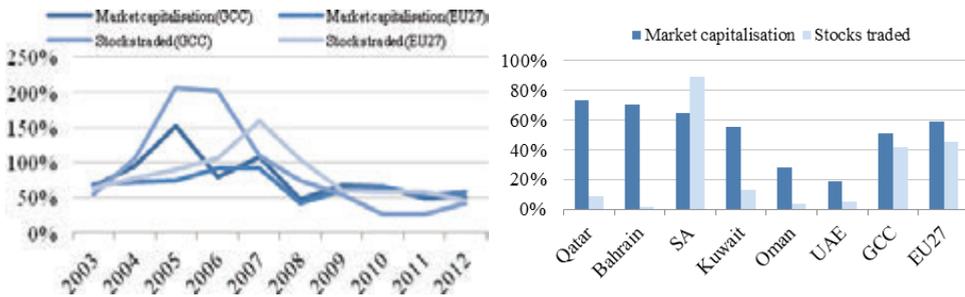
In recent years, access to financial services has improved significantly. However, outside of providing basic banking services for the private and public sectors, it remains relatively underdeveloped. The growth of the GCC banking sectors was partly limited due to stringent regulation and supervision; banks operating in the GCC are restricted in their activities and have to comply with higher capital requirements. Moreover, the banking sectors are often dominated by government-owned banks, with no deposit insurance scheme, and limited possibilities for foreign banks to enter.

The insurance industry has been booming, with premium income increasing significantly over the past ten years. The absolute size of the industry is, however, still small. The specific nature of the region and the severe lack of skilled labour limit its potential and thus its positive spill-over effects on financial markets and the economy overall. In contrast to the banking sector, fragmentation of the insurance market remains high.

Although stock market capitalisations have grown in recent years, they have been outpaced by economic growth. Equity markets are, however, still mostly underdeveloped, while domestic debt markets are virtually non-existent. Figure 22 shows that in Bahrain, Kuwait, Qatar and Saudi Arabia, listed companies represent a total market value of more than half of GDP. This is comparable to the average size of their market value in the EU27. In turn, the equity markets in Oman and Qatar are non-existent. Hence, the main difference between the GCC and EU27 equity markets is in terms of activity. Trading volumes in the GCC countries are substantially lower, with the exception of Saudi Arabia, which has rather deep equity markets. The total value of stocks traded in Saudi Arabia is, for example, only surpassed by the UK among the EU27. The equity and, in a broader sense, the capital markets in the GCC countries are nevertheless still limited in size due to low levels of free float, controls on foreign ownership and limits on inward foreign direct investment.<sup>121</sup>

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<sup>121</sup> See IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions 2012*, Washington, International Monetary Fund, September 2012, <http://www.imf.org/external/pubs/cat/longres.aspx?sk=26012>.

**Fig. 22. Market capitalisation and trade value of listed companies (% of GDP)**

Note: These figures are for the whole GCC region and the EU27 from 2003 to 2012, and by country for 2012.

Source: World Bank World Development Indicators.

This chapter explores the financial sector (banking and insurance) in the GCC in comparison with the EU, assesses regulatory convergence and provides policy recommendations for future financial partnerships between the two regions.

The first part provides an overview of the banking systems in the GCC countries in comparison with the EU27, and assesses regulatory convergence and integration. The second part analyses the insurance sector in the GCC countries. The chapter concludes with some recommendations for the strengthening of EU-GCC cooperation and integration in financial markets.

### 3.1. BANKING STRUCTURE AND REGULATION IN THE EU AND THE GCC: WHAT DEGREE OF CONVERGENCE?

The GCC countries have undergone substantial reforms in their financial sectors in recent years. This chapter develops a number of indicators to assess and track the evolution of the adequacy of banking regulations since the early 2000s, using publicly available and comparable surveys for a large sample of countries. To allow for comparison between the EU and the GCC, we have developed measures for the six GCC countries and the EU27. For the purposes of this analysis, the EU has been split in two groups, namely the 15 countries that joined the EU before 2000 (EU15),<sup>122</sup> and the 12 countries that joined after 2000, also called the new Member States (NMS12).<sup>123</sup>

<sup>122</sup> The EU15 consists of the following countries that acceded to the EU before 1995: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom.

<sup>123</sup> NMS12 consists of the following twelve countries that acceded to the EU in 2004 or 2007 (as indicated): Bulgaria (2007), Cyprus (2004), the Czech Republic (2004), Estonia (2004), Hun-

In what follows, a description of the GCC banking sectors is provided. The methods and data used to analyse the convergence between banking regulation in the GCC countries and the EU27 are then described. Finally, quantitative measures are presented and discussed and, based on the results, some conclusions are drawn and policy recommendations made.

### 3.1.1. Structure of the banking sector in the GCC

The banking sector in the GCC is dominated by a small number of domestic and foreign commercial banks. However, beyond providing basic banking services for the private and public sectors, the banking sector remains relatively underdeveloped. The absence of deep domestic capital markets and ties with governments are the main obstacles to further development.<sup>124</sup> The size of the banking sector in the GCC is, in both absolute and relative terms, much smaller than that of the EU. In turn, the sector's financial soundness and profitability indicators are higher than in the EU.

In the past decade, the total assets of the GCC banks have experienced fast growth, which came to a standstill with the onset of the global financial crisis. Nevertheless, the impact of the crisis on financial stability in the region has been rather limited compared to the EU and the US. After an initial fall in financial soundness and profitability indicators in 2009, a swift recovery followed.

Since the GCC's inception in 1981, the region's countries have pursued ambitious economic and financial integration objectives. While the countries are at different stages of financial market development and monetary policy operations, nominal interest rates have generally tended to converge.<sup>125</sup> For financial integration to progress, however, it is fundamental that regulations converge.

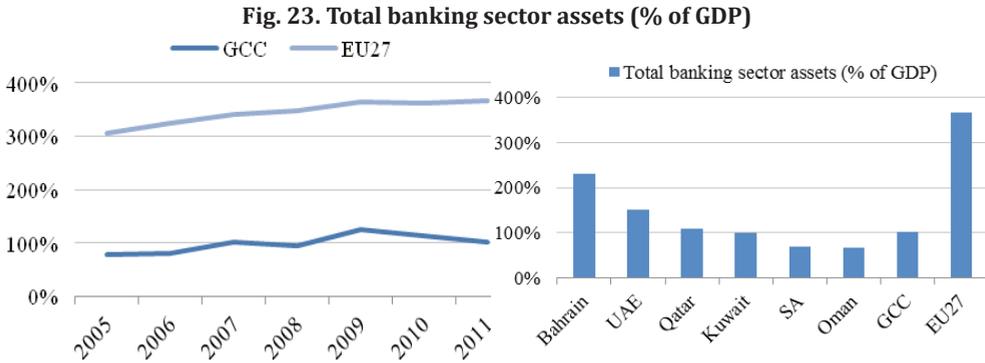
Banks' assets in the GCC countries progressively increased until 2008, and then stabilised soon afterwards. However, the size of the banking sector varies significantly between the GCC countries, with banking sector assets amounting to over double GDP in Bahrain, while they represent only about 70% of GDP in Oman and Saudi Arabia (Figure 23). Bahrain has the largest retail banking sector in the region. The UAE has the second largest banking sector in the GCC, and

gary (2004), Latvia (2004), Lithuania (2004), Malta (2004), Poland (2004), Romania (2007), Slovakia (2004), and Slovenia (2004).

<sup>124</sup> Serhan Cevik and Katerina Teksoz, "Lost in Transmission? The Effectiveness of Monetary Policy Transmission Channels in the GCC Countries", in *IMF Working Papers*, No. WP/12/191 (July 2012), <http://www.imf.org/external/pubs/cat/longres.aspx?sk=26117>.

<sup>125</sup> Interest rates in the GCC countries have followed US interest rates as a result of credible pegging of most of the GCC countries' currencies to the US dollar, except for the Kuwaiti Dinar, which is pegged to a basket of currencies, including the US dollar. Raphael A. Espinoza, Ananthakrishnan Prasad and Oral Williams, "Regional Financial Integration in the GCC", in *IMF Working Papers*, No. 10/90 (April 2010), <http://www.imf.org/external/pubs/cat/longres.aspx?sk=23780>.

also one of the least concentrated. The third largest banking sector is in Qatar.



Note: These figures are for the whole GCC region and the EU27 from 2003 to 2011, and by country for 2011.

Source: National authorities, IMF, ECB.

While a significant number of commercial banks in the region are branches of foreign banks, the largest five banks in the GCC countries are domestic. Several studies have shown that the banking sectors in the GCC economies operate under monopolistic competition and are less competitive than in non-oil producing countries.<sup>126</sup> The statistics on bank concentration given in Table 4 show that the concentration of the industry remains high, and that the GCC banking sector is on average more concentrated than the EU banking sector.

<sup>126</sup> Saeed Al-Muharrami, Kent Matthews and Yusuf Khabari, "Market Structure and Competitive Conditions in the Arab GCC Banking System", in *Journal of Banking and Finance*, Vol. 30, No. 12 (December), p. 3487-3501. Publ. also in *Cardiff Economics Working Papers*, No. E2006/8 (January 2006), <http://orca.cf.ac.uk/2545>; Rima Turk-Ariss, "Competitive behavior in Middle East and North Africa banking systems", in *The Quarterly Review of Economics and Finance*, Vol. 49, No. 2 (May 2009), p. 693-710; Diego Anzoategui, Maria Soledad Martínez Pería and Roberto Rocha, "Bank Competition in the Middle East and Northern Africa Region", in *World Bank Policy Research Working Papers*, No. 5363 (July 2010), <http://dx.doi.org/10.1596/1813-9450-5363>.

Table 4. Structure of the GCC banking systems

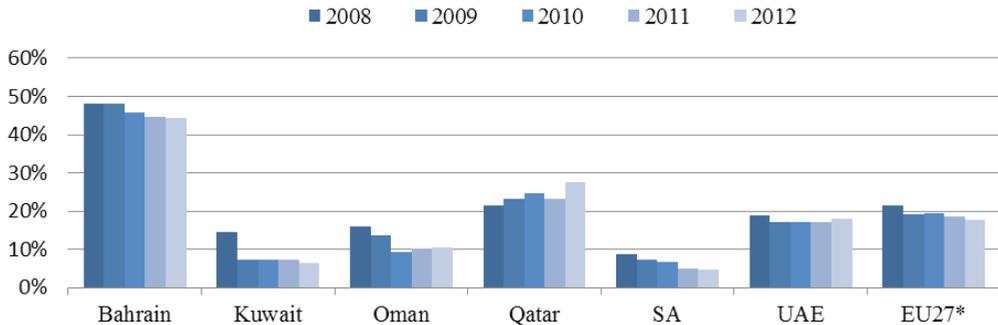
	Concentration ratio (Top 3, 2011)	Commercial banks (2009)	Bank branches (2009)	Bank branches per 100,000 adults (2009)
<b>Bahrain</b>	89	30	414	-
<b>Kuwait</b>	89	21	368	19
<b>Oman</b>	70	17	461	24
<b>Qatar</b>	87	17	254	18
<b>Saudi Arabia</b>	55	23	1,646	9
<b>UAE</b>	61	51	851	15
<b>GCC*</b>	68	159	3,994	12
<b>EU27*</b>	69	8,358	234,077	56

\* Regional averages are weighted by total banking assets.

Source: ECB, *EU Banking Structures*, September 2010, [http://www.ecb.int/pub/pdf/other/eubanking\\_structures201009en.pdf](http://www.ecb.int/pub/pdf/other/eubanking_structures201009en.pdf); World Bank, *Financial Development and Structure Dataset*, 2013, <http://go.worldbank.org/X23UD9QUX0>.

In comparison to their peers in the EU and the US, banks in the GCC region have limited exposure to sub-prime assets and fewer linkages to the rest of the global financial markets. The operations of the banks are domestically oriented, relying mainly on lending and private deposits. Al-Hassan et al.<sup>127</sup> have shown in their analysis of the items used for funding credit growth in the GCC countries that, while client deposits have been the main contributor, foreign liabilities have played a significant role in explaining the rapid credit growth in the GCC countries prior to the outbreak of the global financial crisis. Bahrain's banking system emerges as significantly more exposed to external financing than the banks in other GCC countries. However, a large part of the foreign funding in Bahrain comes from regional banks. The Qatari banking system is the only system which has recently significantly increased its share of foreign liabilities.

<sup>127</sup> Abdullah Al-Hassan, May Y. Khamis and Nada Oulidi, "The GCC banking sector: topography and analysis", in *IMF Working Papers*, No. WP/10/87 (April 2010), <http://www.imf.org/external/pubs/cat/longres.aspx?sk=23737>.

**Fig. 24. Banks' foreign liabilities to total liabilities**

\* Regional averages are weighted by total banking assets.

Source: National central banks.

While the domestic focus of the banking systems has shielded the region's countries from the worst effects of the global financial crisis, it has made them vulnerable to other risks, leading to problems such as credit risk concentration. Banks' exposures to the construction and real estate sector continued to be significant in the years following the onset of the financial crisis, with the exceptions of Saudi Arabia and Oman, where less than 10% of loans made by banks go to the sector.

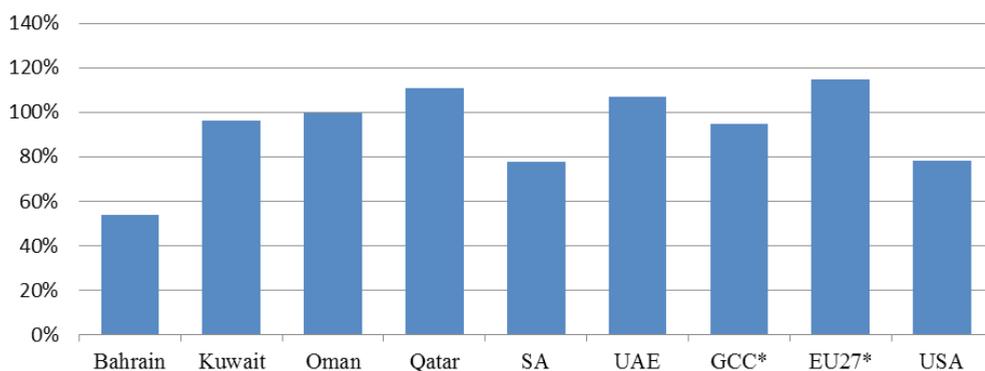
Lending to the government constitutes only a small share of loans in most countries in the region, with the exception of Qatar. The significant and increasing share of loans to the government in Qatar reflects the infrastructure investments the government has decided to make in non-hydrocarbon sectors in order to promote economic diversification. Financing for the government is also on the rise in the UAE, which reflects the state of an emerging market where government-owned enterprises contribute significantly to economic development, meaning that significant amounts of financing are necessarily for government-led projects. The decrease in other countries is in line with the fact that governments have benefitted from rising oil prices in recent years, which has reduced their need for external funding.

Generally, the credit provided by financial institutions is highly concentrated on individuals; 20%-40% of credit is directed to individuals, which is on a similar level to the EU, where loans to individuals makes up about 30% of banks' total credit facilities. The concentration of lending to households has further increased over the past few years. In Oman, personal loans make up the greatest share of commercial banks' credits, and they have been a key profit driver for the Omani banks in the recent period. Again, Qatar proves an exception in this respect, showing a significant decrease in the share of credit directed to individ-

uals. However, household loans in the GCC are generally granted to individuals against salaries, which lowers the risk of lending in this category. Furthermore, GCC governments have started to place restrictions on private lending. In April 2011, for instance, the Qatar Central Bank tightened its limits on personal loans per borrower, and introduced a ceiling on interest rates on salary-assigned and credit card loans, including existing loans.<sup>128</sup> In the UAE, the central bank adopted regulations in February 2011 revising the maximum amount that an individual can borrow and introducing a maximum debt service ratio.<sup>129</sup>

Even though the reversals of foreign deposits reduced the liquidity of the GCC banking sectors, injections by the authorities via central bank deposits and direct placements of government deposits restored liquidity quickly, boosting banks' lending capacity. The loan-to-deposit ratios of GCC banks given in Figure 25 show that, while GCC countries vary significantly in this respect, the average loan-to-deposit ratio for banks in each country is still below the average for EU banks.

**Fig. 25. Banks' loan-to-deposit ratios, 2011**



\* Regional averages are weighted by total banking assets.

Sources: National authorities, ECB, Federal Reserve.

The recent years of financial turmoil have had less impact on the GCC countries than on the more mature financial markets as the banks in the GCC region had limited exposure to sub-prime assets and fewer linkages to the rest of the

<sup>128</sup> The maximum interest rate that banks can charge on salary-assigned loans is the QCB policy lending rate plus 1.5%, which in April 2011 resulted in a maximum rate of 6.5%. Interest rates on credit card loans were capped at 1% monthly. Possible circumventions of the ceiling have been prevented by a QCB directive from February 2010, which set a ceiling on commissions and fees chargeable on personal accounts and services.

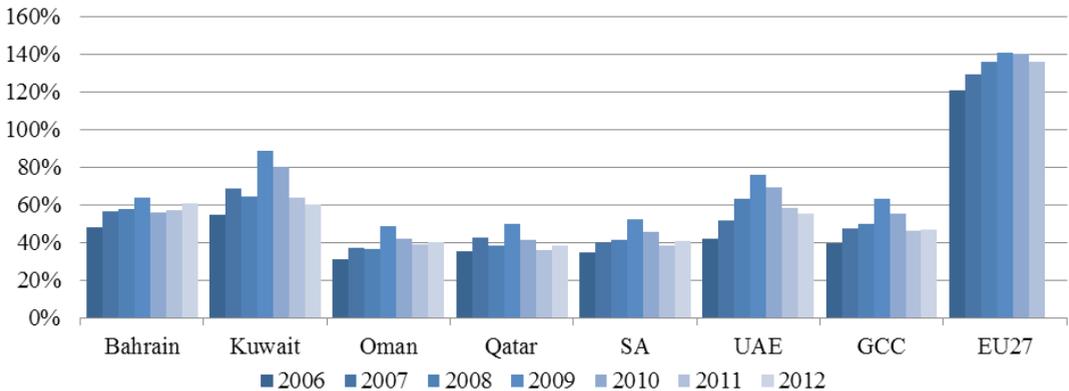
<sup>129</sup> An individual can borrow an amount up to 20 times his monthly income, and the debt service ratio can be 50% of regular income at the most. Terms and conditions for applying for car loans and a minimum salary to qualify for a credit card were also introduced, together with limits on fees, service charges and commissions charged to individual customers.

global financial markets. Nevertheless, the vulnerabilities of the GCC banking systems were revealed by the global crisis, in particular the increased reliance on external funding and exposures concentrated in the real estate and construction sectors.

During the years preceding the financial crisis, the region experienced a rapid growth in credit to the private sector. Higher oil prices, increased government spending and non-oil GDP growth spurred business confidence and private sector investment, leading to an increase in the demand for credit.

However, high rates of credit growth during an economic upturn almost invariably lead to higher levels of credit default when economic activity slows down, which increased the vulnerability of the region.<sup>130</sup> While the favourable macroeconomic environment in the years preceding the financial crisis had been conducive to favourable credit conditions and lower levels of non-performing loans (NPLs), in 2009 NPLs increased sharply and credit stagnated.<sup>131</sup> As can be seen in Figure 26, domestic credit to the private sector as a percentage of GDP has been falling steadily since the peak of the financial crisis in 2009 in every country in the region.

**Fig. 26. Domestic credit to the private sector (% of GDP)**



Source: World Bank World Development Indicators and national authorities.

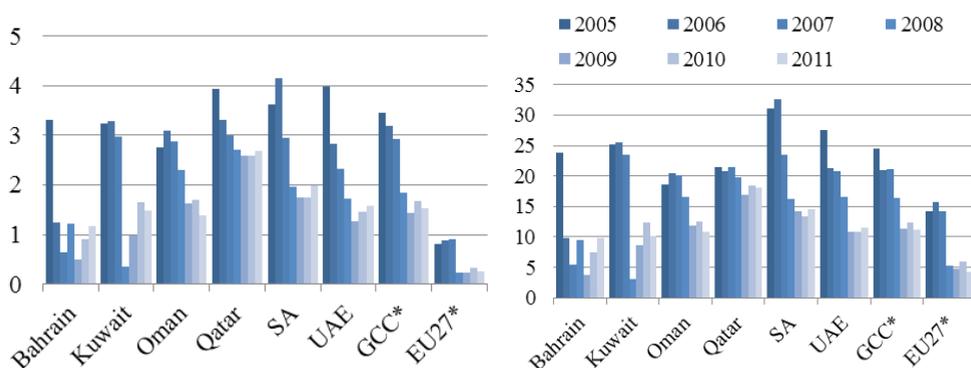
The focus of the GCC banking systems on traditional banking operations has secured relatively stable sources of earnings for the banks. Nevertheless, the financial crisis has had an impact on the profitability of GCC banks. The banking sector in Kuwait was the most profitable in the GCC before the crisis, but was

<sup>130</sup> Abdullah Al-Hassan, May Y. Khamis and Nada Oulidi, "The GCC banking sector...", cit.

<sup>131</sup> Raphael A. Espinoza and Ananthakrishnan Prasad, "Nonperforming Loans in the GCC Banking System and their Macroeconomic Effects", in *IMF Working Papers*, No. 10/224 (October 2010), <http://www.imf.org/external/pubs/cat/longres.aspx?sk=24258>.

also the most affected by it. As can be seen in Figure 27, banks' return-on-asset (ROA) and return-on-equity (ROE) ratios have started to increase again since the peak of the financial crisis in 2008/2009, largely driven by strong credit growth supported by strong government spending. With the economy growing, recoveries on previous loan loss provisions have also boosted the banks' profits. Only Oman and Kuwait experienced decreases in their banks' profitability in 2011. The Qatari banking sector was the least affected by the global crisis, which is reflected in its banks' profitability ratios. The relatively high profitability of Qatari banks through the crisis period also reflects the fact that Qatari banks have the most diversified sources of income within the GCC.<sup>132</sup>

**Fig. 27. Development of bank profitability - ROA (left) and ROE (right)**



\*Regional medians.

Source: World Bank, *Financial Development and Structure Dataset*, 2013, cit., and national authorities.

Banks in the GCC are relatively well capitalised, and the soundness of GCC banking systems has strengthened during recent years. As shown in Table 5 and Subsection 3.1.2.3., capital adequacy ratios of the banks have increased since 2009. Capital adequacy is above national and international standards in all countries. Non-performing loans as a proportion of total loans have also decreased in every country except for the UAE and Bahrain. While the increase in non-performing loans in Bahrain is not significant, the increase in the UAE is of greater significance, reflecting the problems in the country's real estate sector.

For countries with lower levels of non-performing loans, the provisioning rates are relatively high. The high provisioning rates in Oman are driven by the requirements of the Central Bank of Oman for banks to hold provisions of 1% of performing non-personal loans and 2% of performing personal loans. The low provisioning rate in Kuwait is due to write-offs of bad loans. However, since the onset of the financial crisis, banks in Kuwait have been required to set aside

<sup>132</sup> Abdullah Al-Hassan, May Y. Khamis and Nada Oulidi, "The GCC banking sector...", cit.

additional “precautionary” provisions.<sup>133</sup> In the UAE, in November 2010 the central bank issued a regulation (No. 28/2010) requiring banks to implement best practices and to recognise default after 90 days, regardless of the ownership of the entities concerned.

**Table 5. Bank financial soundness indicators**

	Capital adequacy ratio		Non-performing loans (% of gross loans)		Provisioning rate (% of non-performing loans)	
	2009	2011	2009	2011	2009	2011
<b>Bahrain</b>	19.6	20.3	4.3	4.5	63.9	65.9
<b>Kuwait</b>	16.7	18.5	11.5	7.3	38.3	33.9
<b>Oman</b>	15.5	15.9	2.7	2.4	104.0	120.6
<b>Qatar</b>	16.1	20.6	1.7	1.7	84.5	86.3
<b>Saudi Arabia</b>	16.5	17.3	3.3	2.3	89.8	132.8
<b>UAE</b>	19.9	21.2	4.3	6.2	94.4	67.8
<b>GCC</b>	17.8	19.4	4.5	4.3	83.8	87.5
<b>EU27</b>	13.7	14.3	4.8	6.0	63.9	68.6

*Note:* Capital adequacy ratio is total regulatory capital divided by risk weighted assets. Provisioning coverage in Saudi Arabia, Oman and Qatar includes general as well as specific provisioning.

*Sources:* World Bank World Development Indicators and IMF.

While the banks in the region are well capitalised, the crisis continues to strain the banking sector, with the real estate sector in particular putting pressure on it, thereby worsening the banks’ asset quality. Due to the persisting high concentrations on the real estate and construction sectors as well as on credit to individuals, international institutions pushed GCC banks to improve the quality of their credit and asset portfolios. Low levels of bond financing have contributed to the maturity mismatches between the assets and liabilities of banks, with limitations resulting from lower market liquidity and funding issues.

As debt securities markets have remained the least developed financial segment in the GCC economies, deepening domestic debt markets is often referred to as a means of enhancing the resilience of these economies. In particular, putting in place the necessary infrastructure and regular placement of government debt to establish a yield curve in order to develop a corporate debt market have generally been proposed as ways of enhancing domestic financing and reducing reliance on foreign financing.

<sup>133</sup> IMF, *Regional Economic Outlook: Middle East and Central Asia*, Washington, International Monetary Fund, November 2012, p. 18-19, <http://www.imf.org/external/pubs/ft/reo/2012/mcd/eng/mreo1112.htm>.

### 3.1.2. An assessment of EU-GCC regulatory convergence in the banking sector

The aim of this analysis is to use quantitative measures of regulatory development to assess the degree of convergence of banking regulation in the GCC to international norms. Building on the work of Ayadi et al.,<sup>134</sup> seven distinct regulatory areas have been identified in order to assess the various aspects of regulatory adequacy. These areas cover the definition of banking, licensing requirements, capital requirements, the independence and powers of supervisors, the presence of safety nets, disclosure and the availability of credit information. Although these provide a broad view of the extent of regulation, several potential areas (i.e. payment and settlement systems, credit guarantee schemes, financial inclusion, etc.) have been excluded from the convergence analyses due to the unavailability of comparable information sources for the sampled countries for at least two consecutive periods. The results of this analysis are used to distil potential areas of EU-GCC cooperation in the banking sector for the purposes of the follow-up to the 2010-2013 Joint Action Programme.

The main source of information for the regulatory adequacy indices are the Bank Regulation and Supervision Surveys (BRSS) developed by Barth et al. in 2001 and later revised in 2003, 2007 and 2011.<sup>135</sup> All four surveys are built on official responses to questionnaires that were sent to the national regulatory and supervisory agencies of over 120 countries, most of which were returned.<sup>136</sup> The questions cover a wide variety of areas, including banking activity, entry, capital regulations, supervisory authorities, private monitoring, deposit insur-

<sup>134</sup> Rym Ayadi et al., "Convergence of Bank Regulation on International Norms in the Southern Mediterranean. Impact on Performance and Growth", in *CEPS Paperbacks*, September 2011, <http://www.ceps.eu/node/6026>; and Rym Ayadi, Emrah Arbak and Willem Pieter de Groen, "Convergence and Integration of Banking Sector Regulations in the Euro-Mediterranean area. Trends and Challenges", in *MEDPRO Technical Reports*, No. 34 (March 2013), <http://www.ceps.eu/node/7853>.

<sup>135</sup> James R. Barth, Gerard Caprio and Ross Levine, "The Regulation and Supervision of Banks Around the World. A New Database", in *World Bank Policy Research Working Papers*, No. 2588 (February 2001), <http://dx.doi.org/10.1596/1813-9450-2588>; "Bank regulation and supervision: What works best?", in *Journal of Financial Intermediation*, Vol. 13, No. 2 (April 2004), p. 205-248; "Bank Regulations Are Changing: For Better Or Worse?", in *World Bank Policy Research Working Papers*, No. 4646 (June 2008), <http://dx.doi.org/10.1596/1813-9450-4646>; "The Evolution and Impact of Bank Regulations", in *World Bank Policy Research Working Papers*, No. 6288 (December 2012), <http://dx.doi.org/10.1596/1813-9450-6288>. For discussion of the results and other aspects of the data, see also James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation. Till Angels Govern*, Cambridge and New York, Cambridge University Press, 2006; and the World Bank website: <http://go.worldbank.org/SNUSW978P0>.

<sup>136</sup> The number of countries responding to the survey varied over time. The original survey had 117 country respondents, including a wide range of developed, developing and underdeveloped countries. The later revisions achieved greater participation, with 152 countries responding in 2003, 142 in 2007 and 125 in 2011.

ance and external governance.

One of the key advantages of the BRSS is that the questionnaires have remained relatively similar over the years, although the later versions cover more areas than the original survey. This particular feature of the datasets has allowed us to make comparisons by building composite indices based on specific answers over time to track the evolution of the different regulatory and supervisory elements.

A key disadvantage of the BRSS is that the number of questions responded to in the 2003, 2007 and 2011 revisions varies from one country to another. For the GCC countries, the aggregate response rates are on average lower than for the entire sample. As shown in Figure 28 the Bahrain regulatory authorities were the most responsive to the survey among the GCC countries, with an average response rate of over 95%. This is followed by Oman and Kuwait, with response rates of around 95%. Three of the six GCC countries – the UAE, Qatar and Saudi Arabia – only achieved response rates of between 85 and 89%, which is well below the average rate for the GCC countries.

**Fig. 28. Average response rates to BRSS**



*Note:* Response rates are averaged over the four surveys and correspond to the number of questions with complete (i.e. excluding empty or partial) answers divided by the total number of questions used to compute the composite indices presented in this chapter.

*Source:* BRSS.

Although the response rates appear high in general, the existence of one single partial or empty answer renders the construction of a relevant composite index dubious since there is no clear way of scoring for missing responses.

Moreover, some countries did not respond to all four surveys.<sup>137</sup> To avoid any inconsistencies, empty answers have been scored as zero in the construction of the relevant indices. This approach is in line with Barth et al.<sup>138</sup> The assessment of regulatory convergence is based on the calculation of regional averages, weighted by the total banking assets of each country. This has allowed us to make a sounder judgment of whether the regulatory conditions on both coasts of the Mediterranean are converging.

A second disadvantage of Barth et al.<sup>139</sup> and its revisions was that the questions did not cover all regulatory and supervisory areas. Two major areas where the surveys lacked depth were the details of deposit insurance guarantee schemes and institutional variables, such as the extent of credit information sharing and creditors' legal rights. In order to fill the gap, several additional sources have been used to supplement the construction of the composite indices, including the deposit insurance database of Demirgüç-Kunt et al.,<sup>140</sup> the IMF and World Bank's Financial Sector Assessment reports, the World Bank's Doing Business Indicators and the websites of the national authorities.

Seven composite indices have been created using the various data sources identified above. They cover scope restrictions, entry obstacles, capital requirement stringency, supervisory authorities, deposit insurance, private monitoring, and credit information and laws. These areas provide a relatively broad coverage of the quality and evolution of banking regulation and supervision. The composite indices were calculated for each country individually, as well as for GCC countries and the EU27 (EU15 and NMS12) collectively.

The following subsections review and compare the evolution of the regulatory conditions in each of the seven areas listed above.

### 3.1.2.1. Area I: Scope restrictions

As is evident from their differing business models across the world, financial institutions are growing increasingly complex and are offering a wider spectrum of products. Some countries restrict banking to a narrow range of activities, such as taking deposits and issuing credit, with little flexibility in debt and asset management, while others provide more flexibility. Regulations typically

<sup>137</sup> The regulatory authorities of the UAE did not respond to two surveys (2000 and 2007), while those of Qatar (2007), Saudi Arabia (2011), Sweden (2011) and the Czech Republic (2011) did not respond to one survey.

<sup>138</sup> James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit.; and "The Evolution and Impact of Bank Regulations", cit.

<sup>139</sup> James R. Barth, Gerard Caprio and Ross Levine, "The Regulation and Supervision of Banks Around the World. A New Database", cit.

<sup>140</sup> Asli Demirgüç-Kunt, Baybars Karacaovali and Luc Laeven, "Deposit Insurance Around the World: A Comprehensive Database", in *World Bank Policy Research Working Papers*, No. 3628 (June 2005), <http://dx.doi.org/10.1596/1813-9450-3628>.

restrict the extent to which banks may engage in the business of i) securities underwriting, brokering, dealing, and all aspects of the mutual fund industry; ii) insurance underwriting and selling; and iii) real estate investment, development and management.

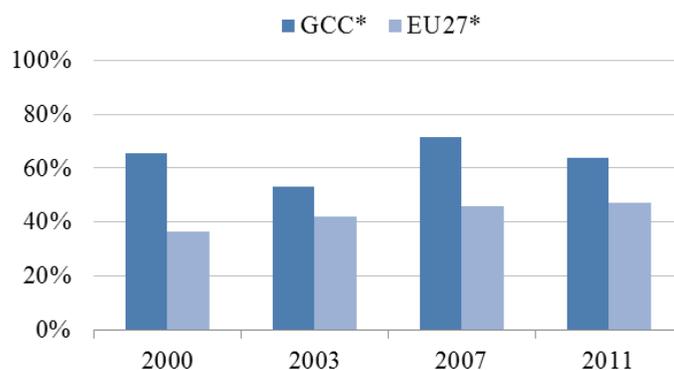
The composite indicator used in this area to assess the extent of restrictions imposed on banking activity is based on the Banking Activity Restrictiveness Index in BRSS.<sup>141</sup> The surveys provide measures for the degree of restrictiveness for each of the following four categories, ranging from unrestricted (1 point) and mostly permitted (2 points), to too restricted (3 points) and fully prohibited (4 points). The Banking Activity Restrictiveness Index totals the scores for each category to come up with a measure of the extent to which banks are restricted, with a maximum restrictiveness score of 12 points where no activity other than narrow banking is allowed.

The results summarised in Table 6 show that the regulators in the GCC countries impose more restrictions than in the EU27 in general. Hence, banks in NMS12 face similar restrictions in their activities to those encountered by their peers in the GCC countries, whereas banks in the EU15 have more freedom. A deeper analysis of the survey results (not included here) shows that most of the GCC and EU27 regulators impose some form of restriction on insurance activities and real estate activities, while there are no restrictions on securities activities. The GCC countries are, however, much more stringent on real estate activities (real estate investment, development, and management). In all GCC countries, except Bahrain and Kuwait, real estate activities are prohibited for banks.

The figures show no clear convergence tendency when the regional weighted averages of the GCC countries and the EU27 are considered. The difference between the GCC and EU27 weighted averages has moved up and down over time, despite the fact that the EU27 average has increased gradually. The changing composition of the GCC sample, as well as the restrictions on real estate activities in Kuwait and Qatar, are the main reasons for the volatility in the GCC average. The level of restrictions on bank activities in the GCC has nevertheless remained above the EU27. This might change as a result of the new banking reforms that are moving the EU27 towards greater restrictions on banking activities following the financial crisis.<sup>142</sup>

<sup>141</sup> The Banking Activity Restrictiveness Index is constructed by adding up the scores for the World Bank Guide (WBG) questions 4.1-4.3, as detailed in Appendix 2 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit.

<sup>142</sup> In 2012, Commissioner Barnier nominated a group of experts, chaired by Erkki Liikanen, to examine the need for reform in the structure of the EU banking sector. In the final report published in October 2012, the experts advised the European Commission, among other things, to curb investment banking activities. See Erkki Liikanen (ed.), *Report of the High-level Expert Group on possible reforms to the structure of the EU banking sector*, Brussels, European Commission, 2 October 2012, [http://ec.europa.eu/internal\\_market/bank/group\\_of\\_experts](http://ec.europa.eu/internal_market/bank/group_of_experts).

**Table 6. Banking activity restrictiveness (% of maximum score)**

	2000	2003	2007	2011
Bahrain	67	67	67	50
Kuwait	58	42	67	33
Oman	83	75	67	67
Qatar	67	25	..	67
Saudi Arabia	67	67	75	..
UAE	..	42	..	75
<b>GCC*</b>	<b>66</b>	<b>53</b>	<b>72</b>	<b>64</b>
EU15*	36	42	45	47
NMS12*	55	62	65	64
<b>EU27*</b>	<b>36</b>	<b>42</b>	<b>46</b>	<b>47</b>
<b>AVG</b>	<b>36</b>	<b>42</b>	<b>46</b>	<b>47</b>
<b>STDEV</b>	<b>13</b>	<b>12</b>	<b>17</b>	<b>15</b>

*Note:* Higher values represent more restrictive rules, as a share of a maximum score of 12 points.

\* Regional averages are weighted by total banking assets. See Annex 8 for the scores of the individual EU Member States.

*Source:* BRSS.

### 3.1.2.2. Area II: Entry obstacles

The competitive conditions in a country depend crucially on the regulatory structure, in particular on conditions that might hinder or prevent entry into the banking sector by domestic or foreign banks. In some countries, obstacles may take the form of excessive licensing or entry requirements, which are applicable to both domestic and foreign banks. In others, governments may restrict foreign entry as part of a deliberate policy choice, either explicitly through setting limits on ownership or, more importantly, by rejecting foreign applications

in a disproportionate manner.<sup>143</sup> Finally, a banking sector that is predominantly state-owned may be disadvantageous for the development of privately-owned banks.

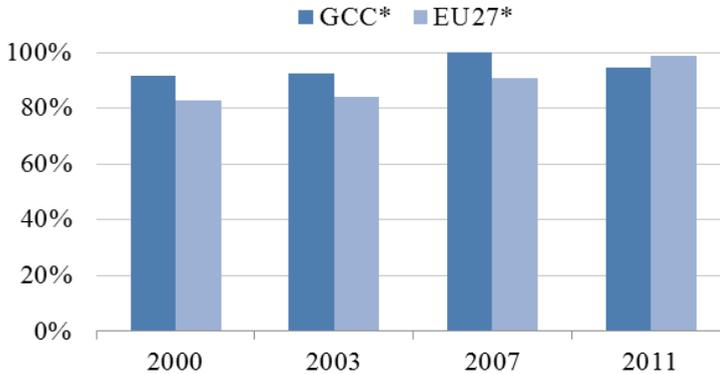
Three indicators are utilised to construct the composite index assessing the impact of entry obstacles.

The first indicators that can be used to measure the extent to which the regulatory structure obstructs entry are legal licensing requirements, which can hamper entry by making procedures unnecessarily cumbersome. The relevant measure is based on the set of requirements for a licensing application to be considered valid. The index is built on the total number of required documents, including i) draft by-laws; ii) an organisational chart; iii) financial projections; iv) financial information on potential shareholders; v) the background of directors; vi) the background of managers; vii) details of funding sources; and viii) the intended market differentiation.<sup>144</sup>

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<sup>143</sup> Rejections of domestic banks are not considered here as they are more likely to arise from prudential concerns, including funding deficiencies or other financial problems, which are common place for home-grown banks in countries with less developed financial systems that have limited access to external capital.

<sup>144</sup> The entry into banking requirements index is constructed by adding up the scores for WBG questions 1.8.1-1.8.8, as detailed in Appendix 2 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit.

**Table 7. Entry into banking requirements (% of maximum score)**

	2000	2003	2007	2011
Bahrain	100	100	100	100
Kuwait	63	75	100	100
Oman	100	100	100	100
Qatar	100	50	..	75
Saudi Arabia	100	100	100	..
UAE	..	100	..	100
<b>GCC*</b>	<b>92</b>	<b>93</b>	<b>100</b>	<b>95</b>
EU15*	83	84	91	99
NMS12*	95	93	93	96
<b>EU27*</b>	<b>83</b>	<b>84</b>	<b>91</b>	<b>99</b>
<b>AVG</b>	<b>83</b>	<b>84</b>	<b>91</b>	<b>99</b>
<b>STDEV</b>	<b>24</b>	<b>23</b>	<b>11</b>	<b>4</b>

Note: Higher values represent more restrictive access, as a share of a maximum score of 8 points.

\* Regional averages are weighted by total banking assets. See Annex 9 for the scores of the individual EU Member States.

Source: BRSS.

Table 7 shows that most GCC countries impose similar levels of stringency in terms of entry requirements to the EU27 countries. In particular, all of the eight requirements listed above are commonplace in four of the five GCC countries for which the latest survey has been filled out. As for the EU27, almost all countries require all of the eight documents. Only Austria, Belgium, Greece, Poland and Portugal do not legally require banks to provide information on the background of future managers. These results show that most countries across the GCC and the EU require similar documents for licensing. This might mean that these figures give an incomplete picture of the obstacles faced by potential entrants. To

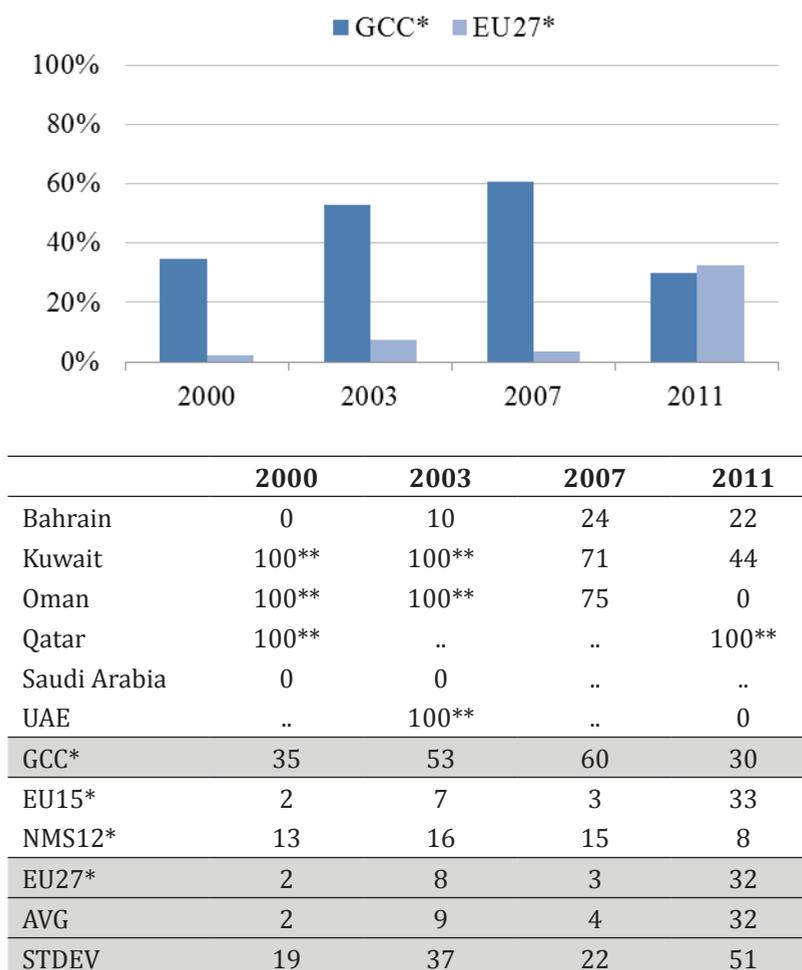
get a more complete picture, foreign banking application rejections and government ownership in banking are considered.

The second index considers the more discretionary power that authorities exert in allowing or rejecting entry. More specifically, the index is based on the fraction of foreign banking licensing applications that were rejected during the five-year period starting from the day the questionnaire was conducted.<sup>145</sup>

Table 8 very clearly shows that foreign banking application denials are commonplace in the GCC countries, which is in stark contrast with the EU27, where such denials are rare. In particular, over 70% of foreign banking licensing applications between 2001 and 2005 were denied in Oman (three out of four applications) and Kuwait (ten out of 14). More recently, the Kuwaiti authorities denied almost half of foreign licensing applications (seven out of 16) in the five years to 2011. The Bahraini authorities denied about a fifth of foreign applications (two out of nine) over the same period. These results show signs of convergence between the GCC countries and the EU27. However, the picture is slightly blurred due to the missing information for Qatar, Saudi Arabia and the UAE in relation to 2007.

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<sup>145</sup> Share of foreign denials is addressed by WBG question 1.10, as detailed in Appendices 1 and 2 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit.

**Table 8. Percentage of foreign applications denied**

\* Regional averages are weighted by total banking assets. See Annex 10 for the scores of the individual EU Member States.

\*\* 100% if no foreign application was registered. No applications can indicate that it is not possible to enter the market, or that the market is saturated. As already mentioned, in most GCC countries it is impossible to enter the banking sector. The countries without foreign applications are therefore rewarded with the highest possible percentage of foreign denials.

Source: BRSS.

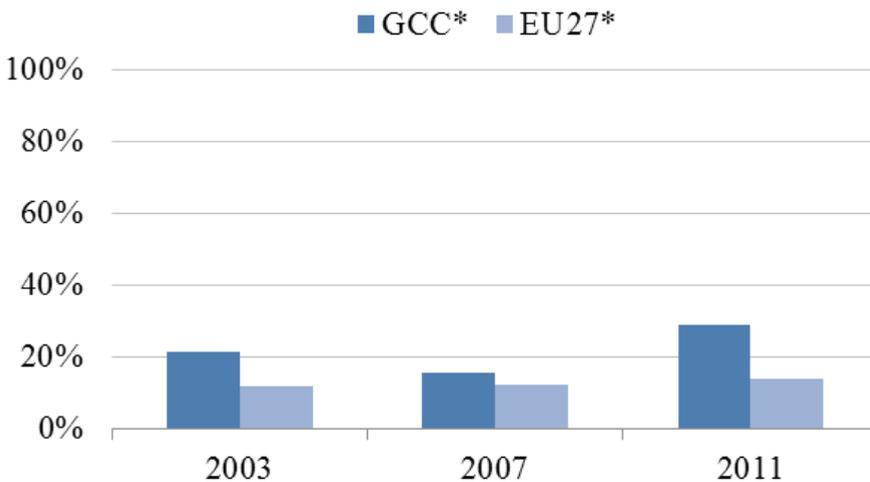
The third and final indicator for entry obstacles relates to the dominance of government-controlled banking. State-owned banks often enjoy implicit or explicit state guarantees, have access to public funding, and are possibly subject to less strict or more flexible rules, which creates a disadvantage for potential entrants and more generally undermines healthy competition.<sup>146</sup> The index is a

<sup>146</sup>James R. Barth, Gerard Caprio and Ross Levine, "Bank regulation and supervision: What-

simple measure of the market power of state-owned banks, where market power is expressed as a percentage of total banking assets, and a bank is considered to be state-owned if the government holds more than 50% of the equity.<sup>147</sup> The relevant data are only available for the surveys conducted from 2003 onwards.

Table 9 shows significant differences between the GCC and EU27 averages, as well as between the individual countries within the regions. In Qatar, Saudi Arabia and the UAE, the governments hold majority stakes in banks which control between 20% and 49% of total domestic banking assets. In addition to the majority holdings, most governments also have minority interests in commercial banks. These minority holdings can be substantial: Bahrain, for instance, holds 49% of the shares of the National Bank of Bahrain (one of the largest commercial banks in the country). Turning to the EU27, the capital injections to banks made during the financial crisis have increased the number of banks controlled by governments. During the crisis, the share of the banking sector owned by the government in Austria, Latvia, Netherlands, Slovenia and the UK increased substantially.

**Table 9. Market share of government-controlled banks (% of total assets)**



works best?", cit.

<sup>147</sup> Share of government-controlled banks is addressed by WBG question 3.8.1, as detailed in Appendix 1 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit.

	2003	2007	2011
Bahrain	0	1	0
Kuwait	0	..	0
Oman	0	0	0
Qatar	46	..	43
Saudi Arabia	21	20	20
UAE	35	..	49
GCC*	21	16	29
EU15*	12	12	14
NMS12*	12	8	12
EU27*	12	12	14
AVG	12	12	15
STDEV	20	21	15

Note: Figures represent the share of banks with at least 50% state ownership.

\* Regional averages are weighted by total banking assets. See Annex 11 for the scores of the individual EU Member States.

Source: BRSS.

Put together, the three indices provide a contrasting picture of the sampled countries in terms of entry obstacles. The set of documents needed for a valid licensing application are, to a large extent, similar in both the GCC countries and the EU27. These requirements are most likely used to ensure that only 'fit and proper' undertakings are allowed to operate as banks. Only Qatar and five out of 27 EU countries can be distinguished in this respect as having fewer licensing requirements. Turning to less official controls that the authorities exert over the banking sector, foreign entry denials are disproportionately high in some of the GCC countries, particularly in Kuwait and Oman. The state also maintains a substantial direct control over the banking sector in most of the countries in the region, with state-owned banks accounting for half of banking sector activities in Qatar and the UAE. In short, although the official entry conditions appear comparable, there are significant and persistent obstacles to entry that can curtail competition in the GCC countries' banking sectors, possibly emanating from official practices and political interference.

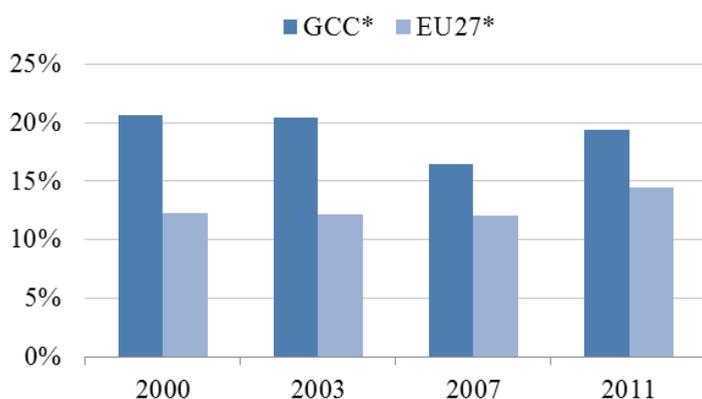
### 3.1.2.3. Area III: Capital requirement stringency

One of the common aims of bank regulation is ensuring that banks operate soundly. Regulatory capital requirements are an important part of this. They determine the minimum amount of capital a bank should hold relative to its total assets (or risk-weighted assets).

Comparing capital ratios represents a first step towards understanding how

sound a banking sector is. The capital ratios in the GCC countries are clearly higher than in the EU27, as shown in Table 10. First of all, all the GCC countries have maintained a total capital ratio of between 10% and 20%. The capital position of banks in the GCC countries deteriorated from 20.6% in 2000 to 16.4% in 2007. In recent years, the capital ratio improved, reaching 19.4% in 2011. The capital ratios of banks in the EU27 increased after the explosion of the financial crisis in the summer of 2008. Supervisors like the EBA *de facto* required systemically important banks to hold more capital, while at the same time capital markets tend to push banks to hold higher capital cushions in times of economic uncertainty.

**Table 10. Regulatory capital ratios (% of risk-weighted assets)**



	2000	2003	2007	2011
Bahrain	21	21	23	20
Kuwait	22	23	17	19
Oman	19	16	18	16
Qatar	..	..	..	21
Saudi Arabia	21	20	18	17
UAE	20	20	14	21
<b>GCC*</b>	<b>21</b>	<b>20</b>	<b>16</b>	<b>19</b>
EU15*	12	12	12	14
NMS12*	14	16	14	14
<b>EU27*</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>14</b>
<b>AVG</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>15</b>
<b>STDEV</b>	<b>2</b>	<b>2</b>	<b>1</b>	<b>2</b>

*Note:* Figures represent the share of total capital in risk-weighted assets using the 1988 Basle Accord definitions.

\* Regional averages are weighted by total banking assets. See Annex 12 for the scores of the individual EU Member States.

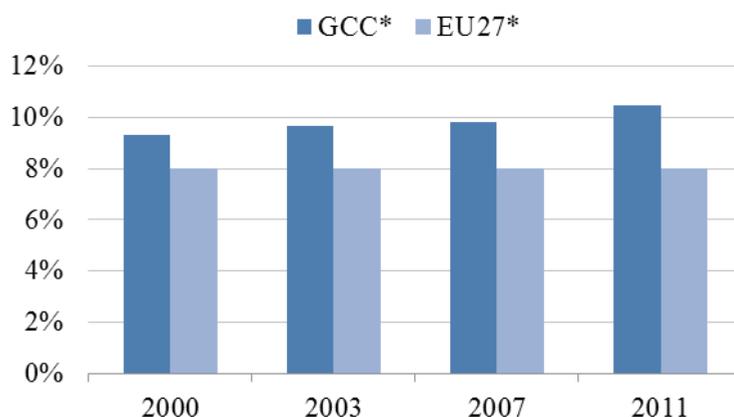
Sources: BRSS and IMF Global Financial Stability Reports.

The GCC countries' banks appear to be better capitalised than their EU27 counterparts. Does this reflect the level and/or stringency of capital requirements, or a lower appetite for risk? In other words, is it the regulations that make the banks sounder, or are the banks simply not willing to take too many risks? To answer this important question, it is necessary to look deeper into the level of the minimum capital ratios and the other rules.

Table 11 shows that the minimum capital requirements for banks in the GCC countries are above those for the EU27 banks. All EU27 countries, except Bulgaria and Estonia, require their banks to have a minimum total capital of at least 8% of risk-weighted assets, in line with the minimum capital standards imposed by the Basel I and Basel II agreements.<sup>148</sup> Of the GCC countries, all but Saudi Arabia impose higher minimum regulatory capital requirements. These remained stable during the sample period, with only Qatar and the UAE increasing their minimum capital requirements. There is therefore no noticeable convergence between the minimum regulatory capital ratios in the GCC countries and the EU27.

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<sup>148</sup> For more information on the status of the implementation of Basel II, 2.5 and Basel III in the EU, see Bank for International Settlements (BIS), *Progress report on implementation of the Basel regulatory framework*, April 2013, <http://www.bis.org/publ/bcbs247.htm>; Financial Stability Institute (FSI), *FSI Survey: Basel II, 2.5 and III implementation*, July 2013, <http://www.bis.org/fsi/fsiop2013.htm>.

**Table 11. Minimum regulatory capital ratios (% of risk-weighted assets)**

	2000	2003	2007	2011
Bahrain**	12	12	12	12
Kuwait	12	12	12	12
Oman	12	12	12	12
Qatar	8	10	10	10
Saudi Arabia	8	8	8	8
UAE	..	10	10	12
<b>GCC*</b>	<b>9</b>	<b>10</b>	<b>10</b>	<b>10</b>
EU15*	8	8	8	8
NMS12*	8	8	9	8
<b>EU27*</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>
<b>AVG</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>
<b>STDEV</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>

*Note:* Figures represent the share of total capital in risk-weighted assets using the 1988 Basle Accord definitions.

\* Regional averages are weighted by total banking assets. See Annex 13 for the scores of the individual EU member states.

\*\* Bahrain has an unadjusted regulatory leverage ratio in addition to the risk-adjusted regulatory capital ratio.

*Sources:* BRSS and national authorities.

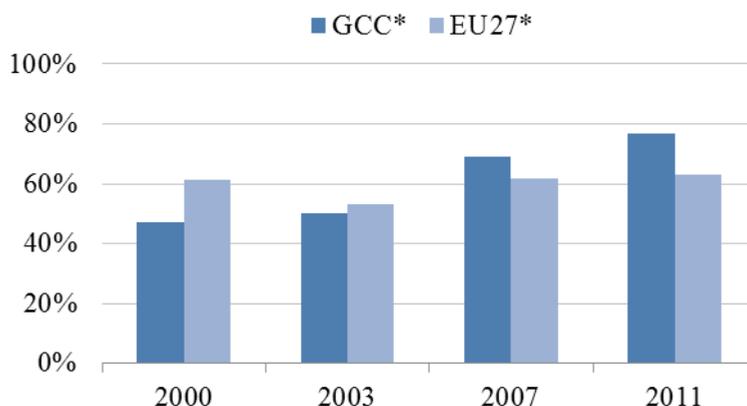
There are different ways of measuring the stringency of capital requirements. The index used here gives consideration to the types of capital allowed, the risk weights applied, and whether the minimum capital ratios vary with risk. More specifically, the capital stringency index aims to determine the extent to which capital requirements restrict leverage potential and risky behaviour, taking account *inter alia* of i) whether the minimum capital-to-asset requirements are in

line with 1988 Basel Accord definitions; ii) whether the minimum ratio varies with the bank's credit risk or iii) market risk; and whether the value of iv) unrealised loan losses, v) unrealised security losses or vi) foreign exchange losses are deducted from regulatory capital. Additionally, the index aims to measure restrictions imposed on the source of regulatory capital, such as vii) whether these funds are verified by regulatory authorities; and whether viii) cash and government securities, or more generally ix) non-borrowed funds are the only forms of capital allowed for initial disbursements and subsequent injections.<sup>149</sup> Hence, the index composed for 2011 does not include whether the value of iv) unrealised loan losses and vi) foreign exchange losses are deducted from regulatory capital. A greater number of affirmative responses to these questions leads to a higher stringency score.

Table 12 presents a comparison of the stringency of capital requirements for the countries in our sample. A quick glance through the figures reveals that capital requirements have become more stringent in most countries in the sample. More and more GCC countries are implementing legislation to align their capital requirements with the Basel II capital standards. All the GCC countries have adopted legislation that allows banks to vary their minimum capital requirements depending on banks' individual credit and market risk. The implementation of this legislation led to a jump in capital stringency between 2003 and 2011. Among the EU27 countries, most have imposed capital requirements that are as stringent as the GCC countries. However, eight of the EU27 countries have less stringent capital measures, mostly because the authorities in these countries allow the banks to use assets other than cash or government securities for capital injections. Looking at these results, it is hard to say that there is convergence, although both the GCC and EU27 countries have become more stringent.

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<sup>149</sup> The stringency of capital requirements index is addressed by WBG questions 3.1.1, 3.2, 3.3, 3.9.1, 3.9.2, 3.9.3, and 1.5-1.7. The calculation of the index is detailed in Appendix 2 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit. p. 337-338. One question (WBG 3.7), on the fraction of revaluation gains allowed as part of capital, has been omitted from the calculation of the index since responses were not available for most countries in our sample.

**Table 12. Stringency of capital requirements (% of maximum score)**

	2000	2003	2007	2011
Bahrain	22	56	67	71
Kuwait	78	67	78	86
Oman	56	56	56	71
Qatar	78	33	..	86
Saudi Arabia	33	33	67	..
UAE	..	67	..	71
<b>GCC*</b>	<b>47</b>	<b>50</b>	<b>69</b>	<b>77</b>
EU15*	62	53	62	63
NMS12*	43	46	45	71
<b>EU27*</b>	<b>61</b>	<b>53</b>	<b>62</b>	<b>63</b>
<b>AVG</b>	<b>61</b>	<b>53</b>	<b>62</b>	<b>63</b>
<b>STDEV</b>	<b>15</b>	<b>22</b>	<b>21</b>	<b>15</b>

*Note:* Higher values represent greater stringency, as a share of a maximum score of 9 points for 2000, 2003 and 2007, and 7 points for 2011.

\* Regional averages are weighted by total banking assets. See Annex 14 for the scores of the individual EU Member States.

*Source:* BRSS.

To sum up, most of the banks in the GCC countries need to comply with higher capital requirements than their peers in the EU27. This is reflected in the average capital ratios, which are significantly higher in almost all GCC countries. There are, however, also differences between the GCC countries and the EU Member States in the actual capital ratios that are independent of the minimum capital standards. Moreover, the capital requirements in the GCC countries are more stringent than those in the EU27.

#### 3.1.2.4. Area IV: Supervisory authorities

A key issue in the effectiveness of banking regulation is whether the supervisory authorities have the powers necessary to apply measures to discipline or, in the extreme, resolve banks that violate the rules or engage in imprudent activities. In most countries, the supervisors take prompt corrective action against a bank if its capital falls below the minimum required level. If the deterioration of the bank continues, the supervisor must have the ability to resolve the bank before it becomes insolvent, thereby posing a systemic threat. To be effective, supervisors need access to reliable and frequently-updated information on the condition of banks. Judicial systems often allow the courts to intervene by diminishing, postponing or reversing illegitimate supervisory actions; however, this should not undermine the supervisor's chief responsibility for protecting and ensuring the orderly functioning of the banking market. These aspects of the supervisory system should be in line with regulatory priorities, and should not be subject to political patronage. In short, supervisors should have the authority to discipline potentially troubled banks and resolve problems while remaining independent from political influence.

Two indices on the power and independence of supervisory authorities have been used to measure the strength of the supervisory system.

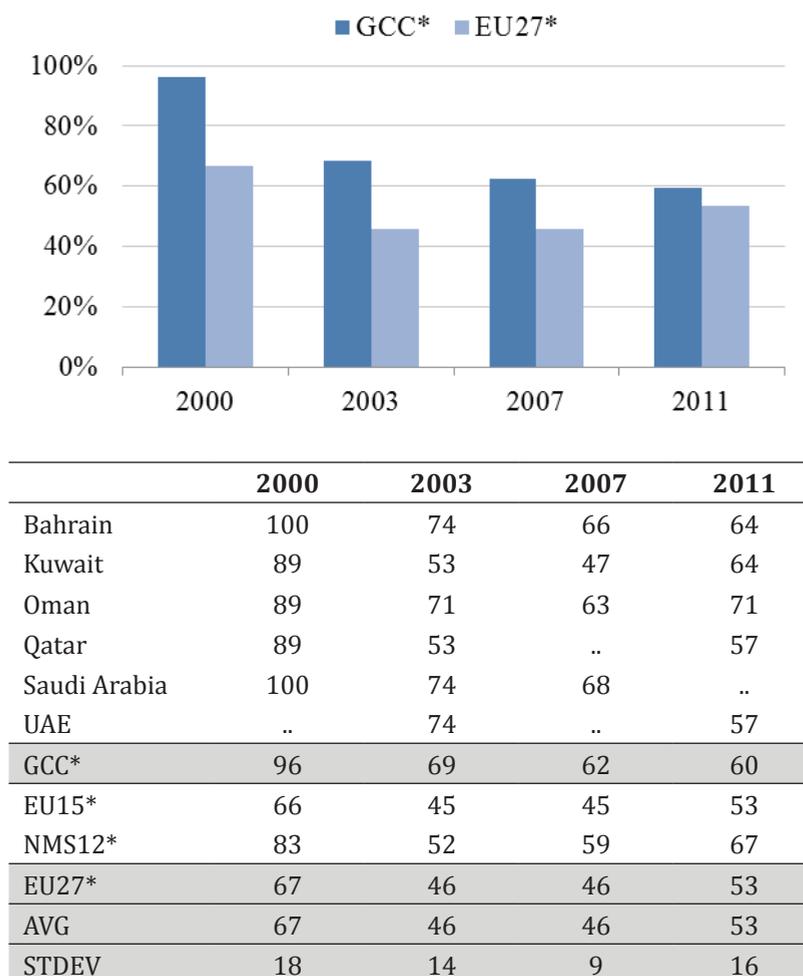
The first index measures the official power of the supervisor to take specific action to correct or prevent problems. The relevant questions include the ability of supervisors to i) meet external auditors without approval of the bank; ii) communicate directly with auditors regarding illicit activities undertaken by the bank's management or directors; iii) receive disclosure of off-balance sheet items; iv) take legal action against negligent auditors; v) change the organisational structure of troubled banks; vi) order management or directors to cover losses; and suspend vii) dividend distributions, viii) bonuses, and ix) management fees. Additionally, in the 2003, 2007 and 2011 surveys, additional questions on troubled banks were also asked regarding the supervisors' ability to x) declare insolvency; xi) suspend ownership rights; xii) supersede shareholder rights; and fire or hire xiii) management, or xiv) directors. The 2011 survey did not include questions on the supervisors' power to suspend ix) management fee distribution and xi) ownership rights, as well as xiv) to remove or replace directors.<sup>150</sup> An affirmative answer to any of these questions indicates greater supervisory power. Some of these powers may only be exercisable by some supervisory-like institutions, such as depository insurance agencies or

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<sup>150</sup> The official supervisory power index is addressed by WBG questions 5.5-5.7, 6.1, 10.4, 11.2, 11.3.1-11.3.3, 11.6, 11.7, and 11.9.1-11.9.3. The calculation of the index is detailed in Appendix 2 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit., p. 339-342.

bank restructuring agencies, as part of which supervisors hold more moderate powers.<sup>151</sup> In other cases, the courts or the government may be involved, which would serve to undermine the power of the supervisors.

**Table 13. Official supervisory power (% of maximum score)**



*Note:* Higher values represent greater supervisory power, as a share of a maximum score of 9 points for 2000, 19 points for 2003 and 2007, and 14 points for 2011.

\* Regional averages are weighted by total banking assets. See Annex 15 for the scores of the individual EU Member States.

*Source:* BRSS.

Table 13 shows that the supervisory powers of the authorities in the GCC

<sup>151</sup> In these cases, the aggregate score has been augmented by 0.5 points only; for more details, see the calculation of the index detailed in Appendix 2 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit., p. 339-342.

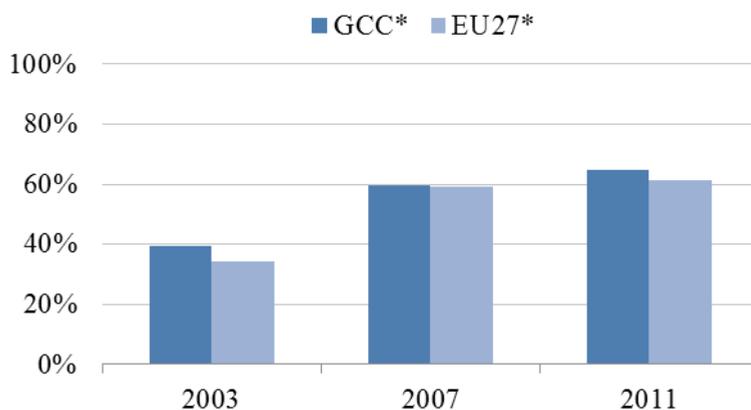
countries and the EU27 have clearly converged; regulatory power in the GCC countries is declining, whereas since 2000 it has gradually increased in the EU27. However, the GCC countries' supervisory authorities still have more power than their EU27 counterparts, excluding the NMS12. In Oman, the official supervisor is allowed to intervene directly in all the issues listed above, except in order to declare a bank insolvent. In contrast, the official supervisors in Qatar and UAE have more elementary tools. They have, for instance, the power to meet external auditors without the approval of the bank, but are not allowed to supersede shareholders' rights, nor to remove or replace management. Moreover, as in all GCC countries excluding Kuwait, the official supervisor does not have the authority to declare a bank insolvent.

The second index for assessing supervisory authority looks at the general independence of the supervisor from political influence. For this index, the following three questions from the BRSS have been considered: i) Are supervisory bodies accountable *only* to a legislative body? ii) Are supervisors legally liable for actions committed in exercising their duties? iii) Does the head of the agency have a fixed term? The level of independence is determined by counting affirmative answers to questions (i) and (iii), and negative answers to (ii). The questions needed to construct the index were only included in the BRSS surveys from 2003 onwards.<sup>152</sup>

Table 14 shows that the GCC countries and the EU27 are increasing the independence of their supervisory authorities at similar speeds, and that they are currently at similar levels. The GCC countries show a harmonious picture. In the GCC countries, none of the authorities is accountable only to a legislative body, and none is legally liable for its actions. Moreover, all heads of the supervisory agencies are nominated for a fixed term, except in Oman. Turning to the EU27, the picture becomes more diffuse. The supervisory authorities in just over half of the Member States are accountable only to a legislative body. In five Member States, including Italy and four belonging to the NMS12, the supervisory authorities can be held legally liable for their actions. Only in four of the 27 Member States are the heads of the supervisory agencies not nominated for a fixed term.

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<sup>152</sup> Independence from political interference index is addressed by WBG questions 12.2, 12.10, and 12.2.2. The calculation of the index is slightly different from the specification in Appendix 2 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit., p. 349-350, in that, in order to score a point under question 12.2, the supervisory bodies have to be accountable to no-one other than a legislative body, such as Parliament or Congress.

**Table 14. Independence from political interference (% of maximum score)**

	2003	2007	2011
Bahrain	33	33	67
Kuwait	67	67	67
Oman	33	0	33
Qatar	33	..	67
Saudi Arabia	33	67	..
UAE	33	..	67
<b>GCC*</b>	<b>39</b>	<b>60</b>	<b>65</b>
EU15*	34	59	61
NMS12*	50	75	81
<b>EU27*</b>	<b>34</b>	<b>59</b>	<b>61</b>
<b>AVG</b>	<b>34</b>	<b>59</b>	<b>61</b>
<b>STDEV</b>	<b>18</b>	<b>29</b>	<b>33</b>

Note: Higher values represent more independence, as a share of a maximum score of 3 points.

\* Regional averages are weighted by total banking assets. See Annex 16 for the scores of the individual EU Member States.

Source: BRSS.

When combined, the two indices for supervisory authority clearly show convergence.<sup>153</sup> The difference in supervisory power between the two regions has declined, while the difference in independence has remained more or less constant. Overall, the strength of both regions has increased. The GCC countries' supervisors have become more independent, whereas the EU27 supervisors have gained both more power and more independence. When the individual

<sup>153</sup> The supervisory authority score is a multiplication of the official supervisory power index and the independence from political interference index.

countries are considered, only limited differences are noticeable. The GCC countries, for instance, are almost all within three percentage points of each other. Oman is the only exception, with a substantially lower score due to the limited independence of its supervisory authorities.

### 3.1.2.5. Area V: Deposit insurance

Deposit insurance systems are among the key elements of a country's financial safety net, being designed to prevent disruptions to financial markets and the economy. By protecting depositors, deposit insurance schemes provide confidence to relatively small depositors, and contribute to preventing bank runs. At the same time, they may introduce moral hazard by diminishing depositors' incentives to monitor and screen banks, while also amplifying the incentives of shareholders in banks to engage in excessive risk-taking. The moral hazard problem implies that banks have incentives to take on risk that can be shifted to a deposit insurance scheme or, ultimately, to taxpayers.

Efforts are being made across the world to mitigate the moral hazard problems arising from deposit guarantee schemes.<sup>154</sup> First, coverage matters. In some countries, aside from limits on the total amount, co-insurance is imposed to ensure that depositors bear some part of the costs.<sup>155</sup> Second, the use of risk-adjusted premiums may also serve to better internalise the costs of the risks taken. Third, the way that deposit insurance schemes are funded also matters. For example, when the government is explicitly or implicitly involved in providing the necessary funds, moral hazard may be attenuated, especially in countries where the government has ample resources. In turn, when the system is backed with funds provided by banks, moral hazard can be limited by the understanding that the amount of the guarantee is restricted to pooled reserves.

Looking at the existing deposit guarantee schemes presented in Table 15, there are clear differences between the GCC countries and the EU27. The revised EU Deposit Insurance Directive requires Member States to maintain deposit insurance with a coverage limit of at least €100,000, raised from a minimum of €20,000 in the aftermath of the financial crisis.<sup>156</sup> Most of the countries in the

<sup>154</sup> For a review of the potential effects and key design features of deposit insurance schemes see Edward J. Kane, "Designing Financial Safety Nets to Fit Country Circumstances", in *World Bank Policy Research Working Papers*, No. 2453 (May 2000), <http://dx.doi.org/10.1596/1813-9450-2453>; Asli Demirgüç-Kunt, Baybars Karacaovali and Luc Laeven, "Deposit Insurance Around the World: A Comprehensive Database", cit.

<sup>155</sup> Empirical evidence shows that coverage limits and co-insurance practices serve to substantially reduce the likelihood of bank failure. Asli Demirgüç-Kunt and Enrica Detragiache, "Does Deposit Insurance Increase Banking System Stability? An Empirical Investigation", in *Journal of Monetary Economics*, Vol. 49, No. 7 (October 2002), p. 1373-1406

<sup>156</sup> Directive 2009/14/EC, which amended the Deposit Guarantee Directive (Directive 94/19/EC). The minimum amount of €100,000 has been in force as of 31 December 2010.

EU27 have chosen to set this base amount as their coverage limit, representing between 1.5 and 9.5 times the average annual income per capita figure. About three-quarters of schemes are *ex ante* or partially *ex ante* (*hybrid*) funded. The remaining six countries have an *ex post* funding structure. The levels of *ex ante*/*hybrid* funds display substantial variation, with a low of 0.3% of eligible deposits in Ireland, and a high of 3.1% of eligible deposits in Bulgaria.

Tuning to the GCC countries, Kuwait, Qatar, Saudi Arabia and the UAE have no schemes in place. The coverage limits of the schemes in Bahrain and Oman represent one to two times average annual income, pointing to a much lower level of protection afforded than in almost all EU27 countries. Moreover, the deposit guarantee scheme in Bahrain only covers a maximum of 75% of eligible deposits.

Table 15. Deposit guarantee schemes in the GCC, latest available figures

	Est. date	Coverage limit		Funding (Public or banks)	Co- insurance	Risk-based premiums	Ex post/ex ante	Coverage ratio**
		€ (current)	(% of GDP per capita in 2012, PPP)					
<b>GCC</b>								
Bahrain***	1994	40,241	225%	Banks	Yes	No	Ex post	..
Kuwait	..	..	..	..	..	..	..	..
Oman	1995	39,417	181%	Both	No	No	Ex ante	..
Qatar	..	..	..	..	..	..	..	..
Saudi Arabia	..	..	..	..	..	..	..	..
UAE	..	..	..	..	..	..	..	..
<b>EU27</b>								
<b>EU15</b>								
Austria	1979	100,000	330%	Both	No*	No	Ex post	0.0%
Belgium	1985	100,000	359%	Banks	No*	No	Ex ante	0.4%
Denmark	1987	100,523	342%	Banks	No*	No	Ex ante	0.5%
Finland	1969	100,000	372%	Banks	No*	Yes	Ex ante	0.6%
France	1980	100,000	363%	Banks	No*	Yes	Hybrid	0.1%
Germany	1966	100,000	352%	Banks	No*	Yes	Ex ante	..
Greece	1995	100,000	515%	Banks	No*	Yes	Ex ante	1.7%
Ireland	1989	100,000	334%	Banks	No*	No	Hybrid	0.3%
Italy	1987	103,291	428%	Banks	No*	Yes	Ex post	..
Luxembourg	1989	100,000	156%	Banks	No*	No	Ex post	..
Netherlands	1979	100,000	325%	Both	No*	No	Ex post	..
Portugal	1992	100,000	561%	Banks	No*	Yes	Ex ante	1.1%
Spain	1977	100,000	424%	Banks	No*	No	Hybrid	0.6%
Sweden	1996	100,000	336%	Both	No*	No	Ex ante	0.7%
UK	1982	104,610	408%	Banks	No*	No	Ex post	..

Table 15. Deposit guarantee schemes in the GCC, latest available figures (continued)

	Est. date	Coverage limit		Funding (Public or banks)	Co- insurance	Risk-based premiums	Ex post/ ex ante	Coverage ratio**
		€ (current)	(% of GDP per capita in 2012, PPP)					
<b>NMS12</b>								
Bulgaria	1999	100,215	941%	Banks	No*	No	Hybrid	3.1%
Cyprus	2000	100,000	479%	Banks	No*	No	Hybrid	0.3%
Czech Republic	1994	100,000	531%	Banks	No*	No	Hybrid	0.6%
Estonia	1998	100,000	633%	Banks	No*	No	Ex ante	2.3%
Hungary	1993	100,000	643%	Banks	No*	Yes	Hybrid	0.0%
Latvia	1998	100,000	792%	Banks	No*	Yes	Hybrid	1.0%
Lithuania	1996	100,000	685%	Banks	No*	No	Hybrid	2.0%
Malta	2003	100,000	494%	Banks	No*	No	Ex ante	0.4%
Poland	1995	100,000	655%	Banks	No*	No	Ex ante	0.6%
Romania	1996	100,000	919%	Banks	No*	No	Ex ante	1.8%
Slovakia	1996	100,000	582%	Banks	No*	No	Ex ante	1.6%
Slovenia	1991	100,000	516%	Both	No*	No	Ex post	..

Co-insurance was abolished by Directive 2009/14/EC.

\*\* The current EU27 coverage ratios are calculated as the ratio of ex ante collected funds and eligible deposits using published figures for 2007-8.

\*\*\* The Bahrain Deposit Protection Scheme covers up to 15,000 BHD (approximately 40,000 EUR) and no more than 75% of eligible deposits. Moreover, the total pay-out in a single year is limited to 25 million BHD. It is foreseen to revise the Deposit Protection Scheme to make it an ex ante funded system.

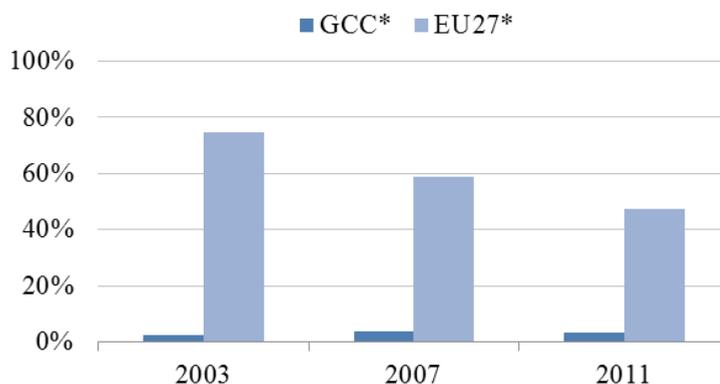
Sources: European Commission, *Impact assessment*, cit., World Bank, Central Bank of Bahrain and Central Bank of Oman.

The deposit insurance scheme index identifies the level of compliance with standards that are thought to mitigate the moral hazard problem. For countries with an explicit system, three issues are relevant: i) whether a co-insurance discount is applicable to pay-outs; ii) whether premiums are risk-adjusted; and iii) whether only banks take a primary role.<sup>157</sup> A point is scored for an affirmative answer to each one of these questions. A score of zero has been assigned to countries where no explicit system exists, since in those cases the government is assumed to provide implicit guarantees, which implies that banks have a greater incentive to take risks.<sup>158</sup> The BRSS surveys have included the questions necessary to construct the index from 2003 onwards.

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<sup>157</sup>The calculation of the deposit insurance scheme index follows the format detailed in James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit., p. 354, except that a score of zero has been assigned to countries with no explicit insurance scheme.

<sup>158</sup>Gropp and Vesala show that credible implicit guarantees operating by means of an expectation of public intervention at times of distress can aggravate the moral hazard problem when compared to explicit deposit guarantee schemes. As the authors note, the key issue is whether the institutional and fiscal conditions make the inherent guarantees credible. It is assumed here that the four countries with no explicit systems – Kuwait, Qatar, Saudi Arabia and United Arab Emirates – have ample fiscal resources and the necessary institutional framework to make such guarantees credible. Reint Gropp and Jukka Vesala, “Deposit Insurance, Moral Hazard and Market Monitoring”, in *Review of Finance*, Vol. 8, No. 4 (2004), p. 571-602. Also publ. in *ECB Working Paper Series*, No. 302 (February 2004), <http://www.ecb.int/pub/pdf/scpwps/ecbwp302.pdf>.

**Table 16. Deposit insurance index (% of maximum score)**

	2003	2007	2011
Bahrain	67	67	67
Kuwait	0	0	0
Oman	0	0	0
Qatar	0	0	0
Saudi Arabia	0	0	0
UAE	0	0	0
<b>GCC*</b>	<b>2</b>	<b>4</b>	<b>3</b>
EU15*	75	59	48
NMS12*	66	58	37
<b>EU27*</b>	<b>75</b>	<b>59</b>	<b>48</b>
<b>AVG</b>	<b>74</b>	<b>58</b>	<b>47</b>
<b>STDEV</b>	<b>29</b>	<b>19</b>	<b>24</b>

*Note:* Higher values represent more restrictive rules, as a share of a maximum score of 3 points.

\* Regional averages are weighted by total banking assets. See Annex 17 for the scores of the individual EU Member States.

*Sources:* BRSS, European Commission, *Impact assessment*, cit., World Bank, Central Bank of Bahrain and Central Bank of Oman.

Table 16 shows that moral hazard due to implicit guarantees are more of a threat in the GCC countries. For the most part, this is due to the absence of explicit deposit guarantee schemes in Kuwait, Qatar, Saudi Arabia and the UAE. A poorly-designed scheme can invite additional risks, and may be no better than a system with no scheme at all. The Omani scheme, for instance, might amplify the risk of moral hazard. Although it has an explicit deposit guarantee scheme, it does not give a better score. In addition to the facts that there is no co-insurance and that the premium is not risk-based, the central bank contributes one-third

of funds. The remaining GCC deposit guarantee scheme, that of Bahrain, gives positive answers to two of the questions outlined above, but does not require banks to pay a risk-based premium.

All EU Member States have an explicit deposit guarantee scheme. However, this does not mean that there is no moral hazard. In almost 20% of Member States, banks are not exclusively responsible for funding, and just over 70% of Member States do not have a risk-based contribution. Yet, no Member State requires small depositors to absorb part of the losses. This is a consequence of an amendment adopted in 2009 that *de facto* abolished co-insurance in the EU. In 2007, almost half of the EU27 still allowed up to 10% of losses to be shared with covered depositors. This change in regulation is reflected in an increase in the risk of moral hazard.

In the aftermath of the financial crisis, deposit guarantee schemes in the EU might be further harmonised. In 2010, the European Commission adopted a proposal foreseeing a risk-based bank-funded deposit guarantee scheme. However, the legislative act has not been adopted, since the European Parliament and the Council have not been able to agree on the final terms.

These results, however, should be interpreted with care. As the recent financial crisis has shown, when a run on a bank has the potential to create broader panic, governments and central banks are likely to step in to stop it, notwithstanding the type of explicit arrangements in place.<sup>159</sup> One may wonder, quite justifiably, whether any given arrangement really does mitigate moral hazard when it may so easily be replaced with limitless state support.

### 3.1.2.6. Area VI: Private monitoring

Most of the regulatory factors considered in this chapter relate to the rules and standards set out by regulators, which are used to distinguish between acceptable and unsound behaviour. Regulatory principles are often well-defined, calling for compliance with specific rules or standards. However, market forces and investors may also be crucial in shaping decisions and, in particular, restraining risky behaviour. Debtors or stockholders use available information to assess a bank's condition and indirectly influence the management by withdrawing funds, which has an impact on the borrowing costs of banks.

The availability of reliable and timely information to investors is at the core of market discipline. The private monitoring index is therefore based on the survey responses to a number of questions on disclosure rules and standards, including whether: i) a certified audit is required; all of the top ten banks are rated by ii)

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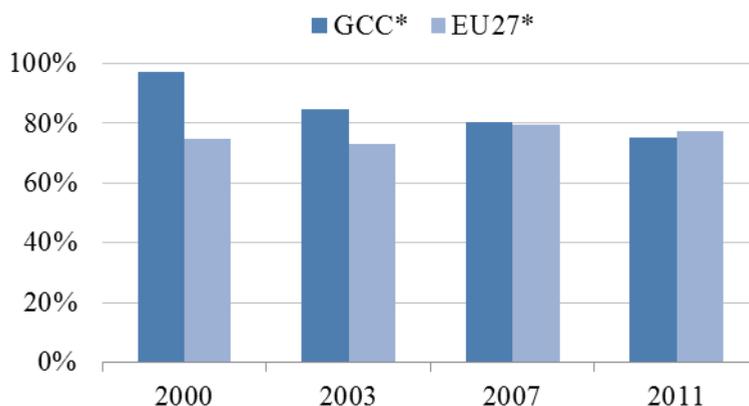
<sup>159</sup> This was amply demonstrated during the Northern Rock crash of 2007, when the UK Treasury extended the existing guarantees on bank deposits – with a maximum payout of £31,700 at the time – to cover all deposits.

domestic or iii) international credit rating agencies; income standards include accrued though unpaid interest on iv) performing or v) non-performing loans; vi) banks are required to produce consolidated accounts; vii) directors are liable for erroneous or misleading reporting; viii) subordinated debt is allowable or required as part of capital; ix) off-balance items are disclosed to the public; x) banks are required to disclose risk management procedures; and xi) supervisors are required to make enforcement action public.<sup>160</sup> The private monitoring score increases with each affirmative answer to each of these questions.

Table 17 shows a clear convergence between the GCC countries and the EU27. The initial disparities between both regions have diminished in the past decade; private monitoring in the GCC countries has gradually decreased, whereas it has remained constant in the EU27.

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<sup>160</sup> The private monitoring index is addressed by WBG questions 3.5-6, 5.1, 5.3, 10.1, 10.1.1, 10.3, 10.4.1, 10.5, 10.6, 10.7.1-2, and 11.1.1. The calculation of the index is slightly different from the specification in Appendix 2 to James R. Barth, Gerard Caprio and Ross Levine, *Rethinking Bank Supervision and Regulation*, cit., p. 350-352, in that it excludes a question on the presence of explicit deposit insurance, which is covered by another index.

**Table 17. Private monitoring (% of maximum score)**

	2000	2003	2007	2011
Bahrain	89	64	82	91
Kuwait	100	91	82	82
Oman	89	82	55	64
Qatar	78	73	..	73
Saudi Arabia	100	82	82	..
UAE	..	91	..	73
<b>GCC*</b>	<b>97</b>	<b>85</b>	<b>80</b>	<b>75</b>
EU15*	75	73	80	77
NMS12*	67	69	69	75
<b>EU27*</b>	<b>75</b>	<b>73</b>	<b>80</b>	<b>77</b>
<b>AVG</b>	<b>75</b>	<b>73</b>	<b>80</b>	<b>77</b>
<b>STDEV</b>	<b>12</b>	<b>13</b>	<b>10</b>	<b>11</b>

*Note:* Higher values represent greater monitoring, as a share of a maximum score of 9 points for 2000, and 11 points for 2003, 2007 and 2011.

\* Regional averages are weighted by total banking assets. See Annex 18 for the scores of the individual EU Member States.

*Source:* BRSS.

There are broad similarities between the GCC countries and the EU27 at the regional level, although there are differences between the levels of private monitoring in the individual countries. The share of the top ten banks that are rated by (international or domestic) credit rating agencies varies widely, for instance. In the EU27 countries, about 30% of the top ten banks are rated by an international rating agency, and only in Greece, France and Poland are all top ten banks are rated by a domestic rating agency. In none of the GCC countries are all

top ten banks rated by a domestic rating agency, but in half of them the top ten banks are rated by international agencies. The differences between countries are, in some cases, due to the inherent structure of the market.

Another common issue, especially more recently, is the exclusion of accrued (though unpaid) interest from income statements, which allows banks undue flexibility in determining their earnings. Finally, according to the 2011 BRSS survey, bank regulators/supervisors in Bahrain, Cyprus, Denmark, Hungary, Ireland, the Netherlands, Poland, Slovakia, and the UK are required to make their risk management procedures public.

These results show that the regulatory structures of the GCC countries have converged with those of the EU27, and that there are broad similarities between the regions. For example, a certified audit is compulsory in all of the sample countries, and accounting rules exhibit similarities in most of the countries.

### 3.1.2.7. Area VII: Credit information and laws

Access to information and creditor protection laws are crucial for ensuring the smooth operation of credit markets. Economic theory suggests that two factors in particular limit the amount of credit that financial institutions will lend to potential borrowers. On the one hand, credit conditions are clearly influenced by the ability of creditors to enforce contracts, require repayment, claim collateral and possibly gain control over receivables. The easier these actions, the more likely lenders are to make loans. On the other hand, lenders would like to have access to accurate information on potential borrowers, such as credit histories, other lenders and other banking transactions.

Theoretical models suggest that an operational information-sharing infrastructure can reduce adverse selection in credit markets and facilitate access to credit, especially among more opaque borrowers such as small and medium-sized enterprises (SMEs).<sup>161</sup> When such information is available, creditors can make a better judgement of the creditworthiness of borrowers. Other studies have documented the importance of creditors' rights to the availability of credit.<sup>162</sup> Recent studies have confirmed these views with increasingly convincing evidence that both credit information mechanisms and creditors' rights have a non-trivial impact on the flow of credit and financial development.<sup>163</sup>

<sup>161</sup> Marco Pagano and Tullio Jappelli, "Information Sharing in Credit Markets", in *The Journal of Finance*, Vol. 48, No. 5 (December 1993), p. 1693-1718, <http://www.csef.it/pagano/jf-1993.pdf>.

<sup>162</sup> Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, "Law and Finance", in *Journal of Political Economy*, Vol. 106, No. 6 (December 1998), p. 1113-1155; Ross Levine, "The Legal Environment, Banks, and Long-Run Economic Growth", in *Journal of Money, Credit, and Banking*, Vol. 30, No. 3 (August 1998), p. 596-613, [http://faculty.haas.berkeley.edu/ross\\_levine/Papers/1998\\_JMCB\\_Legal%20Environ%20LR%20Growth.pdf](http://faculty.haas.berkeley.edu/ross_levine/Papers/1998_JMCB_Legal%20Environ%20LR%20Growth.pdf).

<sup>163</sup> Tullio Jappelli and Marco Pagano, "Information Sharing, Lending and Defaults: Cross-Country Evidence", in *Journal of Banking and Finance*, Vol. 26, No. 10 (October 2002), p. 2017-2045;

The credit information and laws indices developed in this subsection are based on the Getting Credit methodology developed in the World Bank's Doing Business surveys.<sup>164</sup> The relevant area covers the legal rights of borrowers and lenders with respect to secured transactions and the extent of credit information sharing. Two sets of indicators are used for these purposes.

The first set describes how well collateral and bankruptcy laws facilitate lending, covering: i) the ability to use moveable assets while keeping possession of assets; the ability to obtain non-possessory security rights in ii) a single or iii) all moveable asset classes without requiring a specific description of the collateral; iv) the extension of security rights to future or after-acquired assets; v) the ability to secure all types of debts and obligations via a general description; vi) the availability of a collateral registry; the ability of secured creditors to obtain priority without exception in the case of vii) defaults, viii) liquidations, and ix) restructuring; and x) the possibility of out-of-court agreements on collateral enforcement. An affirmative answer to any of these questions adds to the relevant score.<sup>165</sup>

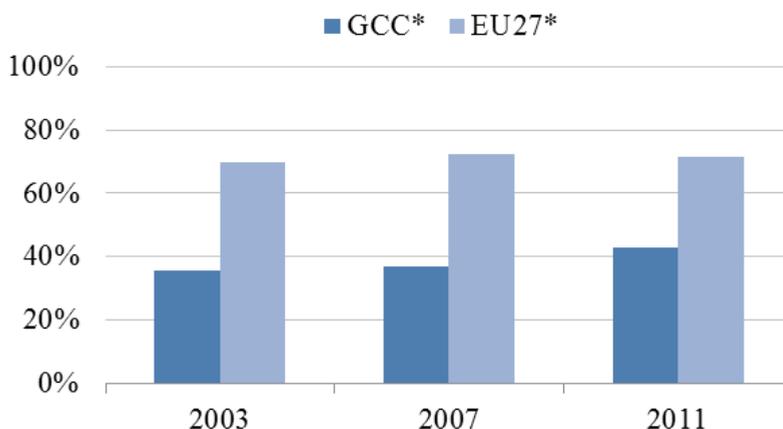
Table 18 shows that the legal rights granted to creditors are fewer in the GCC countries; security rights to future or after-acquired assets can be extended only in the UAE, and the possibility to obtain possessory security rights in a single or all moveable asset classes without a specific description of the collateral is only provided for in Saudi Arabia, Kuwait and the UAE. In contrast, this is much more common in the EU27 countries, while the UK and Latvia provided affirmative answers to all questions.

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Simeon Djankov, Caralee McLiesh and Andrei Shleifer, "Private Credit in 129 Countries", in *Journal of Financial Economics*, Vol. 84, No. 2 (May 2007), p. 299-329; Rainer Haselmann, Katharina Pistor and Vikrant Vig, "How Law Affects Lending", in *The Review of Financial Studies*, Vol. 23, No. 2 (February 2010), p. 549-580.

<sup>164</sup> First started in 2003, the World Bank's Doing Business surveys cover over 180 countries, providing a snapshot of regulatory and legal conditions and their effects on businesses, especially SMEs. Each year, the surveys are sent out to a large number of local experts specialising in different fields, including lawyers, consultants, officials and other professionals who are in close contact with the legal and regulatory structures of the countries covered. The results of the surveys are available at <http://www.doingbusiness.org>.

<sup>165</sup> See the World Bank's Doing Business website for further details of the methodology: <http://www.doingbusiness.org/methodology/getting-credit>.

**Table 18. Strength of legal rights (% of maximum score)**

	2003	2007	2011
Bahrain	..	40	40
Kuwait	40	40	40
Oman	40	40	40
Qatar	40	40	40
Saudi Arabia	30	30	50
UAE	40	40	40
<b>GCC*</b>	<b>36</b>	<b>37</b>	<b>43</b>
EU15*	70	72	71
NMS12*	75	75	77
<b>EU27*</b>	<b>70</b>	<b>73</b>	<b>72</b>
<b>AVG</b>	<b>69</b>	<b>72</b>	<b>71</b>
<b>STDEV</b>	<b>27</b>	<b>22</b>	<b>23</b>

*Note:* Higher values represent stronger rights, as a share of a maximum score of 10 points.

\* Regional averages are weighted by total banking assets. See Annex 19 for the scores of the individual EU Member States.

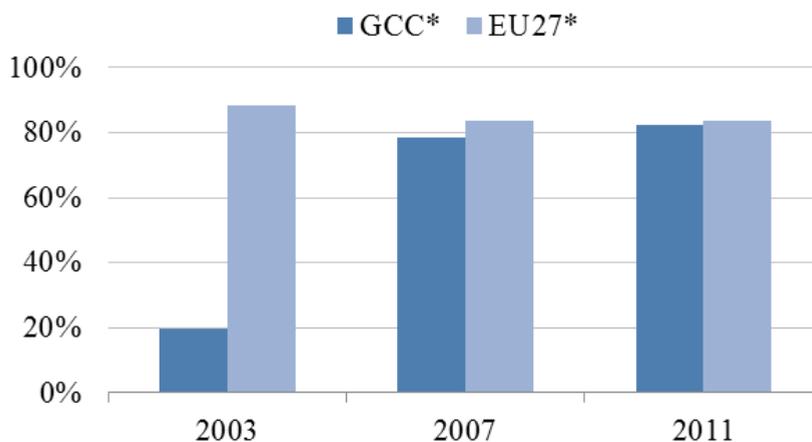
*Source:* World Bank Doing Business surveys.

The second index measures the availability, coverage and depth of credit information provided through either public credit registries or private credit bureaus. The relevant questions relate to: i) the collection of both positive and negative information; ii) the collection of data on both firms and individuals; iii) the collection of data from retailers and utility companies; iv) the availability of a credit history for at least two years; v) the availability of data on small loans (i.e. less than 1% of annual income); and vi) the ability of borrowers to access

their credit history. As above, an affirmative answer to any one of these questions adds a score to the credit information index.

Table 19 clearly shows that the GCC countries have progressively closed the gap with the EU27 in terms of the depth of credit information. The average score of the GCC countries is almost as high as that of their EU27 counterparts. In recent years, the credit bureaus in Oman, Qatar, Saudi Arabia and the UAE have substantially improved their provision of information. In the recent Doing Business surveys, Saudi Arabia even satisfied all six criteria, while the credit bureaus in Oman and the UAE only fail to distribute credit information from non-financial institutions. The Qatari public credit bureau does not provide credit information from non-financial institutions, and there is no legal guarantee that borrowers can inspect their data. In addition to the absence of such a guarantee, the private credit bureau in Kuwait only provides credit information on customers. The private credit bureau in Bahrain neither guarantees borrowers the possibility to inspect their credit profile nor provides credit information from firms or non-financial institutions.

The large majority of the EU27 countries report similar scores to those of the GCC countries, with Cyprus, Luxembourg and Malta the only clear exceptions. In Cyprus, the private credit bureau only meets two criteria, and in Luxembourg and Malta there are no credit bureaus at all. More broadly, the other EU27 countries comply with almost all the criteria. Like many of their GCC counterparts, the credit registries in two-thirds of the EU27 countries do not collect information from retailers or utility companies. Moreover, in almost half of the EU27 countries, the credit bureaus do not provide both positive and negative information and/or distribute a credit history of more than two years. Finally, in contrast to the GCC countries, all credit registries in the EU27 are legally obliged to offer borrowers the possibility to inspect their data.

**Table 19. Depth of credit information (% of maximum score)**

	2003	2007	2011
Bahrain	..	50	50
Kuwait	50	67	67
Oman	..	33	83
Qatar	0	33	67
Saudi Arabia	0	100	100
UAE	33	83	83
<b>GCC*</b>	<b>20</b>	<b>78</b>	<b>82</b>
EU15*	89	84	84
NMS12*	66	73	75
<b>EU27*</b>	<b>89</b>	<b>84</b>	<b>84</b>
<b>AVG</b>	<b>88</b>	<b>84</b>	<b>83</b>
<b>STDEV</b>	<b>18</b>	<b>22</b>	<b>21</b>

*Note:* Higher values represent deeper information, as a share of a maximum score of 6 points.

\* Regional averages are weighted by total banking assets. See Annex 20 for the scores of the individual EU Member States.

*Source:* World Bank Doing Business surveys.

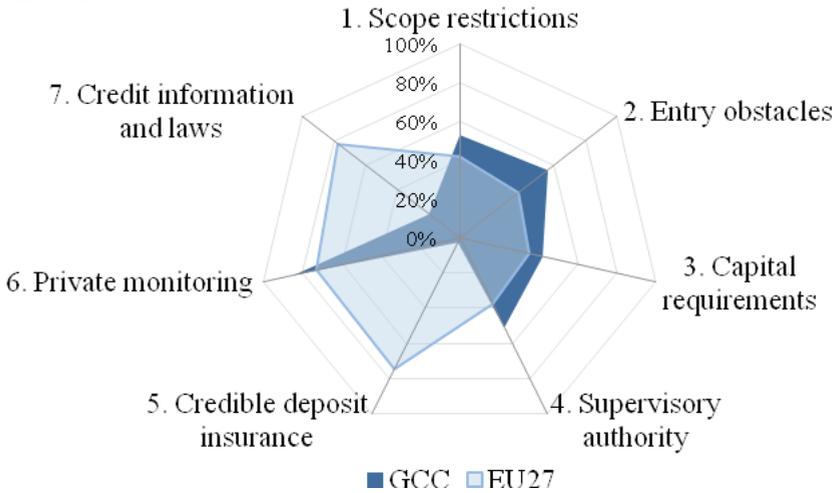
To sum up, the figures above show that substantial reforms in recent years have clearly helped the GCC countries to close the gap with the EU27 in terms of the use of credit information. The same cannot be said concerning the strength of legal rights; the EU27 average here is clearly higher than that of the GCC countries.

3.1.2.8. Results

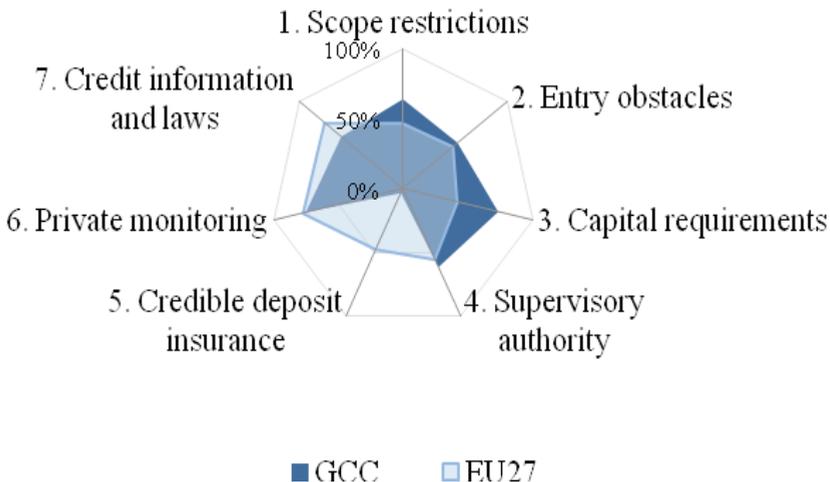
The previous subsections reviewed the quality of the regulatory and supervisory structures of the GCC countries and the EU27, and their level of convergence. The assessment included seven dimensions: the scope of banking; entry obstacles; the stringency of capital requirements; the power and independence of the supervisory authorities; incentives provided by deposit insurance schemes; private monitoring; and creditors' rights and access to information. Figure 29 and Table 20 summarise the key weaknesses that distinguish the GCC countries from the EU27.

Fig. 29. Regulatory standards in the EU and the GCC

**2003**



**2011**



*Note:* The figures above sum the GCC and EU27 weighted averages for the regulatory indices in each of the seven areas discussed in Subsection 3.1.2.

The collective assessment of the convergence of the regulatory and supervisory structures of the GCC countries with EU27 standards gives a mixed picture. Despite some improvements, key weaknesses remain in deposit insurance, entry obstacles and the strength of legal rights. Other disparities have also become more apparent, especially as regards capital requirements.

The deposit insurance index has failed to improve in recent years as the authorities in Kuwait, Qatar, Saudi Arabia and the UAE have chosen not to put in place an explicit insurance scheme. Implicit schemes may enhance risk-taking through a blanket government guarantee for the leading institutions. Moreover, no effort has been made in Oman to align banks' incentives by implementing risk-based premiums or co-insurance schemes, which would help to internalise some of the costs to deposit guarantee schemes of excessive risk-taking.

Table 20. Key regulatory weaknesses in the GCC

	Description	General remarks	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
AREA I. Scope restrictions	Restrictions on or prohibition of various activities	Slightly more stringent than EU27 standards	Insurance activities prohibited	Some restrictions on insurance activities	Insurance activities restricted; real estate activities prohibited	Some restrictions on securities trading & insurance activities; real estate activities prohibited	Some restrictions on securities trading; insurance restricted; real estate activities prohibited	Insurance & real estate activities prohibited
AREA II. Entry obstacles	Licensing, foreign entry & presence of public banks	Below EU27 standards due to foreign denials & the role of government	Foreign denials	Foreign denials		No foreign applications, Public banks represent >40% of banking activity	Public banks represent about 20% of banking activity	Public banks represent almost 50% of banking activity
AREA III. Capital requirements	Extent to which capital requirements restrict risks	More stringent and higher minimum capital requirements than the EU27	Borrowed funds can be used to disburse initial capital		Borrowed funds can be used to disburse initial capital			
AREA IV. Supervisory authorities	Ability of supervisors to prevent & correct problems	Supervisors have slightly more power and independence than in the EU27	Some potential for interference	Some potential for interference	High potential for political interference	Some potential for interference	Some potential for interference	Some potential for interference
AREA V. Deposit insurance	Presence of an explicit scheme & mitigation of moral hazard	Below EU27 standards due to implicit insurance & adverse incentives	No co-insurance or risk-adjusted premiums	No explicit deposit insurance scheme	No co-insurance or risk-adjusted premiums; co-funded	No explicit deposit insurance scheme	No explicit deposit insurance scheme	No explicit deposit insurance scheme
AREA VI. Private monitoring	Availability of reliable & timely information to investors	Similar to the EU27		No disclosure of enforcement action	Flexibility in accounting rules, no disclosure of enforcement action	No disclosure of enforcement action	No public disclosure of risk management	No disclosure of enforcement action
AREA VII. Credit info. & laws	Ability of legal & information systems to facilitate lending	Below EU27 standards due to deficient legal rights	Limited legal rights for creditors; no public credit register; private register has limited coverage and borrowers have no access to it	Limited legal rights for creditors; no public credit register; private register has limited coverage and borrowers have no access to it	Limited legal rights for creditors; no private credit register & public register has no information on credit distributed by non-financials	Limited legal rights for creditors; no private credit register; public register has limited coverage and borrowers have no access to it	Limited legal rights for creditors; no public credit register	Limited legal rights for creditors; no information on credit distributed by non-financials

Another major issue, the presence of entry obstacles, continues to be a key weakness of the regulatory structures of the GCC region. Although the licensing requirements exhibit similarities in both the GCC countries and the EU27, other indicators point to substantial barriers to entry. Government ownership, which is widespread in the region, gives undue advantages to incumbent banks and restricts entry incentives. In Qatar and the UAE, as well as to some extent in Saudi Arabia, government ownership remains significant. Although government ownership may have some benefits, the authorities have to ensure that roles are well-defined within a national strategy with clear objectives and instruments, and that it does not become an obstacle to the development of the financial system.<sup>166</sup> The rates of foreign denials are also high, further supporting the idea of substantial entry barriers and competitive advantages enjoyed by domestic incumbent banks.

In addition to the two key weaknesses summarised above, the GCC countries fall short in terms of legal rights. Less stringent legal rights reduce the ability of creditors to enforce contracts, require repayment, claim collateral and gain control of receivables, making it less attractive to make loans.

The GCC countries have implemented a number of reforms to improve the availability and use of credit information by financial institutions. Qatar and Saudi Arabia have established public and private credit bureaus respectively in recent years. Moreover, while the score of the private credit bureau in Bahrain has remained unchanged, the private credit bureaus in Kuwait, the public bureau in Oman and the private as well as public bureaus in the UAE have all improved the depth of credit information. The GCC countries have thus almost closed the gap with the EU27. Although the literature provides little guidance, private credit bureaus have improved access to new technologies and know-how to ensure that information-sharing mechanisms work effectively. The countries in the GCC region should continue to monitor developments and spearhead innovative systems to use the stock of information and infrastructure already set up by the public systems.

Finally, there is a large difference in the strength and level of capital requirements between the GCC and the EU27. All of the GCC countries, except Saudi Arabia, require banks to hold more capital than the 8% minimum required under the Basel accords. The implementation of Basel II in the GCC countries is reflected in rising capital stringency scores. Increasing the levels of and strength-

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<sup>166</sup> Rocha et al. note the essential role that public banks play in the region by providing financing to SMEs. The authors note that private banks are unable to fill this gap largely due to the generally weak quality of financial infrastructure, including the availability and reliability of information on potential borrowers. Roberto Rocha et al., "The Status of Bank Lending to SMEs in the Middle East and North Africa Region: The Results of a Joint Survey of the Union of Arab Bank and the World Bank", in *World Bank Policy Research Working Papers*, No. 5607 (March 2010), <http://dx.doi.org/10.1596/1813-9450-5607>.

ening capital requirements has an ambiguous effect. On the one hand, bank efficiency is decreased due to an increase in the cost of capital. On the other hand, the higher loss absorption capacity enhances financial stability. The Basel II minimum requirements proved to be insufficient to safeguard global financial stability during the financial crisis in 2008-9. Under the new Basel III Accord, the balance therefore shifts to higher minimum requirements. Since these accords will also be implemented by the EU27, the capital requirements in the two regions are expected to converge soon.

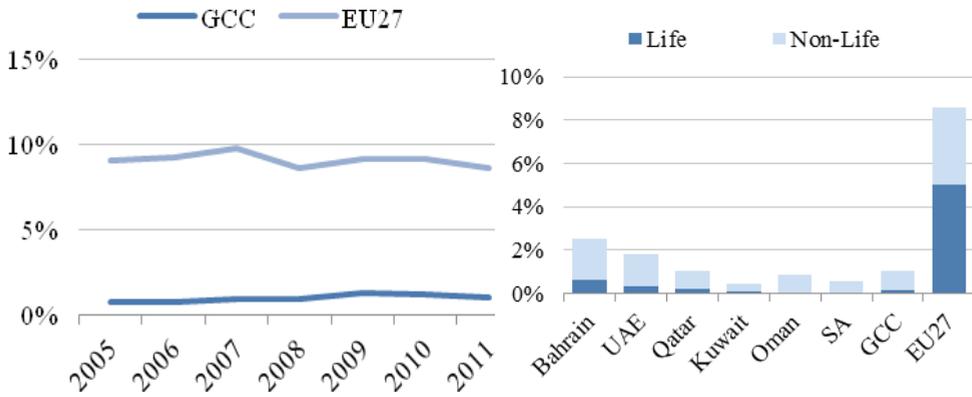
### 3.2. OVERVIEW OF THE STRUCTURE AND REGULATION OF THE INSURANCE SECTOR IN THE GCC COUNTRIES

In high-income, natural resource-oriented economies like the GCC countries, a developed insurance sector is a prerequisite for a robust and diversified economy. It removes tail risks from businesses and enhances risk allocation. If premiums are retained domestically, further expansion of the sector can also provide financial markets with attractive and diverse assets and decrease the overall risk premiums on credit thanks to collateral and default insurance products. In many respects, the need for developed insurance markets is in line with the long-term goals of the GCC. The general recurrent picture of the GCC countries' insurance industries, however, is one of insufficiently regulated markets with extremely low penetration rates and high growth potential. At a closer look, this depiction becomes too simplistic, since it ignores recent developments, competition-related issues and the challenges of future regulatory and enforcement adjustment, as well as the potential structural limits of the regional insurance markets. In terms of convergence with the mature insurance markets of the EU27, a set of structural, regulatory and cultural challenges exists which is unlikely to disappear in the medium term.

#### *3.2.1. Development of the insurance industry in the GCC*

With an annual increase of approximately 20%, insurance premiums have been growing faster than GDP and populations in the past eight years, effectively increasing penetration and density levels, although the expansion of insurance markets in terms of premiums can be misleading considering the extremely low base and the virtual non-existence of domestically-based insurers at the turn of the century. What appears to be solid growth could also be interpreted as a very steady catch-up with countries with comparable incomes (Figure 30).

**Fig. 30. Insurance premiums in the EU and the GCC (ratio of total premiums to GDP)**



Note: Numbers for Bahrain in 2005 and 2006 and Qatar in 2008 and 2009 are estimates. Penetration levels denote the ratio of total premiums to GDP.  
Sources: Swiss Re, CEPS.

Although insurance densities (premiums per capita) in the GCC countries are higher than in other emerging economies<sup>167</sup> and are, on average, comparable with the NMS12, they remain extremely low relative to the EU15, reflecting an extremely low insurance penetration (the ratio of premiums to GDP). The entire insurance market of the GCC countries is lower than that of Portugal and between five to six times lower than that of Spain, with a similar population size. When compared to countries with developed mandatory private insurance policies, the contrast is even more striking. For example, in the Netherlands – with a population of roughly one third of the GCC region – the overall volume of insurance premiums is more than seven times higher.<sup>168</sup> The insurance sector is also unevenly distributed within the GCC region, with the two major markets in the region (UAE and Saudi Arabia) together generating approximately 80% of all insurance premiums. The concentration of life insurance business is even higher, with the UAE being the only major player.

Recent high GDP growth has been one of the most important factors determining the perceived potential of insurance markets in the region,<sup>169</sup> but other characteristics of the GCC countries also point to a significant potential for future growth. The demographic composition and future dynamics of the market

<sup>167</sup> Latin America, Central and Eastern Europe, South and East Asia, the Middle East (excluding Israel) and Central Asia, Turkey, and Africa.

<sup>168</sup> Thomas Seiler, Daniel Staib and Mahesh Puttaiah, “World insurance in 2012”, in *Swiss Re Sigma*, No. 3/2013, [http://www.swissre.com/r/sigma3\\_2013\\_en.pdf](http://www.swissre.com/r/sigma3_2013_en.pdf).

<sup>169</sup> Cyril Garbois and Alexander von Pock, “Insurance in the GCC”, in *Ideas and Insights*, June 2010, [http://www.atkearney.it/financial-institutions/ideas-insights/article/-/asset\\_publisher/LCcgOeS4t85g/content/insurance-in-the-gcc/10192](http://www.atkearney.it/financial-institutions/ideas-insights/article/-/asset_publisher/LCcgOeS4t85g/content/insurance-in-the-gcc/10192).

– most importantly, the proportion of the pre-active population about to enter the labour market – is exceptionally high when compared to other high-income countries. The majority of the region’s population is younger than 25 and is set to remain so until at least 2020. The population is set to grow by 12 million – or 29% – between 2010 and 2020.<sup>170</sup> As the young population is expected to enter labour markets with an enhanced understanding of financial products, growth rates are likely to accelerate in the upcoming years.

Governments across the GCC region are also implementing spending programmes to support infrastructure development. Saudi Arabia, Kuwait and Qatar have large-scale medium-term development programmes focusing on economic diversification. Due to the existence of national insurance or large captive schemes dealing with the risks related to the oil industry and many auxiliary (mostly engineering) services, economic diversification as well as privatisation are crucial drivers of general-access insurance markets in the GCC countries, although with little prospect of increasing life insurance rates.

**Table 21. Distribution of insurance markets**

	Insurance premiums (€ millions, 2011)			Insurance penetration (premiums to GDP, 2011)			Insurance density (€ per capita, 2011)		
	Total	Life	Non-life	Total	Life	Non-life	Total	Life	Non-life
Bahrain	416	106	310	2.41%	0.62%	1.80%	414	106	308
Kuwait	583	133	450	0.52%	0.12%	0.40%	290	66	224
Oman	551	108	443	1.14%	0.22%	0.92%	274	54	220
Qatar	691	39	652	0.53%	0.03%	0.50%	534	30	504
Saudi Arabia	3,571	208	3,364	0.86%	0.05%	0.81%	177	10	167
UAE	4,771	881	3,890	1.81%	0.33%	1.48%	1,384	255	1,128
<b>GCC</b>	<b>10,583</b>	<b>1,474</b>	<b>9,109</b>	<b>1.07%</b>	<b>0.15%</b>	<b>0.92%</b>	<b>353</b>	<b>49</b>	<b>304</b>
EU15	1,043,487	618,283	425,203	8.97%	5.31%	3.65%	2,652	1,570	1,082
NMS12	32,192	14,193	17,999	3.25%	1.43%	1.82%	333	147	186
EU27	1,075,679	632,476	443,202	8.52%	5.01%	3.51%	2,165	1,273	892

Sources: Swiss Re and CEPS.

Despite the large number of positive factors in favour of growth in the region, there are also specific reasons for scepticism concerning the long-term potential of the GCC countries’ insurance markets. Savings rates are extremely high in the region, and many households retain large asset buffers and therefore feel low incentives to insure their lives and property. This could be a major hin-

<sup>170</sup> EIU, *The GCC in 2020. The Gulf and its People*, London, Economist Intelligence Unit (EIU), September 2009, p. 5, <http://graphics.eiu.com/upload/eb/Gulf2020part2.pdf>.

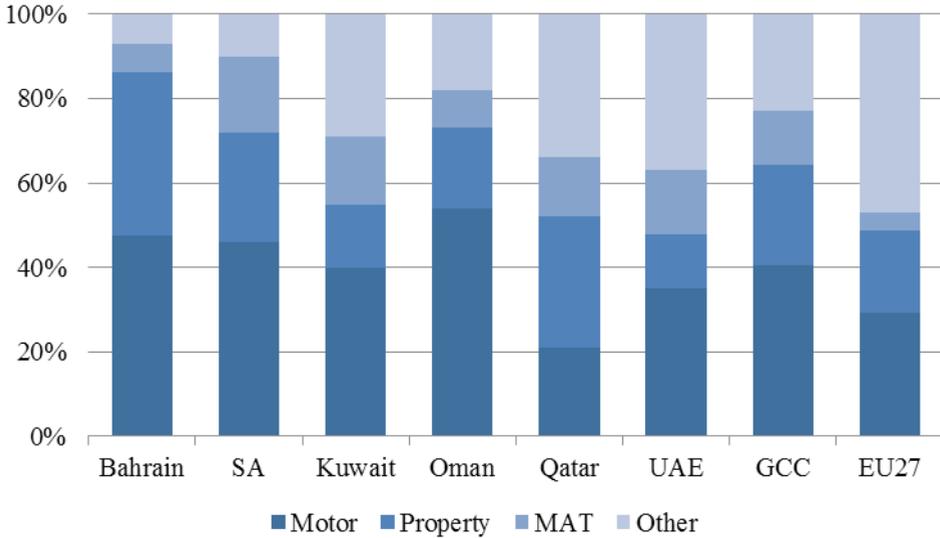
drance to the long-term development of insurance markets, as there appears to be a trade-off between savings and insurance.<sup>171</sup> The region is also away from major hurricane and earthquake areas, with the exception of Oman as regards the former. Weather extremes are also very rare. There may therefore be natural and cultural limits to the perceived need for insurance due to the low natural and political extremes of the GCC countries (in contrast to other MENA countries). Moreover, changing the approach towards insurance and overall awareness could take generations.

One of the particular and potentially important idiosyncrasies of the GCC countries' insurance markets is the low share of life insurance. While non-life insurance penetration is almost comparable to NMS12 (Table 15), life insurance has been, until recently, virtually non-existent in some GCC countries. This is in a stark contrast to the rest of the world, where life insurance clearly dominates. The non-life insurance sector tends also to be dominated by motor insurance, which is the only insurance line which is compulsory across the region. The dominance of motor insurance is even more important when the lower premiums for life insurance are taken into account. When compared to the EU27, the major difference in non-life insurance composition is the relatively lower development of insurance lines related to general liability, accident and legal expenses ("Other" in Figure 31).

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<sup>171</sup> Timothy Besley, "Savings, credit and insurance", in Jere Behrman and T.N. Srinivasan (eds.), *Handbook of Development Economics*, Amsterdam, North-Holland, 1995, p. 2123-2207.

Fig. 31. Non-life insurance by type



Note: MAT refers to approved marine, aviation and transit insurance.  
Sources: World Bank, Insurance Europe.

Another, and maybe the most important, characteristic of the GCC countries' insurance markets is the persistently high cession rates. Although the markets could have not developed at such a pace without the involvement of reinsurers,<sup>172</sup> retention rates are strikingly low compared to the rest of the world. On average, the GCC markets cede 46% of their premiums (compared with 8% in the rest of the world). Cession rates in all GCC countries exceed 40%, and even exceed 50% in Qatar and Oman.<sup>173</sup>

Cession rates at these levels are both a symptom of a deficient market and a reason for its low potential. Low retention rates mean that along with ceded risks, margins and profitability are also passed on to global reinsurance players. The bulk of the industry in the region could therefore be considered to be operating as sophisticated brokers, rather than fully-fledged insurers.<sup>174</sup> It also paints a rather negative picture of the region's capacity to deal with risks internally. Actuary and underwriting capacity in the region appears, on average, to

<sup>172</sup> Mark Jeffrey, "The future of insurance in MENA", in *Middle East Insurance Review*, Vol. 7, No. 10 (October 2012).

<sup>173</sup> Stephen Ballantine, "Class Update - Liability: GCC medical malpractice insurance: Risk versus reward", in *Middle East Insurance Review*, Vol. 7, No. 7 (July 2012).

<sup>174</sup> Rodney Lester, "The Insurance Sector in the Middle East and North Africa: Challenges and Development Agenda", in *World Bank Policy Research Working Papers*, No. 5608 (March 2011), <http://dx.doi.org/10.1596/1813-9450-5608>.

be unable to compete with foreign players due to cost effectiveness and limited skill availability. It is therefore more rational for companies to cede their premiums and act effectively as brokers for insurance deals. This, however, raises problems of risk-allocation in the market, since there is less incentive for correct underwriting. It also prevents insurance markets from serving as financial diversifiers, limiting the positive externalities of insurance penetration, most importantly in respect to other sectors of the financial markets.

Another reason for high cession rates is the ongoing struggle for market share. Many companies are not keen to invest in the short term to develop their actuarial and underwriting capacity lest they compromise their immediate market position. Some commercial insurers therefore cede up to 90% of their commercial portfolios. Low retention rates are also linked to the fact that non-life lines prevail in the region, as life insurance tends to have higher retention rates. Overall, it can be assumed that profitability in the region will remain low until underwriting becomes cost-efficient and retention rates rise, but dependence on reinsurers is unlikely to decrease soon, unless there is market consolidation or an abrupt rise in the availability of highly-skilled individuals.<sup>175</sup>

The great potential for growth has naturally attracted a large set of domestic and international players. An increasing number of foreign insurers have registered with the local authorities over the past five years, sometimes despite elevated entry expenses. By 2011, approximately 180 insurance players were competing for a market of less than €11 billion.<sup>176</sup> Although it is not high in absolute terms, considering the nominal amount of premiums, the number of insurance players in the region is relatively high, and is a matter of concern for both regulators and businesses. The only insurance market in the GCC countries that appears to be relatively consolidated is that of Qatar, where only nine insurers were operating as of 2010. This is in contrast to the UAE, with 57 insurers, and the other GCC countries, with between 23 and 36 registered insurers (Table 22).

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<sup>175</sup> Amany Elmahy, "Reinsurance in MENA: Ready for change?", in *Middle East Insurance Review*, Vol. 7, No. 11 (November 2012).

<sup>176</sup> Alpen Capital, *GCC Insurance Industry Report 2011*, 21 August 2011, <http://www.alpencapital.com/Me-insurancegcc.htm>.

**Table 22. Number of active insurers (excluding reinsurers), 2010**

	Total	Life	Non-life	Composite	Concentration ratio (top 3)
Bahrain	36	3	29	4	29%
Kuwait	29	2	14	13	..
Oman	23	2	12	9	22%
Qatar	9	0	6	3	65%
Saudi Arabia	26	..	..	..	53%
UAE	57	..	..	..	21%
<b>GCC (average)</b>	<b>30</b>	<b>2</b>	<b>15</b>	<b>7</b>	<b>34%*</b>
EU27 (average)	..	43	106	..	56%***

Notes: \*Weighted by premiums. \*\*Top five concentration.

Sources: Insurance Europe, Alpen Capital.

The high level of competition in the market has led to aggressive pricing. To compensate for this, insurers tend to be rather under-capitalised, raising doubts about their overall solvency. The under-pricing also induces losses or very low margins. As mentioned above, companies subsequently lack resources for further investment or the creation of appropriate underwriting and actuarial capacities within the region. This leads to high cession rates, effectively causing a flight of potential profit margins abroad.<sup>177</sup> In order to force rationalisation upon the markets, some jurisdictions have adopted temporary moratoria on granting new licences (such as the UAE since 2008), or limitations on foreign direct ownership for markets outside the financial centres; while Saudi Arabia and Oman limit foreign ownership of insurance companies to 25% and 70% respectively, Qatar and Kuwait forbid foreign shareholding in local insurance companies operating outside the financial centres,<sup>178</sup> which clearly discourages the entry of multinationals into domestic markets.<sup>179</sup>

Today, most operators agree that consolidation of the markets is required to stabilise the profitability of the sector and to avoid inclusion of volatile or high-risk assets in insurers' portfolios and over-dependence on reinsurance.<sup>180</sup> Big global players are already present in the region, and if risk-based solvency rules were to be imposed upon the markets, those players would likely be the win-

<sup>177</sup> Ali Karakuyu, "Kuwait: Competition overshadows growth opportunity in Kuwait", in *Middle East Insurance Review*, Vol. 7, No. 5 (May 2012).

<sup>178</sup> Fadi B. Nader, "Regulatory challenges in the Levant and GCC insurance markets", in *International Reinsurance Review*, No. 12 (2011), p. 61-65, <http://www.levantip.com/Articles%5Cp61-65%20IRR%20-%20Levant%20PR.pdf>.

<sup>179</sup> John R. Cashin, "Towards a robust supervisory framework for the MENA insurance industry", in *Middle East Insurance Review*, Vol. 7, No. 10 (October 2012).

<sup>180</sup> Schanz, Alms & Co., *GCC insurance barometer*, No. 1 (March 2012), <http://www.schanz-alms.com/publications/1st-gcc-insurance-barometer.html>.

ners, due to their asset management and actuarial capacities.<sup>181</sup> If a balanced and non-monopolistic market were created, this would induce economies of scale and lead to the creation of more stable companies and larger and more conservative portfolios to hedge against losses. Such consolidation would be likely to proceed through mergers and acquisitions. It is less clear, however, when it might occur.

The limited supply of skilled labour is yet another important issue confronting the GCC countries. The skills necessary for the industry to operate in advanced global markets have had little time to develop due to the recent expansion of insurance markets. The need for skilled labour has been especially urgent in the case of high-end professions, such as actuaries, underwriters and claims professionals. Although this gap has been filled quite successfully by the expatriate community (as in many other industries), there is a chronic shortage of readily available skilled labour, and most importantly local labour.<sup>182</sup> The most flagrant shortages concern skilled personnel for underwriting and portfolio management, making it difficult to retain premiums in primary insurance, and having a huge impact on the profitability of the industry.

The industry is not the only one suffering from a scarcity of skilled labour. Shortages have been also acute in the regulatory and supervisory authorities. The competitive and diverse markets in the GCC region are often more difficult to supervise than mature and consolidated markets. More competent and highly skilled and technical employees are thus necessary to enable the authorities to exercise effective regulation and supervision.<sup>183</sup> Insurance supervision is specifically affected by the lack of insurance professionals; many supervisors have a banking or general finance background, which causes flaws in communication and enforcement. To tackle the situation, some countries, such as Qatar, have established subsidised centres to develop the relevant financial skills, but high-skilled insurance professionals take years to train, and even more time will be required to produce a stream of new graduates every year. Although the establishment of training centres is essential for the future development of the markets, the GCC countries are destined to remain heavily dependent on expatriates in the short and medium term.

Another hindrance to convergence of insurance levels is the still relatively low development of culturally specific insurance lines. Since standard insurance products are mostly prohibited under *sharia*, the development of *takaful* insurance business models is considered essential for the expansion of insurance business in the GCC region, most importantly in relation to life insurance. *Sharia*

<sup>181</sup> Alpen Capital, *GCC Insurance Industry Report 2011*, cit.

<sup>182</sup> Rodney Lester, "The Insurance Sector in the Middle East and North Africa...", cit.

<sup>183</sup> John R. Cashin, "Towards a robust supervisory framework for the MENA insurance industry", cit.

compliance is an important means of building awareness in the GCC region and of developing a high-growth regional hub for the rest of the MENA region. It also presents an opportunity to host high savings of GCC residents. *Takaful* insurance is expanding quickly, and has registered above-average growth over the past few years (when compared to other financial markets, GDP or even standard insurance premiums), with an annual growth rate of 45% between 2004 and 2009.<sup>184</sup> As in the general insurance business, however, such growth rates should be viewed with the utmost precaution, due to the extremely small initial base. The generally accepted *takaful* model has also recently seen several development hiccups. In 2012, *takaful* growth slowed down across the GCC region,<sup>185</sup> partly due to new constraints imposed upon the business by regulators in order to increase consumer confidence in such products (see the following Section). The cultural understanding of insurance products remains poor, and consumer confidence in these products is proportionately weak. The large numbers of multinational players have broadly similar return-on-investment requirements from *takaful* insurance as from ordinary lines of insurance. This creates an effective gap between insurers and their clients, which could become an obstacle to the future development of the industry.<sup>186</sup>

Another prominent issue in relation to the development of the GCC countries' insurance markets is the captive insurance industry. There are currently ten companies operating as captives in the GCC region, mostly state-owned or private oil producers. The emergence of captives was driven in the first place by the inability of local insurance markets to meet the needs of large businesses. More recently, the development of captive regulation has become part of the strategy to increase the domestic-based financial environment, in which companies can develop their activities in order to support a diversified economy. At the moment, the existence of captive insurance is an important obstacle to the growth of an open insurance market, since what are by far the largest companies in the region manage portfolios on the corporate level and thus remain outside the potential client pool. Before the development of the insurance markets in the GCC region in the mid-2000s, most large companies using captives operated in offshore locations, generating no particular need for local captives. The liability of the state for risks and losses had also made insurance schemes redundant in many cases. Recent privatisation has increased the scope of the captive business, however, and is likely to increase it further in the future.<sup>187</sup>

<sup>184</sup> Alpen Capital, *GCC Insurance Industry Report 2011*, cit.

<sup>185</sup> Marcel Omar Papp, "Takaful Review 2012: Easing inherent tensions in the *takaful* model", in *Middle East Insurance Review*, Vol. 7, No. 12 (December 2012).

<sup>186</sup> MEIR, "Thought Leadership Roundtable. Don't wait for the regulator", in *Middle East Insurance Review*, Vol. 7, No. 1 (January 2013).

<sup>187</sup> Robin Ali, "Captives in MENA Choosing the right home", in *Middle East Insurance Review*, Vol. 8, No. 1 (January 2013).

To sum up, all statements about the insurance market in the GCC region have to be made with the utmost precaution. The potential for growth is indeed great if we consider the EU27 or other emerging markets as benchmarks. However, high premium growth rates have been driven in the past by the extremely low initial base as well as by exceptional GDP growth linked to oil prices. It is unclear whether such a development can continue, and whether the GCC market overall has the same potential for insurers as currently mature insurance markets.

Until now, the market has generated losses or extremely low margins. The overall profitability and macro-financial stability of the sector suffers from high competition, under-pricing and high cession rates. Indeed, the future prospects for the GCC market could be even bleaker. Muslim countries are generally prone to lower insurance penetration due to cultural specifics. As is shown in the following Section, even *sharia*-compliant *takaful* insurance is legally and religiously controversial.

Overall, although future growth potential is still high, it is probably significantly lower than current insurance penetration levels in the EU27 due to high savings rates, lower extremes in meteorological conditions and a generally lower cultural propensity to insure ordinary skills. The long-term potential of the GCC market may therefore be lower than is expected by current local insurers. There is, nonetheless, still a case for regulatory advancement towards convergence to make the market more efficient and stable, and to serve the interests of policy-holders and the overall economy. In order to succeed in this endeavour, further regulatory changes have to be considered.

### *3.2.2. What degree of convergence to international regulatory standards?*

Income and wealth are often quoted as among the main determinants of insurance market potential. Insurance in the GCC region nonetheless clearly shows that culture, macro-financial stability and the regulatory framework are also important, as underlying macroeconomic indicators, to the development of the industry.<sup>188</sup> Until recently, the local industry was highly unregulated, with the relative exception of Bahrain, which served until the early 2000s as an insurance hub for the modest demand of the GCC region.

Over the past ten years, a set of changes across the region has transformed insurance regulation into, in some cases, a comprehensive regulatory framework which tries to comply with international standards and to adopt best practices, often following the model of the EU27. The Central Bank of Bahrain, the Saudi Arabian Monetary Agency (SAMA), the Qatar Financial Center Regulatory Au-

<sup>188</sup> Amany Elmahy, "Reinsurance in MENA: Ready for change?", cit.

thority (QFCRA), the Dubai Financial Services Authority (DFSA), and the Oman Capital Market Authority (OCMA) have been fairly determined in advancing their regulatory reforms and enforcing insurance laws. All GCC countries, with the exception of Kuwait, have joined the International Association of Insurance Supervisors (IAIS) in the past five years, while the UAE and Qatar have taken a step further by becoming signatories to the IAIS's Multilateral Memorandum of Understanding (MMoU). These last two countries have also made policy commitments towards future best practice. The most significant progress on the regulatory side in recent years has been in terms of determining clear rules on market access, non-weighted capital requirements, and taxation, and in terms of regulating proprietary structures. Progress has been made on the supervisory side, particularly as regards risk management and governance, but only to a limited extent.

Enforcement inefficiency, supervisory capacity and legal clarity remain underlying issues, however.<sup>189</sup> The bulk of the current critique addresses the absence of market-consistent solvency rules and effective governance and risk management requirements. Clear and non-discriminatory reporting and consumer protection are also matters for concern. The most serious hurdle in implementing advanced international standards has been the inability of local regulators to be at the forefront of future regulatory frameworks, such as the EU's Solvency II or the Swiss Solvency Test (SST). The development of insurance regulation has also varied across the region.

Although the GCC insurance sectors continued to grow during the crisis, their dependence on equity and real estate assets, as well as their relative undercapitalisation when compared to global standards, exposed the fragility of the industry.<sup>190</sup> Such asset volatility in insurers' portfolios is mostly attributable to premium-based liability rules and non-risk-weighted capital requirements. This clearly undermines the solvency and growth prospects for the sector. Returns on investments are correspondingly as unstable as insurers' undertakings and assets. As a reaction to the crisis, insurers are now more likely to include debt-related securities as part of their capital requirements. A risk-based solvency (RBS) framework would, however, move the whole industry in a coordinated way towards more stable assets without putting asymmetrical strain on responsible insurers only. In its 2012 updated Insurance Core Principles, the IAIS requires signatories to apply a total balance sheet approach and RBS requirements. Although the IAIS does not stipulate the concrete format, the GCC countries now have three years to apply the RBS model.

Currently, overall valuation regimes for liabilities are risk-based only in Qa-

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<sup>189</sup> John R. Cashin, "Towards a robust supervisory framework for the MENA insurance industry", cit.

<sup>190</sup> Alpen Capital, *GCC Insurance Industry Report 2011*, cit.

tar and the UAE, where they are built on the US rather than the EU (Solvency II) or Swiss (SST) model. Other GCC countries follow simple premium-based liability, roughly comparable to Solvency I principles, with few effective requirements along the lines of the total balance sheet approach. The risk-based capital (asset side) requirements of the region are also largely undeveloped, and are based on unspecified internal models evaluated by the respective supervisors. Little legal attention has been given to the matter, and no deterministic models are offered by the regulatory authorities to domestic insurers. This does not allow external players or observers to quantify the solvency of the market, due to large supervisory discretion in the form of such internal models.

Nonetheless, most businesses expect regulators to focus on RBS and supervisors to pay more attention than in the past to capital adequacy, setting clear solvency margins and risk-based capital requirements and ultimately preparing for more robust frameworks such as the EU's Solvency II.<sup>191</sup> This could lead to more risk-adequate underwriting and, ultimately, more risk and premium retention in the long term, albeit with medium-term costs. Indeed, Solvency II is often quoted as the benchmark to which the GCC countries are likely to evolve in the three-year period stipulated by the IAIS.<sup>192</sup> Solvency II is a fully RBS framework, and adopts economic perspectives in asset and liability valuation on a strictly market-consistent basis. This could be a challenge for the volatile GCC markets, although a move towards less volatile assets to avoid market risks would be necessary after the introduction of any similar framework. Solvency II not only requires a valuation of additional risk types (operational and market risk), but also stipulates the need to establish an internal risk management framework with the capacity to identify, measure and manage all risks. In terms of solvency capital determination, contrary to the general practice of the GCC, Solvency II would require the fulfilment of criteria from a standard deterministic formula, thus reducing the discretion of the regulator. Such regulatory adjustment could have major consequences for the structure of the GCC insurance markets. Since Solvency II has not yet come into force, its effects on the GCC region can only be estimated from observation of the enforcement of a similar framework, e.g. the SST as implemented in Switzerland. On balance, insurers have become more conservative in Switzerland, increasing capital and reducing risk, mostly due to a move towards government bonds and other less risky assets and, in some cases, even abandoning some high-risk underwritings.<sup>193</sup>

High-quality underwriting and actuarial skills require significant resources, and the GCC's unconsolidated markets are a major obstacle to upgrading legis-

<sup>191</sup> Amany Elmahy, "Reinsurance in MENA: Ready for change?", cit.

<sup>192</sup> Kai-Uwe Schanz, "The Swiss model for insurance regulation", in *Middle East Insurance Review*, Vol. 7, No. 10 (October 2012).

<sup>193</sup> *Ibidem*.

lation to RBS due to the possible vested interests of currently under-capitalised insurers. In countries with a relatively high level of market consolidation, such as Qatar, the introduction of risk-based solvency is however likely to generate fewer mergers and acquisitions as well as a more modest increase in cession rates. The implementation of RBS rules could therefore pose problems to some businesses in the region and would have a highly asymmetrical impact on the industry. It is unavoidable in the long term in order to stabilise the volatile assets of GCC insurers and to consolidate the market. While Solvency II is a relevant regulatory framework for global insurance markets, it is not clear that the GCC region is ready to implement such demanding regulation, nor generally to what extent regions with such a short history of insurance development and markets as unconsolidated as those in the GCC are ready for such a framework to become a benchmark. The ultimate trade-off that local authorities face is phasing catch-up with the implementation of risk-based regulatory standards; either regulatory authorities wait for the market to clear and consolidate and let the winners cope with more stringent requirements, or they effectively force the whole market into consolidation by the implementation of RBS rules and limits on cession rates.

Although nominal regulation and its implementation has been the focal point of analyses of the GCC insurance markets as well as of business, the effectiveness of enforcement remains an area of concern, mostly due to the lack of reliable and official information on enforcement efficiency. The biggest pressure on improving enforcement has come from multinational insurance players, which fear the role of insiders, while their business model is clearly based on stable and highly enforceable regulatory frameworks. The region has recently been subject to recommendations on the development of more stringent supervisory and enforcement capacities in regulatory bodies due to their perceived inefficiencies and high discretion. There is a belief among international organisations and market players that even state-of-the-art regulation can be unevenly and non-transparently enforced, causing market distortions by incentivising market players to circumvent nominal regulation to gain competitive advantage.

Feeble enforcement also feeds consumer mistrust, further undermining insurance development in the region. In the case of lenience or arbitrary dealings, policy-holders are not properly protected, and the probability of ensuing insolvencies or a rise in uncovered underwritings increases. As stipulated by the IAIS Insurance Core Principle 11, corrective sanctions must be enforceable and based on objective criteria, something that many businesses present in the GCC region doubt is the case. Some authorities have already identified enforcement as an important issue. The DFSA, together with the QFCRA, has demonstrated a willingness to exercise enforcement powers following the regulatory model

of the EU27, and to increase supervisory staff capacity to gain credibility in the markets.<sup>194</sup>

Supervisory capacity is tightly linked to the reporting system, which is an important part of the Solvency II framework. Along with risk-based solvency, the World Bank has identified weak financial reporting – mostly the inability to obtain consistent, accurate and timely statistical information – as one of the major problems of the GCC region’s insurance regulation, and has underlined the strengthening of reporting and disclosure as a prerequisite of sound regulatory enforcement.<sup>195</sup>

Among specific insurance types, *takaful* insurance regulation has been expanding in the region, with virtually all GCC countries establishing a regulatory framework for *sharia*-compliant insurance, mostly modelled as mutual insurance funds under the *takaful* model. Although the recent expansion of the *takaful* market has been extensive, investment in *takaful* business is not without regulatory challenges, such as the need to avoid direct allusions to speculative or excessive risk-taking, as well as the issues raised by profit generation and returns on the investments of foreign investors. As consequence of the regulatory problems, the *takaful* markets saw a slowdown in 2012.

The recent expansion of *takaful* regulation has clearly exposed the conflict between the benevolent and charitable nature of *takaful* on the one side, and its commercial dimension on the other.<sup>196</sup> Despite the consolidation efforts made by the Islamic Financial Services Board (IFSB), concrete definitions of *takaful* vary between scholars and jurisdictions, making enforcement difficult and leading to the risk of void contracts.<sup>197</sup> The market is therefore fragmented, and insurers struggle to find *sharia*-compliant counterparties. Unless there is a broad and unique understanding of *sharia* compliance by all legislators, there will be counterparty risks and asset costs which are significantly higher than in ordinary insurance, putting pressure on pricing and subsequently on the possible expansion of the whole industry. From a legal perspective, the issue can provoke the sort of extreme reaction seen in Saudi Arabia, where the regulatory authority decided to ban current *takaful* business to protect policy-holders from disputed *sharia* compliance. Due to the great potential of the *takaful* model, the market has, nevertheless, good growth potential, and is likely to overcome the regulatory hurdles, since it is most probably the only way to increase life insurance penetration levels in the region to rates seen in more mature markets.

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<sup>194</sup> John R. Cashin, “Towards a robust supervisory framework for the MENA insurance industry”, cit.

<sup>195</sup> Rodney Lester, “The Insurance Sector in the Middle East and North Africa...”, cit.

<sup>196</sup> Marcel Omar Papp, “Takaful Review 2012...”, cit.

<sup>197</sup> Susan Dingwall and Martin Schneider, “New standards on risk management for takaful operators”, in *Middle East Insurance Review*, vol. 7, No. 1 (January 2013).

Businesses simply have to find ways to align *sharia* compliance to the interests of commercial shareholders, and the IFSB must act credibly to find a common, culturally acceptable solution.<sup>198</sup>

As much as *takaful* business insurance is an example of partial regulatory failure to support an insurance line with great potential, the captive business is an example of regulatory success in attracting and promoting a potentially beneficial industry. Since underwriting issues are secondary in captives and assets are part of the company's larger portfolio, insurance in captives has been largely seen as efficient and uncontroversial. Before the development of the insurance markets in the GCC region in the mid-2000s, most large companies using captives operated in offshore locations. Almost immediately after the establishment of the relevant regulation, companies moved their operations to domestic markets.<sup>199</sup> This underlines the essential role of regulation in the development of regional insurance industries and in promoting convergence with other mature insurance markets.

Insurance regulation can also easily be affected by the development of other financial products and regulation. The overall development of financial regulation, especially in asset markets, would boost the potential pool for insurance businesses, and could decrease the high regional cession rates. A clear legal mortgage framework or the establishment of rules for private pension schemes (as well as the sector's privatisation) would also increase the currently low levels of life insurance.

Nonetheless, compulsory insurance represents by far the best prospect for expanding domestic insurance markets. The establishment of compulsory insurance across the region has been evaluated as one of the biggest drivers of insurance growth in the region,<sup>200</sup> most significantly in motor insurance and, in some countries, health insurance for expatriates or liability insurance in the engineering and medical professions.<sup>201</sup> Scope therefore exists in compulsory insurance for professional liability insurance in other professions, as well as for more extensive insurance for healthcare going beyond state welfare provisions. State-funded health insurance for public workers, private pension insurance schemes and major risk schemes have also been depicted as ways of boosting insurance.<sup>202</sup> Such new legal insurance requirements should, however, go hand in hand with the development of underwriting capacities, so that risk is priced in a sound way within the economy and does not increase moral hazard. Local

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<sup>198</sup> Marcel Omar Papp, "Takaful Review 2012...", cit.

<sup>199</sup> Robin Ali, "Captives in MENA Choosing the right home", cit.

<sup>200</sup> David Anthony, "Country Profile - Navigating unique terrains of the Saudi market", in *Middle East Insurance Review*, Vol. 7, No. 6 (June 2012).

<sup>201</sup> Stephen Ballantine, "Class Update - Liability: GCC medical malpractice insurance...", cit.

<sup>202</sup> Amany Elmahy, "Reinsurance in MENA: Ready for change?", cit.

authorities should also pay attention to the efficiencies of specific mandatory insurance schemes, and carefully study their positive externalities, so as to avoid falling into the net of insurers' vested interests by putting in place more compulsory insurance schemes with little or no benefit to the economy.

Although the size of the regional industries remains limited, some jurisdictions are developing projects to harvest future growth by becoming regional hubs. At least two local financial centres aspire to transform themselves into regional insurance hubs, namely the Bahrain Central Bank and the Qatar Financial Centre Authority (QFCA), which are working in parallel to establish a natural common law-based jurisdiction to serve as a regional hub for insurance, captive insurance and reinsurance.<sup>203</sup> While Bahrain historically has a more favourable position, the QFCA has been more active in perspicuously addressing the potential of reinsurance markets as a consequence of current high cession rates. As part of its Strategic Focus of 2010, the QCFA implemented special tax concessions for reinsurers and allowed full foreign ownership of reinsurance companies, thus attracting major global companies to a region with otherwise strict limits on foreign ownership. Although more than purely regulatory changes are needed, the potential of such special jurisdictions, especially in reinsurance, is vast. The GCC is not the only area of the Middle East with very low density and penetration levels. Other countries of the MENA region are – with some exceptions – equally significantly undersized. Building up regulation enabling the establishment of regional insurance hubs is therefore in line with attempts by the GCC countries to diversify their economies towards export-oriented services.

To sum up, the main hindrance to the implementation of market-consistent valuation rules has been the market itself, most importantly the limited supply of high-level skills. The rather weak governance requirements have also been a consequence of the restricted managerial capacity of the region. The very high cession rates are not yet directly linked to the complexity of the regulation; they are rather determined by the lack of such skills. Enhancing the shift in the regulatory paradigm from simple premium-based requirements and non-weighted assets towards RBD and a total balance sheet approach could put further strains on the market, increasing the already high reinsurance rates or requiring more foreign involvement in the medium term. It is therefore likely that regulators and supervisors are being cautious about the possible impact of such rules, and are setting the regulatory agenda accordingly. In this respect, the introduction of RBS clearly clashes with the internal goals of local authorities.

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<sup>203</sup> FTSE Global Markets, "Opportunity in GCC insurance at a time of change", in *FTSE Global Markets*, No. 59 (March 2012), <http://www.ftseglobalmarkets.com/issues/issue-59-march-2012/opportunity-in-gcc-insurance-at-a-time-of-change.html>.

## CONCLUSION

This chapter has reviewed the current structure of the banking and insurance sectors in the GCC countries in comparison with the EU27. Convergence and integration of the regulatory frameworks in the GCC countries and the EU27 has also been assessed.

The banking sectors in the GCC region are dominated by a small number of commercial banks, both locally incorporated banks and the branches of foreign banks. Relative to the sizes of the population of the GCC countries, the banking systems are widely present, and access to financial services has improved significantly with payment networks connected throughout the region. However, beyond providing basic banking services to the private and public sectors, the banking systems remain relatively underdeveloped. The absence of deep domestic capital markets and tied relations with governments are the main obstacles to further development.

The analysis of regulatory convergence shows substantial improvements in credit information in the GCC countries. However, the region still suffers from key weaknesses in deposit insurance, entry obstacles and the strength of legal rights. In particular, deposit insurance systems in many GCC countries are not explicit, which could lead to uncertainties over the provision of support to banks in case of default. Another persistent issue is the presence of entry obstacles, in particular signs of substantial barriers to entry and continued government ownership of banks. The comparison of regulatory systems also highlights the fact that the GCC countries have not been able to catch up in terms of creditor protection. However, substantial improvement in credit information has occurred since 2003, in particular through the establishment of private credit bureaus with a broad coverage.

Despite the significant development of insurance regulation, the potential for convergence, most notably through the risk-based requirements of Solvency II, remains high. The GCC region has much to gain from applying such rules, as they would ensure a greater degree of solvency of the insurance sector and increase trust of policy-holders and investors. This advanced and complex regulatory framework, designed for the mature insurance markets of the EU27, is, however, rather demanding for the GCC's young insurance industries, and its implementation could be further postponed due to concerns about the sustainability of the current domestic industry and its structural shortcomings.



# 4.

## EU-GCC Cooperation on Energy

*Abdulaziz Al-Shalabi, Nicolas Cottret and Emanuela Menichetti\**

### INTRODUCTION

The GCC countries show some common characteristics and are among the world's leading oil and gas producing and exporting countries. They also constitute prominent members of the Organization of the Petroleum Exporting Countries (OPEC). The economies of the GCC countries are heavily dependent on the fossil fuel resources which have contributed to the rapid socio-economic growth in the region over the past couple of decades. Indeed, energy remains central to relations between the GCC and the EU. In fact, fossil fuels remain the most traded product between the two regions. This is mainly due to the proximity of the regions and the complementarity of their energy production and consumption patterns, which create favourable exchange conditions between the EU and the GCC. As a result, energy has an important weight in the trade flows

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\* This chapter was prepared by the Renewable Energy Division of OME (Observatoire Méditerranéen de l'Énergie), under the guidance of its Director, Dr. Emanuela Menichetti. Other main authors are: Nicolas Cottret, who was responsible for the data collection and analysis, and Abdulaziz Al Shalabi (Environment Public Authority of Kuwait), who contributed to data gathering and drafting during his three-month stay at OME as a Sharaka fellow.

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Alsayegh, Osama	Kuwait Institute for Scientific Research
Al-Seiari, Abdulla	Masdar Institute
Chami, Mays	ILF Consulting Engineers
Darwish, Muhammad	Qatar Environment & Energy Research Institute
Ghedira, Hosni	Masdar Institute
Güçlü, Evren	Türkiye Elektrik İletim
Mezher, Toufic	Masdar Institute
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Şenocak, Kazım	Türkiye Elektrik İletim
Zamora, Mireia	Tawasul

between the two parties. Mineral fuels represented almost 80% of EU imports from the GCC and about 9% of total EU imports in the year 2012, amounting to over 48 billion Euros.<sup>204</sup>

Relations between the EU and the GCC are not recent. Economic cooperation started from the very beginning after the creation of the GCC. On 22 July 1985, the Council of Ministers of the then EEC expressed its deep-seated interest in developing economic and political links with the GCC, and decided in principle on a meeting between the Community and the Gulf states.

More recently, on the occasion of the 20th session of the Joint Council held in Luxembourg on 14 June 2010, officials of the EU and the GCC states endorsed the EU-GCC Joint Action Programme 2010-2013, which had been negotiated during the senior officials meeting held in Riyadh on 9-10 February 2010. The Joint Action Programme has the aim of strengthening cooperation in areas of strategic mutual interest over the 2010-2013 period. Within the Joint Action Programme, particular attention is paid to the issue of energy diversification through the development of alternative energy technologies (such as renewable energy technologies and the development of energy efficiency for conventional energy technologies), as well as the issue of the development of energy infrastructure. Indeed, since the beginning of the cooperation, the Joint Councils and Joint Cooperation Committee meetings have stressed the need for policy support for the promotion of renewable and energy efficiency options in the GCC countries. A main tool of cooperation in this field is the establishment of the Clean Energy Network, a framework in which GCC institutions can access European Commission partnerships and participate in discussion groups and pilot projects.<sup>205</sup>

The follow-up to the Joint Action Programme has, however, not been complete. At the 22nd session of the Joint Council and Ministerial Meeting held in Luxembourg on 25 June 2012, delegates evaluated progress achieved so far, and agreed to prepare a joint work programme for the next period (2013-2016) and to identify priorities and objectives.

Several EU-GCC expert meetings' conclusions have underlined the importance of enhancing cooperation in energy, with particular focus on energy efficiency and conservation, clean energy, climate change, and technology transfer. This chapter aims to identify areas of potential cooperation in the fields of energy, the environment and climate change. The research is based on analysis of primary and secondary data emerging from the contributions and knowledge of EU/GCC stakeholders.

The rapid socio-economic growth experienced by the GCC countries over the

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<sup>204</sup> European Commission DG Trade Statistics, 2013.

<sup>205</sup> EU-GCC Clean Energy Network, Network Activities and Offering, <http://www.eugcc-clean-energy.net/TheNetwork/NetworkActivitiesOffering.aspx>.

past couple of decades has led to higher local demand for energy, thus making the GCC countries large consumers of fossil fuels. The rising local energy demand is stimulated by several factors, including the population increase, higher urbanization rates, the industrialization of the economies, changes in transportation modes, and water scarcity. Water scarcity has forced the GCC countries to develop energy-intensive water desalination processes.

Electricity demand is increasing particularly fast, having grown at an average rate of 6.6% per year from 1999 to 2009,<sup>206</sup> which implies massive investment in power generation capacity to meet requirements. The GCC countries are looking at several technologies, among which are nuclear power and renewable energy, in order to be able to supply part of the extra capacity needed. In the last few years, the GCC countries have implemented the GCC interconnection grid, which would, in theory, allow for a reduction in the amount of new power plant construction needed, and provide standby backup capacity.

The GCC countries are ranked among the world's highest carbon footprint countries. Greenhouse gas (GHG) emissions increased by more than 75% over the period from 2000 to 2010, and by more than 200% over the period from 1990 to 2010.<sup>207</sup> Per capita CO<sub>2</sub> emissions and energy intensities in the GCC countries are higher than the world and EU-27 averages.<sup>208</sup> These patterns of fossil energy use and related CO<sub>2</sub> emissions are encouraged by the fact that GCC governments heavily subsidize energy, especially electricity, leading to wasteful practices on both the demand and the supply sides.

These patterns give rise to an unsustainable energy system across the GCC. All the patterns described show the non-sustainability of the GCC countries' energy systems. This increases the necessity of moving towards sustainable energy solutions, as the region cannot depend on non-renewable resources forever. Despite the high exploitable potential, till now, only pilot, research and some small-scale activities related to renewable energy and energy efficiency have been conducted in the GCC countries. Nevertheless, the GCC countries have recently adopted a more pro-active approach towards the sustainable development of their economies, looking at solutions to switch towards a more efficient use of fossil fuels, combined with an increased development of both renewable energies and energy efficiency.

The EU has a well-founded interest to cooperate with the GCC countries and support them in addressing and successfully tackling energy issues. EU-GCC co-

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<sup>206</sup> IEA, Annual Database Statistics, Paris, OECD/IEA, 2011, <http://data.iea.org/ieastore/stat-listing.asp>.

<sup>207</sup> IEA, CO<sub>2</sub> Emissions from Fuel Combustion. Highlights 2012, October 2012, Paris, OECD/IEA, <http://www.iea.org/co2highlights/co2highlights.pdf>.

<sup>208</sup> IEA, Key World Energy Statistics 2011, Paris, OECD/IEA, 2011, <http://www.iea.org/publications/freepublications/publication/name,26707,en.html>.

operation makes particular sense when one considers that the EU is on the one hand one of the world's major importers of hydrocarbons, and on the other the leading global proponent of sustainable development. On-going EU-GCC cooperation on energy highlights the paramount importance of the producer-consumer dialogue, which is currently focused on the identification of prospects and opportunities for the development of a sustainable energy economy in order to move from the current carbon-constrained economy to new and prosperous sustainable development paths.<sup>209</sup>

The first part of this chapter focuses on the energy sector in the GCC countries. It includes an analysis of the latest energy trends in the EU-27 and the GCC, and their respective roles on the global energy stage. Additionally, it includes an in-depth analysis of the energy sector in the GCC countries, examining issues ranging from the importance of fossil fuels to electrical interconnections, and focusing on the latest developments in relation to renewable energy and energy efficiency in the region. The second part looks at the historical relationship in terms of energy between the EU and the GCC, and outlines the main areas of possible in-depth cooperation between the two regional organizations.

## 4.1. OVERVIEW OF THE ENERGY SECTOR IN THE GCC

Although the GCC countries represent a small proportion of the global population compared to the EU-27<sup>210</sup> (0.6% compared to 7.4%, with 26 out of 38 million people living in Saudi Arabia), they are very important actors on the global energy scene.

### 4.1.1. Fossil fuel reserves

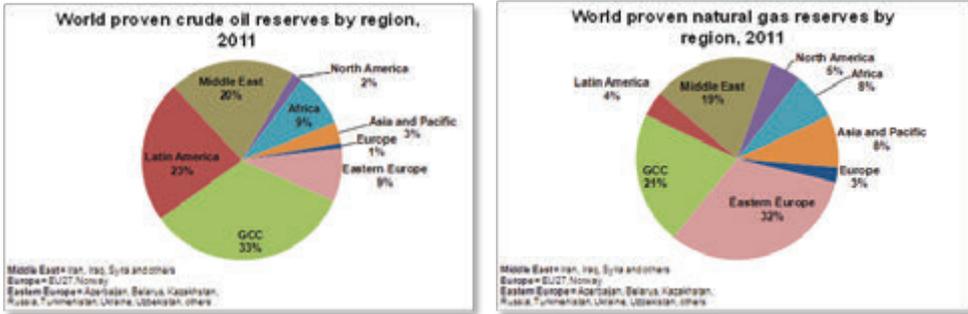
Past and current trends in energy within the GCC countries have been driven by their large hydrocarbon endowments, on which they have relied to support and develop their economies. Indeed, the GCC countries hold approximately one third of the world's proven crude oil reserves (Figure 32-left), with more than half being held by Saudi Arabia, and around one fifth of global proven natural gas reserves, with around 60% in Qatar (Figure 32-right).

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<sup>209</sup> A. Papadopoulou et al., "Tools and Mechanisms Fostering EU GCC Cooperation on Energy Efficiency", in Bahram Moshfegh (ed.), *World Renewable Energy Congress 2011* (Linköping, Sweden, 8-13 May), Vol. 10: Policy Issues, 2011, p. 2308-2315, <http://dx.doi.org/10.3384/ecp110572308>.

<sup>210</sup> Please note that in the interests of having comparable data, all 27 Member States are included since 1990, despite their different dates of accession to the European Union.

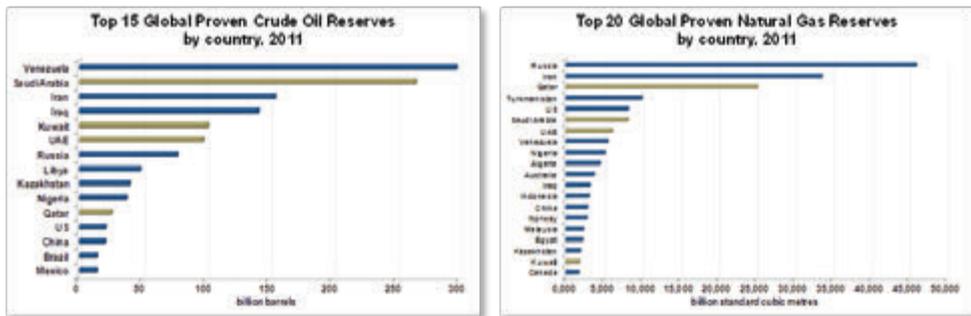
Fig. 32. Global proven crude oil reserves by region, 2011 (left); global proven natural gas reserves by region, 2011 (right)



Source: OPEC, *Annual Statistical Bulletin 2012*, Vienna, OPEC, 2012, [http://www.opec.org/opec\\_web/en/publications/202.htm](http://www.opec.org/opec_web/en/publications/202.htm).

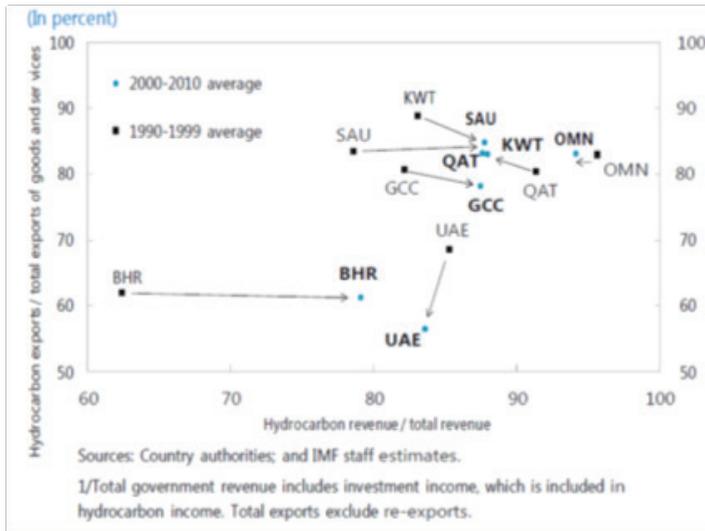
Four of the GCC countries are among the 15 countries holding the highest proven crude oil reserves (Saudi Arabia with 265 bn b, Kuwait with 101.5 bn b, UAE with 97.8 bn b and Qatar with 25.4 bn b), and four GCC countries are among the 20 countries holding the highest proven natural gas reserves (Qatar with 25,110 bcm, Saudi Arabia with 8,151 bcm, UAE with 6,091 bcm and Kuwait with 1,700 bcm) (Figure 33).

Fig. 33. Top 15 global proven crude oil reserves by country, 2011 (left); top 20 global proven natural gas reserves by country, 2011 (right)



Source: OME based on OPEC, *Annual Statistical Bulletin 2012*, cit.

Given these extraordinary hydrocarbons resources, the GCC countries have developed their economies in almost exclusively reliance on hydrocarbons, and thus are highly dependent on revenues coming from that sector (Figure 34).

**Fig. 34. Hydrocarbon dependency in GCC countries**

Source: US Energy Information Administration, "United Arab Emirates", in *EIA Analysis Briefs*, 3 January 2013, <http://www.eia.gov/countries/cab.cfm?fips=TC>.

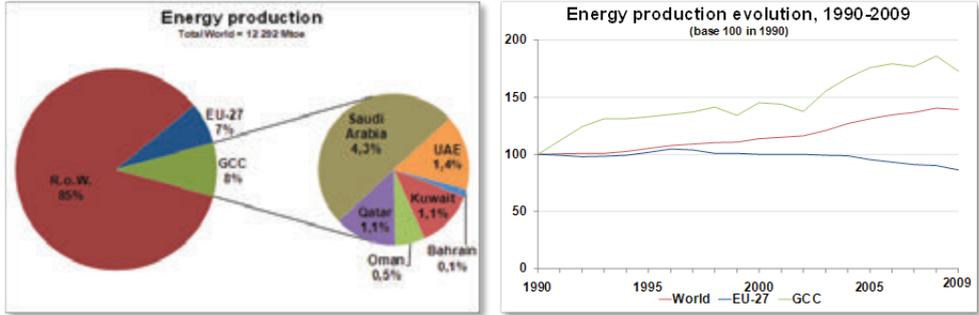
In all the GCC countries, 80% of total government revenue depends on revenues coming from hydrocarbons-related activities (Figure 34), and hydrocarbon exports account for more than 50% of total exports of goods and services (around 80% for most of the GCC countries).

#### 4.1.2. Energy production

According to the IEA,<sup>211</sup> in 2009, the GCC countries' energy production represented 8% of the world's energy production, while the EU-27's energy production represented around 7% (Figure 35-left). In other words, in 2009 the GCC countries produced more than 1,000 Mtoe of energy thanks to their reserves of crude oil and natural gas, while the EU-27 produced just over 800 Mtoe. More than half of the GCC countries' production was supplied by Saudi Arabia (mainly crude oil). It is also observed that the GCC's energy production has increased over the period 1990 to 2009, while the opposite is true of the EU-27, raising concerns as to security of energy supply among the EU-27 Member States (Figure 35-right).

<sup>211</sup> IEA, *Energy Balances of non-OECD Countries 2011*, Paris, OECD/IEA, 2011, [http://www.planbleu.org/portail\\_doc/energy\\_balances\\_non\\_oecd\\_2011.pdf](http://www.planbleu.org/portail_doc/energy_balances_non_oecd_2011.pdf).

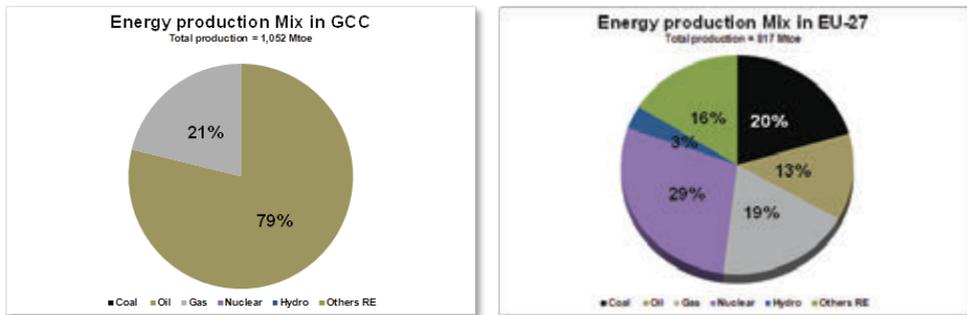
**Fig. 35. Worldwide energy production, 2009 (left); energy production evolution in the EU-27 and the GCC, 1990-2009 (right)**



Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

The breakdown of the energy production mix is widely different between the EU-27 and the GCC. The EU-27 energy production mix is relatively diversified, with half of production based on fossil fuels (coal, oil and gas), 29% based on nuclear, and 19% based on renewable energy sources (including hydro). The energy production mix of the GCC is much less diversified, with almost 80% of production based on oil, and the remainder based on gas (Figure 36).

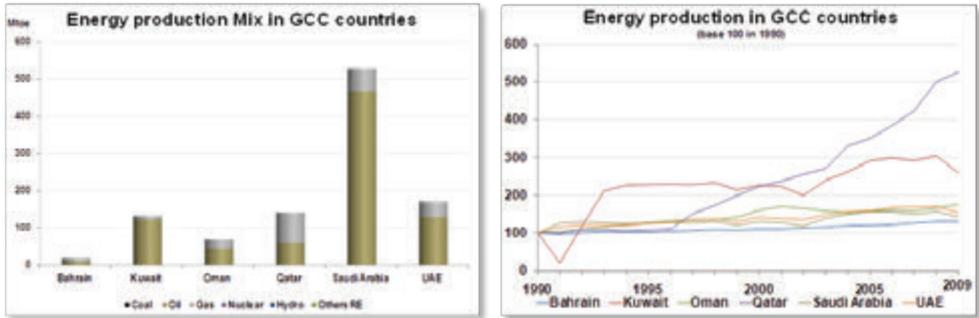
**Fig. 36. Energy production in the GCC, 2009 (left); the energy production mix in the EU-27, 2009 (right)**



Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

Among the GCC countries, Qatar, Bahrain and, to a lesser extent, Oman are the countries with the highest share of gas in their production mixes (Figure 37-left). However, in terms of absolute value, Qatar is the main producer of gas, followed by Saudi Arabia and the United Arab Emirates (Figure 38). The GCC's energy production has tended slightly to increase from 1990 onwards, except for Qatar and Kuwait, whose production has multiplied by 5 and 3 respectively (Figure 37-right).

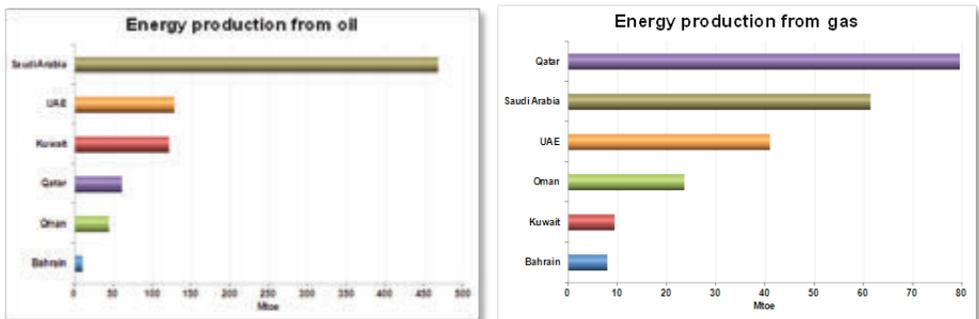
**Fig. 37. The energy production mix in GCC countries, 2009 (left); energy production evolution in GCC countries, 1990-2009 (right)**



Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

Saudi Arabia is the biggest producer of oil in the region, with more than 450 Mtoe, followed by the United Arab Emirates (around 130 Mtoe) and Kuwait (120 Mtoe) (Figure 38-left). As for energy production from gas, Qatar is the leading producer with 80 Mtoe, followed by Saudi Arabia (61 Mtoe) and the United Arab Emirates (40 Mtoe) (Figure 38-right).

**Fig. 38. Energy production from oil in GCC countries, 2009 (left); energy production from gas in GCC countries, 2009 (right)**



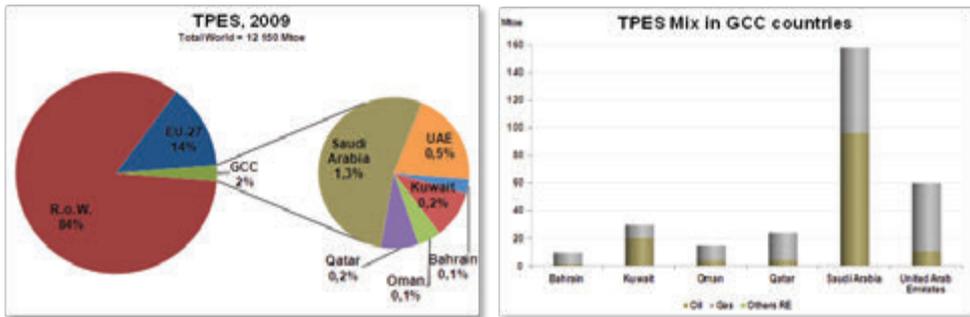
Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

### 4.1.3. Energy production

In terms of energy demand, in 2009, the GCC countries consumed roughly 300 Mtoe, i.e. 2% of the world's total, while the Total Primary Energy Supply (TPES) to the EU-27 represented 14% of the worldwide TPES (Figure 39-left). Saudi Arabia alone consumes more than half of the TPES to the GCC countries

(158 Mtoe). It is followed by the UAE (60 Mtoe) and Kuwait (30 Mtoe). While the GCC countries' energy production systems are largely dominated by oil (except for Qatar), their energy consumption is more equally shared between oil and gas, mainly due to the use of gas for electricity and heating purposes (Figure 39-right).

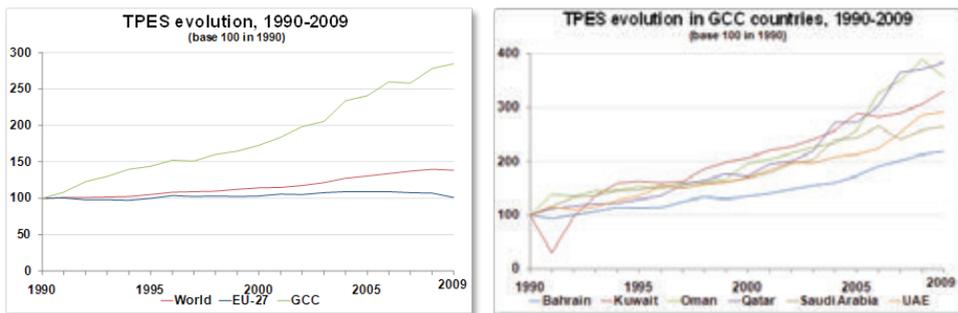
Fig. 39. Worldwide TPES, 2009 (left); the TPES mix in the GCC, 2009 (right)



Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

The GCC countries are facing rapid socio-economic growth (increasing population, high rates of urbanization, substantial industrialization), which forces them to consume more and more energy. As a result, energy consumption for all GCC countries has strongly increased from 1990 to today. Bahrain's energy consumption has doubled from 4 Mtoe to 9 Mtoe. Saudi Arabia, the UAE and Kuwait have almost tripled their consumption, from 60 Mtoe, 20 Mtoe and 9 Mtoe to 160 Mtoe, 60 Mtoe and 30 Mtoe respectively. Finally, Qatar and Oman are the countries which have most increased their energy consumption, from 6 Mtoe and 4 Mtoe to 24 Mtoe and 15 Mtoe respectively (Figure 40-right).

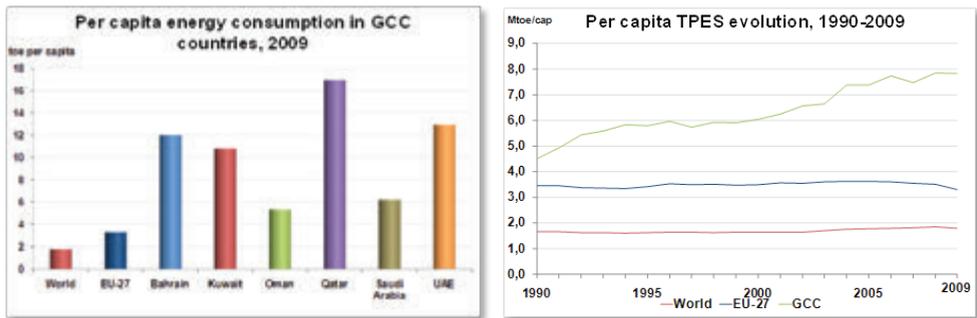
Fig. 40. TPES evolution, 1990-2009 (left); TPES evolution in GCC countries, 1990-2009 (right)



Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

Soaring energy consumption in the GCC is accentuated by pricing policy for energy, which is heavily subsidized (see 4.1.5 Energy tariffs/subsidies). GCC citizens are among the highest consumers of energy, with per capita energy consumption being among the highest in the world. Qataris are the greatest consumers, with an average exceeding 16 toe per capita, more than eight times global average per capita consumption (Figure 41-left).

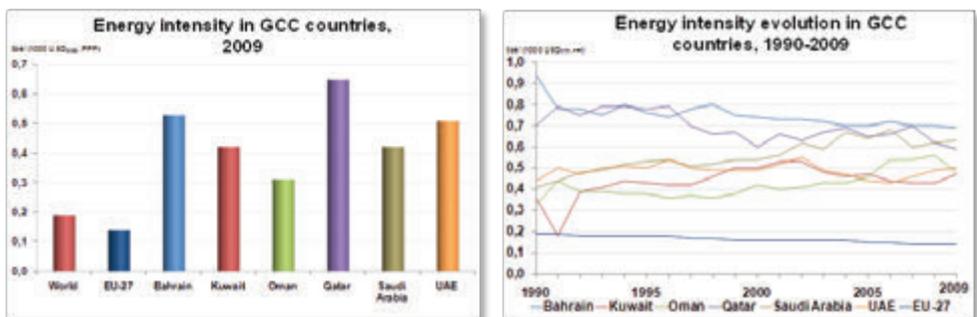
**Fig. 41 Per capita energy consumption in GCC countries, 2009 (left); per capita energy consumption evolution, 1990-2009 (right)**



Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

GCC economies are among the most energy intensive, all of them (except Oman) having energy intensity twice the global rate (Figure 42-left). While energy intensity has been decreasing in Bahrain and Qatar from the 1990s onwards, other GCC countries have seen their energy intensity increase, particularly Saudi Arabia (Figure 42-right). Indeed, despite being only the 20<sup>th</sup> largest economy in the world, Saudi Arabia is the sixth biggest consumer of oil.

**Fig. 42. Energy intensity in GCC countries, 2009 (left); energy intensity evolution in GCC countries (right)**



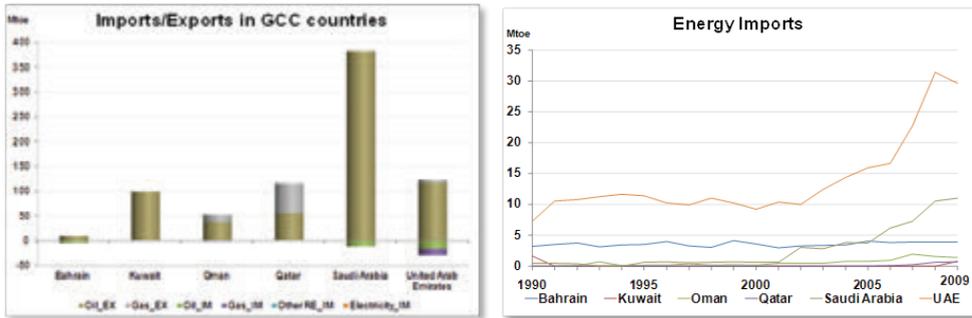
Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

Several analyses indicate that demand for both oil and natural gas in the GCC countries is expected to increase by more than 50 per cent by 2030.

#### 4.1.4. Energy exports/imports

All GCC countries are net exporters of energy (Figure 43-left). Despite their large endowments of hydrocarbon resources, soaring energy demand, driven by the increasing population and resulting increased energy needs, has led some of the GCC countries to import energy (notably natural gas) in order to meet local energy demand. For instance, the UAE recently became a net importer of natural gas for two main reasons: (i) nearly 30 percent of natural gas produced in recent years was re-injected into existing fields as part of enhanced oil recovery (EOR) techniques; and (ii) the country’s inefficient and rapidly-expanding electricity grid relies on natural gas for the majority of its feedstock. Oman has also seen its gas exports constrained by soaring domestic demand.

**Fig. 43. Imports/exports in GCC countries, 2009 (left); evolution of energy imports in GCC countries, 1990-2009 (right)**

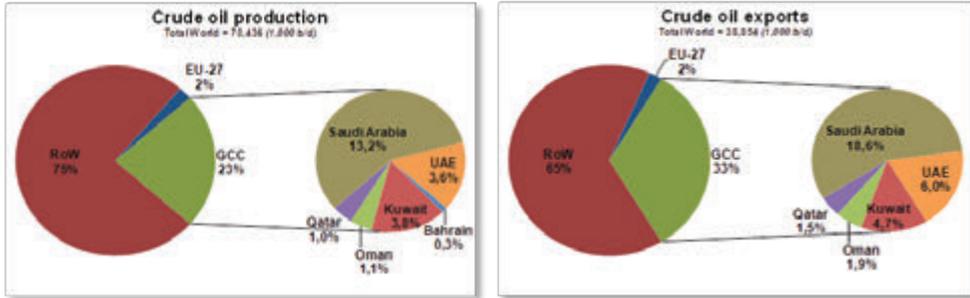


Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

According to OPEC,<sup>212</sup> in 2011 Saudi Arabia supplied 13.2% of the world’s total crude oil production, and was also the main exporter, with 7,218 thousand barrels per day. Kuwait and the United Arab Emirates are also major worldwide suppliers, with 3.8% and 3.6% respectively of the world’s total crude oil production, and exporting respectively 1,816 and 2,330 thousand barrels per day (Figure 44).

<sup>212</sup> OPEC, *Annual Statistical Bulletin 2012*, cit.

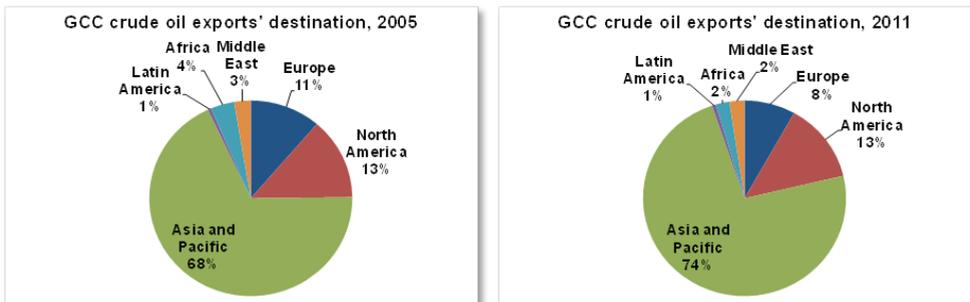
Fig. 44. Worldwide crude oil production, 2011 (left); worldwide crude oil exports, 2011 (right)



Source: OME based on OPEC, *Annual Statistical Bulletin 2012*, cit.

In total, the GCC countries account for 33% of global crude oil exports (Figure 44-right). The EU's share of the crude oil exports of the GCC has decreased from 11% in 2005 to 8% in 2011, as a result on the one hand of the emerging and energy-intensive Asian economies, which are playing an increasing role in the oil trade with the GCC countries, and on the other of the stagnant/declining demand in Europe (Figure 45).

Fig. 45. The destination of GCC crude oil exports, 2005 (left); the destination of GCC crude oil exports, 2011 (right)

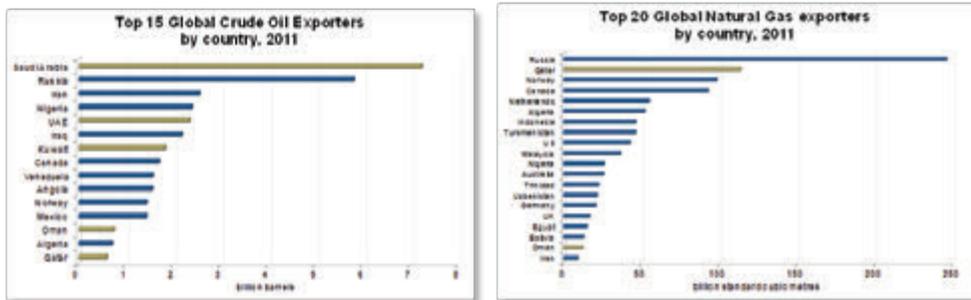


Source: OME based on OPEC, *Annual Statistical Bulletin 2012*, cit.

The GCC countries remain among the biggest energy exporters, with five of them ranked among the top 15 global crude oil exporting countries (Figure 46). Saudi Arabia is the main worldwide exporter of crude oil with more than 7.2 bn b exported in 2011. In relation to natural gas exports, Qatar is ranked second in the world with 113 bcm exported in 2011, and Oman 19th with 12 bcm. In ad-

dition, Qatar exports one third of total global exports of liquefied natural gas.<sup>213</sup>

**Fig. 46. Top 15 crude oil exporters by country, 2011 (left); top 20 natural gas exporters by country, 2011 (right)**



Source: OME based on OPEC, *Annual Statistical Bulletin 2012*, cit.

#### 4.1.5. Energy tariffs/subsidies

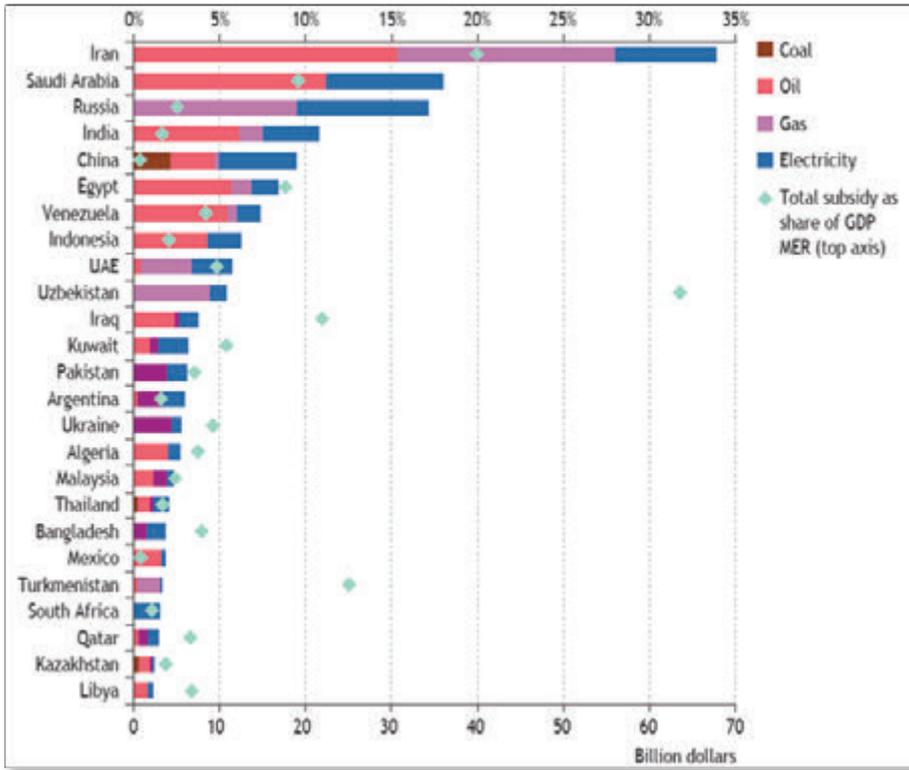
Low energy prices are often conceived of as being part of a subsidy. In the case of crude oil, the marked reference price for domestic pricing is often the marginal cost of production rather than the achievable export price to the international market. This represents an issue in regions where electricity generation is exclusively dependant on fossil fuels. While energy subsidies are aimed at ensuring access for all GCC residents, the economic consequences are significant. According to the IMF,<sup>214</sup> energy subsidies result in distorted resource allocation by encouraging excessive energy consumption, artificially promoting capital-intensive industries, reducing incentives for investment in renewable energy, and accelerating the depletion of natural resources.

In 2010, the IEA established a ranking of the top 25 countries in terms of subsidies to their energy sector. Four GCC countries appear in this ranking. Saudi Arabia was ranked second, behind Iran (Figure 47).

<sup>213</sup> BP, *Statistical Review of World Energy 2012*, June 2012, <http://www.bp.com/sectionbody-copy.do?categoryId=7500&contentId=7068481>.

<sup>214</sup> IMF, *Energy Subsidy Reform: Lessons and Implications*, Washington, IMF, 28 January 2013, <http://www.imf.org/external/np/pp/eng/2013/012813.pdf>.

Fig. 47. Economic value of fossil-fuel consumption subsidies by country and type, 2009



Source: IEA, *World Energy Outlook 2010*, Paris, OECD/IEA, 2010, <http://www.worldenergyoutlook.org/publications/weo-2010>.

Table 23 summarizes the subsidies given to energy in 2011 in some of the GCC countries. The Kuwaiti Government spent \$11.1 billion in 2011 on energy subsidies, representing 6.3% of GDP. Qatar devoted \$5.98 billion to energy subsidies, of which \$2.1 billion were for electricity. Overall, subsidies in Qatar represented 3.4% of GDP in 2011. Saudi Arabia spent \$87.94 billion (almost half on electricity), which represents 10.6% of GDP. Finally, the UAE spent \$21.82 billion (half on natural gas), i.e. 6.1% of GDP.

The UAE, with \$4,172/cap, is the country which spent the most on its citizens in terms of yearly energy subsidies. Kuwait and Qatar follow with \$3,729/cap and \$3,622/cap respectively. Saudi Arabia “only” spends \$2,291/cap.

Table 23. Energy subsidies in some GCC countries, 2011

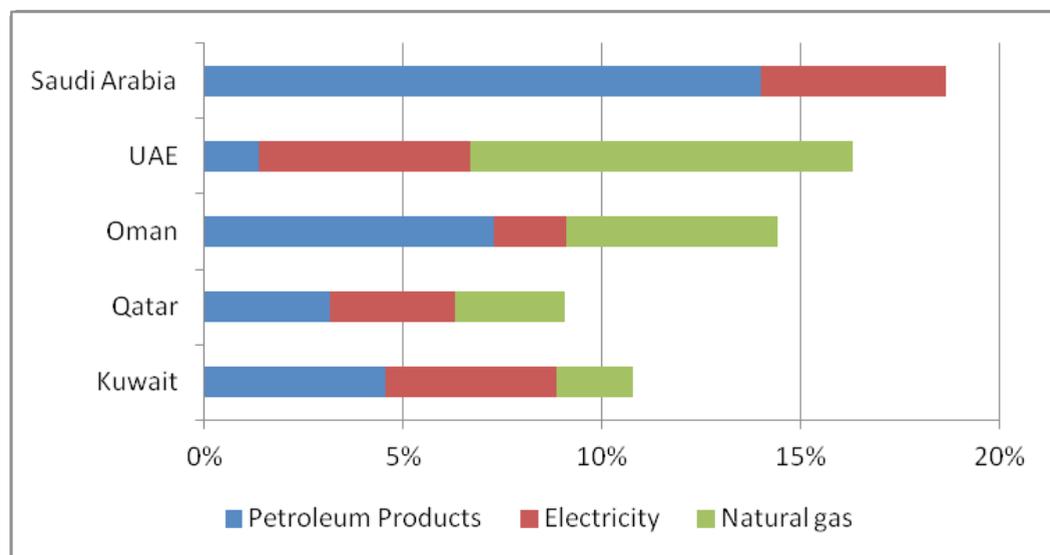
	Kuwait	Qatar	Saudi Arabia	UAE
<b>Average subsidisation rate*</b>	87.8%	78.6%	79.5%	69.1%
<b>Oil (billion \$)</b>	4.34	2.03	46.12	3.93
<b>Natural Gas (billion \$)</b>	2.08	1.86	0	11.52
<b>Electricity (billion \$)</b>	4.68	2.09	41.82	6.37
<b>Total (billion \$)</b>	11.1	5.98	87.94	21.82
<b>Total subsidy as share of GDP</b>	6.3%	3.4%	10.6%	6.1%
<b>Subsidy (\$/person)</b>	3 729.3	3 622	2 291.2	4 172.1

\* Fossil-fuel consumption subsidy rate as a proportion of the full cost of supply.

Source: IEA, *Fossil-fuel consumption subsidy rates as a proportion of the full cost of supply 2011*, Paris, OECD/IEA, 2012, <http://www.iea.org/subsidy/index.html>.

The GCC governments are aware of the burden on the state budget that results from energy subsidies (Figure 48). Oman was the first GCC country to review its energy tariffs, followed by Saudi Arabia and the UAE. However, the current political climate in the region tends to challenge such initiatives. One of the reasons is that subsidies are seen as a mechanism to distribute the benefits of the endowment in natural resources to the population.

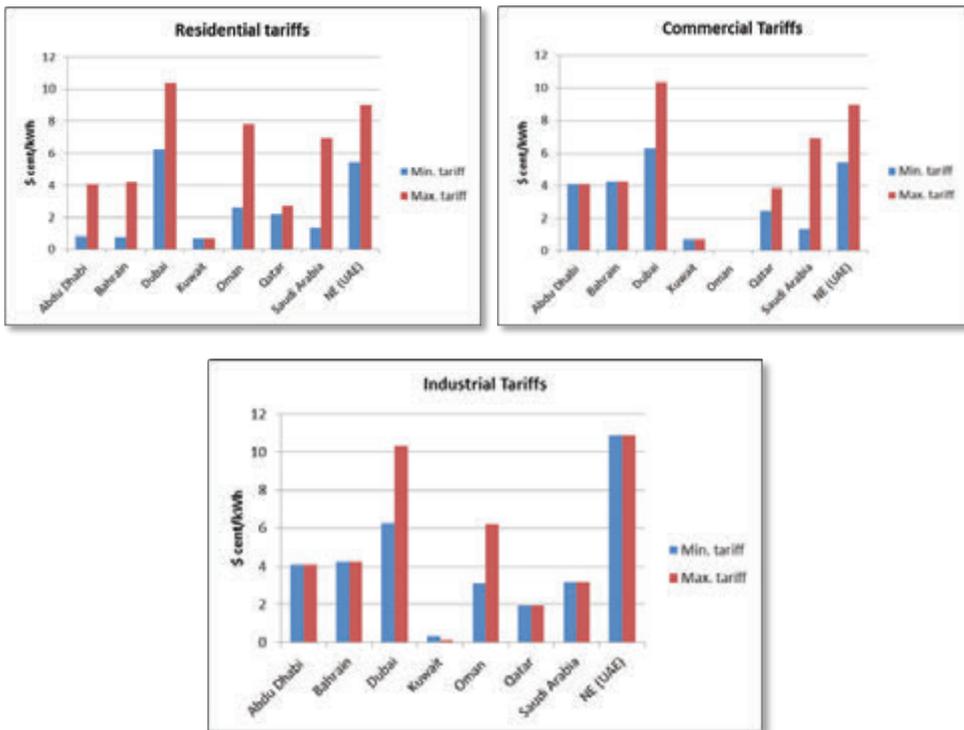
Fig. 48. Total subsidies as a share of government revenue, 2011



Source: OME based on IMF, *Energy Subsidy Reform...*, cit.

The utilities sector in the GCC has historically been dominated by state-owned power companies supplied with low-priced oil and natural gas by mostly government-owned oil and gas companies. When electricity is supplied to the final consumer, an additional subsidy is often applied. GCC residents enjoy some of the world's lowest energy prices, particularly as regards electricity (Figure 49). The market distortion created by this subsidy undermines the growth potential of renewable energy in the region.

Fig. 49. Retail electricity prices in GCC countries by sector



Source: OME based on national sources 2013.

The current move toward the liberalization of the utility markets in the GCC has not influenced electricity pricing.<sup>215</sup> According to the IEA,<sup>216</sup> some GCC countries are on the way to reducing energy subsidies. In that respect, Qatar increased gasoline, diesel and kerosene prices by 25% in January 2011, and the UAE increased gasoline prices in 2010 to the highest level in the GCC. These

<sup>215</sup> Laura El-Katiri, "Interlinking the Arab Gulf: Opportunities and Challenges of GCC Electricity Market Cooperation", in Oxford Institute for Energy Studies Working Papers, No. EL 82 (2011), <http://eprints.soas.ac.uk/id/eprint/14264>.

<sup>216</sup> IEA, Recent Developments in Energy Subsidies, Paris, OECD/IEA, 2012, <http://iea.org/media/weowebiste/2012/developments-energy-subsidies.pdf>.

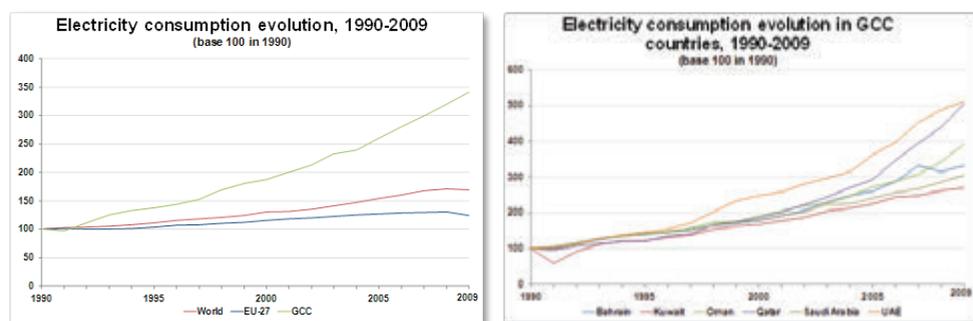
prices were still below international prices, and despite the higher international prices seen in 2011, there have been no further increases. In Kuwait, the Ministry of Finance started reviewing government service tariffs in 2011. Though no further details have been published, the desire to move this forward in 2013 is being met with parliamentary opposition, and has been described as unconstitutional.<sup>217</sup> In early 2013, Oman announced plans to double the industrial gas price by 2015.

## 4.1.6. Electricity

### 4.1.6.1. Electricity consumption

Soaring energy demand is parallel to electricity demand, mainly driven by the basic needs of the population, such as air-conditioning in buildings and potable water (desalinated water), and the low electricity tariff policies resulting from subsidies (see above). In all GCC countries, electricity consumption has greatly increased over the past 20 years, leading to a significant development in power capacities (see Annex 23). Qatar and the UAE are the countries which have seen the greatest increase (Figure 50-right).

**Fig. 50. Electricity consumption evolution in GCC countries, 1990-2009 (left); per capita electricity consumption evolution in GCC countries, 1990-2009 (right)**

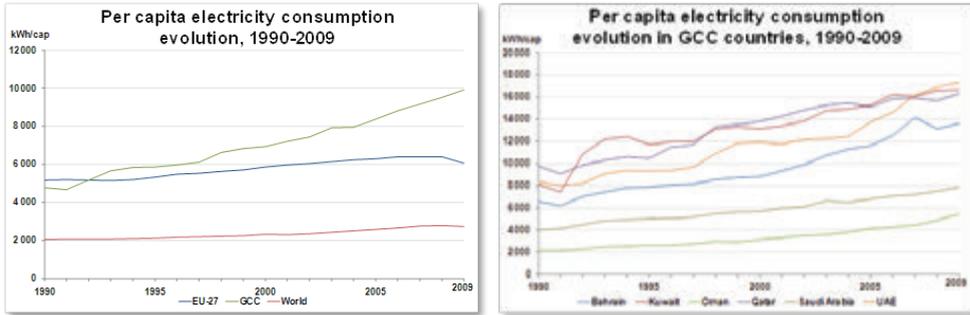


Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

On a per capita basis, the GCC countries show fast growth, increasing on average from 4,700 kWh/cap in 1990 to 9,900 kWh/cap in 2009. UAE inhabitants are the greatest consumers of electricity with more than 17,000 kWh/cap, more than six times global average per capita electricity consumption (Figure 51-left).

<sup>217</sup> "MPs adamant against fees increase", in Kuwait Times, 13 April 2013, <http://news.kuwait-times.net/2013/04/13/mps-adamant-against-fees-increase>.

**Fig. 51. Per capita electricity consumption evolution, 1990-2009 (left); per capita electricity consumption evolution in GCC countries, 1990-2009 (right)**



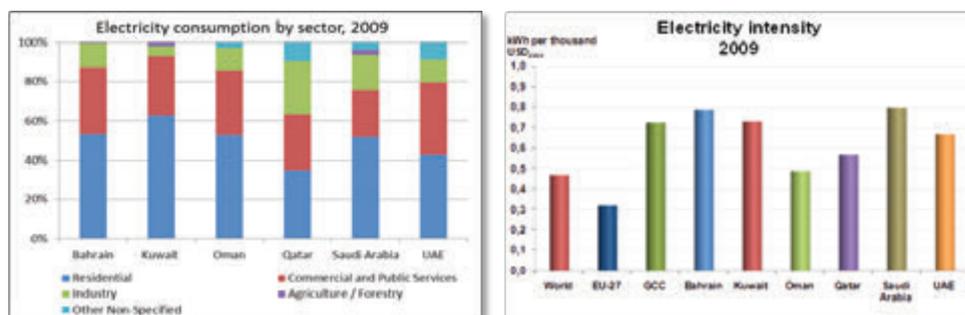
Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

Further analysis of electricity consumption in the GCC countries reveals that in most of them (except Qatar), the residential sector is the highest consumer of electricity, followed by the commercial and public services sectors (Figure 52-left). Consumption is indeed very high in buildings, which is mainly due to the use of air conditioning systems.<sup>218</sup> Given that electricity is heavily subsidized, GCC residents are not incentivized to change their habits, which should evolve from being wasteful to being more sustainable.

The GCC economies are among the most electricity-intensive in the world. The economies of Bahrain and Saudi Arabia are the most intensive in the region, with electricity intensity of around 0.8 kWh/thousand US\$<sub>2,000</sub> in 2009 (Figure 52-right).

<sup>218</sup> Deloitte, “Energy on demand: the future of GCC energy efficiency”, in *Managing scarcity for the future Whitepapers*, No. 4 (2011), [http://www.deloitte.com/assets/Dcom-Lebanon/Local%20Assets/Documents/Energy\\_and\\_resources/E&R%20whitepaper%204%20energy%20efficiency%20V2.pdf](http://www.deloitte.com/assets/Dcom-Lebanon/Local%20Assets/Documents/Energy_and_resources/E&R%20whitepaper%204%20energy%20efficiency%20V2.pdf).

**Fig. 52. Total final electricity consumption by sector, 2009 (left); electricity intensity in GCC countries, 2009 (right)**



Source: OME based on IEA, *Annual Database Statistics 2011*, cit. and national sources.

#### 4.1.6.2. Electricity market structure

The GCC countries have been experiencing increased demand for electricity due to rapid population growth and economic development. In order to shoulder the financial burden, most GCC governments have restructured their electric power markets in order to involve the private sector in power generation, transmission and distribution. The current trend across the GCC countries is to reform the power sector by enabling IPPs (Independent Power Producers) and IWPPs (Independent Water and Power Producers) to compete at the stage of generation. A summary of the market structure is set out in Table 24.

#### Bahrain

In previous years, the Ministry of Electricity and Water (MEW) was responsible for electricity generation, transmission and distribution. However, recent reform of the electric power sector has enabled the private sector to participate in electricity generation. Today, the Electricity and Water Authority (EWA)<sup>219</sup> acts as regulator for the private sector. The Government has encouraged IPPs to undertake projects, and allowed the privatization of some state-owned power sector assets. The Kingdom's first IPP is Al-Ezzel Power Company, which began operations in 2006. Today, there are three privatized power companies (IPPs and IWPPs). The EWA owns the transmission and distribution mechanisms and participates in electricity generation.

#### Kuwait

The entire energy market of Kuwait is solely owned by the Government. Ku-

<sup>219</sup> EWA website: <http://www.mew.gov.bh>.

wait's electric power system is no exception, and is vertically integrated. The MEW generates, transmits and distributes electric power. Several studies have proposed restructuring the electric power sector in the country. Until 2008, the MEW had taken responsibility for the planning, procurement, operation and maintenance of the entire production, transmission and distribution supply chain and for demand control, the latter by means of both approval of consumers' installations and conservation outreach initiatives. In 2008, a legislative framework, including means of privatization, was introduced by the Public-Private Partnership Law No. 7/2008. It involved competition and the award of contracts to private developers/investors under Build Operate and Transfer (BOT) arrangements, as well as the subsequent formation of PPPs. The process is so far considered to be in its infancy. Implementation of the first IPP tender for Az Zour North power station Phase 1 is now in progress. Currently, IPP tenders apply only to new generation projects of more than 500 MW.

## **Oman**

In 2005, a law decree passed operational responsibility for the electricity sector from the Ministry of Housing, Electricity and Water to the newly-created generation, transmission and distribution companies. Today, the Public Authority for Electricity and Water oversees the electricity sector in the Sultanate. The government still owns approximately 99% of the shares in each of the companies, but privatization is nevertheless expected to occur in the coming years in the generation, transmission and distribution sectors. According to Al-Asaad et al, the procurement company will however remain under government ownership.

The Oman Power and Water Procurement Company (OPWP) is the single buyer of power and water for all IPP and IWPP projects in Oman. The Ministry of Finance owns 99.9% of the shares in OPWP. The Ministry also owns 98.1% of the shares in the Dhofar Power Company (DPC). The power system in Oman is not fully interconnected. The largest part of the system, known as the Main Interconnection System (MIS), covers the northern part of the Sultanate. A smaller system owned by DPC serves the Salalah area in the south of the Sultanate. The rest of the country is supplied by the Rural Areas Electricity Company (RAECO).

Generation and privatization of the electricity sector falls under the responsibility of the Electricity Holding Company (EHC). Established in 2002, the EHC is wholly-owned by the Ministry of Finance. The EHC also holds the shares of the Government in nine companies engaged in the generation, transmission and distribution of electricity and related water services. Transmission activities are the responsibility of the Oman Electricity Transmission Company (OETC).

Other entities such as the Ministry of Defense, the Oman Cement Company and the Oman Mining Company have their own dedicated power systems. Pe-

troleum Development Oman (PDO), which is responsible for oil and gas exploration and production, owns and operates its own power system, which is also interconnected with the MIS and Salalah systems.<sup>220</sup>

## **Qatar**

Until 1990, all electrical power generation, transmission and distribution services were carried out by the MEW. The rapid increase in electricity demand in Qatar has led the government to encourage foreign investment in IPP projects. By 2000, the power sector had undergone a restructuring that led to the separation of power generation and water production services and their privatization. The Qatar Electricity and Water Company (QEWCo), which had already been founded in 1990 as a company limited by shares with the purpose of acquiring and managing power generation and water desalination plants, took over. Approximately 43% of the company's shares are held by the government, while the remaining 57% are held by individuals and private companies. The company owns and operates power plants to meet consumption needs, and sells its output to the Qatar General Electricity and Water Corporation (KAHRAMAA), a government entity. Transmission and distribution of electricity remains a government service carried out by KAHRAMAA. Qatar Petroleum (QP) remains the sole source of natural gas as fuel for power production facilities run by IPPs.

## **Saudi Arabia**

The Ministry of Water and Electricity (MOWE) is responsible for setting electricity sector policy and long-term energy plans. MOWE also oversees private investment in the energy sector. The Saudi government restructured the electricity industry to unbundle the sector into separate generation, transmission and distribution functions. In 2001, the Saudi Electricity Company (SEC) was established by a decision of the Council of Ministers issued in 1998. The decision was to merge ten electric companies, as well as projects run by the General Electricity Company which covered most parts of Saudi Arabia, into one company forming the SEC. Part of the restructuring process was the establishment of the Electricity and Cogeneration Regulatory Authority (ECRA) in 2001. The role of the ECRA is to regulate the electricity sector in order to maintain the lowest price for electricity at the highest standard and quality of service. Today, the electricity market in the kingdom is open to IPPs, and some large electricity consumers have on-site generation, with which some of them supply the SEC.

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<sup>220</sup> OPWP, Oman Power & Water Procurement (OPWP) Co. SAOC, <http://www.linkedin.com/company/oman-power-&-water-procurement-opwp-co-saoc>.

## UAE

The national grid of the UAE is managed by the Ministry of Energy, and consists of four utilities covering different Emirates. Each utility is responsible for maintaining the quality, security and control of its own power system. The four utilities are:

- the Federal Electricity and Water Authority (FEWA),<sup>221</sup> which was established in 2008 to provide electricity and water services to the Northern Emirates (Ajman, Oum AQuain, Fujairah and Ra'as Al Khaima);
- the Sharjah Electricity and Water Authority (SEWA),<sup>222</sup> which was established in 2007 to provide electricity and water services to Sharjah;
- the Dubai Electricity and Water Authority (DEWA),<sup>223</sup> established in 1992 to replace the Dubai Electric Company. There are as yet no plans to privatize the electricity and water sector;<sup>224</sup>
- the Abu Dhabi Water and Electricity Authority (ADWEA),<sup>225</sup> established in 1998. It is wholly owned by Abu Dhabi government and supplies electricity and water to the Emirate of Abu Dhabi. It has five wholly-owned subsidiaries and holds 60% of the shares in nine independent power and water producers. The vertical and horizontal organizational system of the water and electricity sector was dissolved upon the establishment of ADWEA. The new structure of the electricity and water sector came into effect in 1999. The electricity sector in Abu Dhabi is currently under a single-buyer model, where all production capacity is purchased by Abu Dhabi Water and Electricity Company (ADWEC).

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<sup>221</sup> FEWA website: <http://www.fewa.gov.ae>.

<sup>222</sup> SEWA website: <http://www.sewa.gov.ae/english>.

<sup>223</sup> DEWA website: <http://www.dewa.gov.ae>.

<sup>224</sup> Zaher Bitar, "No privatisation for water and electricity sector", in *Gulf News*, 19 February 2013, <http://m.gulfnews.com/business/no-privatisation-for-water-and-electricity-sector-1.1148248>.

<sup>225</sup> ADWEA website: <http://www.adwea.ae/en>.

Table 24. Electricity market structure in GCC countries

	Regulator	Generation	Transmission	Distribution	Procurement
<b>Bahrain</b>	Electricity and Water Authority (EWA)	<ul style="list-style-type: none"> <li>Electricity and Water Authority (EWA)</li> <li>Al-Ezzel Power Company (Al-Ezzel PC)</li> <li>Hidd Power Company (HPC)</li> <li>Al Dur Power and Water Company (Aldur)</li> </ul>	Electricity and Water Authority (EWA)		
<b>Kuwait</b>	Ministry of Electricity and Water (MEW)				
<b>Oman</b>	Authority for Electricity Regulation (AER)	<ul style="list-style-type: none"> <li>SMN Barka Power Company</li> <li>Al Rusail Power Company</li> <li>Sohar Power Company</li> <li>ACWA Power Barka</li> <li>United Power Company</li> <li>Al Karril Power Company</li> <li>Al Ghubrah Power and Desalination</li> <li>Al Rusail Power Company</li> <li>Wadi Al Jizzi Power Company</li> <li>Rural Areas Electricity Company</li> <li>Ministry of Defense (generates electricity and sells it to OPWP)</li> <li>Petroleum Development Oman (PDO)</li> </ul>	<ul style="list-style-type: none"> <li>Oman Electricity Transmission Company</li> <li>Rural Areas Electricity Company</li> </ul>	<ul style="list-style-type: none"> <li>Rural Areas Electricity Company</li> <li>Muscat Electricity Distribution Company</li> <li>Mazoon Electricity Company</li> <li>Majan Electricity Company</li> </ul>	Oman Power and Water Procurement Company (OPWP)
<b>Qatar</b>	Companies are self-regulated	<ul style="list-style-type: none"> <li>Qatar Electricity and Water Company (QEWC)</li> <li>Ras Laffan Power Company (RLPC)                             <ul style="list-style-type: none"> <li>Ras Gasas Power Company</li> <li>Q Power</li> </ul> </li> <li>Mesaieed Power Company</li> </ul>	Qatar General Electricity and Water Corporation (KAHBRAMAA)		
<b>Saudi Arabia</b>	Electricity and Cogeneration Regulatory Authority (ECRA)	Saudi Electricity Company (SEC)			Sustainable Energy Procurement Company (SEPC)
<b>UAE</b>					
The Northern Emirates	Federal Electricity and Water Authority (FEWA)				
Sharjah	Sharjah Electricity and Water Authority (SEWA)				
Dubai	Dubai Electricity and Water Authority (DEWA)				
<b>Abu Dhabi</b>	<ul style="list-style-type: none"> <li>Abu Dhabi Water and Electricity Authority (ADWEA)</li> <li>Regulation and Supervision Bureau (RSB)</li> <li>Federal Authority for Nuclear Regulation (FANR)</li> </ul>	<ul style="list-style-type: none"> <li>Al Mirfa Power Company (AMPC)</li> <li>Emirates CMS Power Company</li> <li>Gulf Total Tractebel Power</li> <li>Sharweihat CMS International Power Company</li> <li>Arabian Power Company</li> <li>Taweelah Asia Power Company</li> <li>Emirates SembCorp Water and Power Company</li> <li>Fujairah Asia Power Company</li> <li>Ruwais Power Company</li> <li>Sharweihat Asia Power Company</li> </ul>	Abu Dhabi Transmission and Dispatch (TRANSCO)	<ul style="list-style-type: none"> <li>Abu Dhabi Distribution Company (ADDC)</li> <li>Al Ain Distribution Company (AADC)</li> </ul>	Abu Dhabi Water and Electricity Company (ADWEC)

Source: OME based on national sources 2013.

#### 4.1.6.3. Electricity shortage

It has become evident over the past several years that there is a significant shortage in the electric power capacities of some of the GCC countries. However, this shortage is felt only during peak demand periods. Electricity consumption peaks in the GCC during summer as a result of the high demand for air conditioning. Maximum peak loads occur in the afternoon periods between 12hr and 16hr, depending on the temperature and humidity. Peak loads can be as twice off-peak summer rates and three times winter rates. Sustained high loads and inadequate capacity at peak hours have caused recurring electricity outages in several major cities across the GCC (mainly in Kuwait, Bahrain, Jeddah and Sharjah).

The power outages and load shedding have affected not only the residential sector, but have also raised concerns among the business and industrial sectors, which are often left with no other option than to shut down operations during power outages. The economic loss due to power cuts in Sharjah in 2009 was estimated at more than \$19 million. Saudi Arabia had to shut down its most important petrochemical complexes in 2010 due to power outages. In recent years, the Saudi Electric Company had to shut down parts of the industrial zone in south Jeddah during afternoon hours in order to avoid larger power outages. This has led some businesses to install their own generation capacities, while other projects have been delayed or in some cases cancelled.<sup>226</sup>

#### 4.1.6.4. Interconnections

Realizing the urgent need to meet growing energy needs and the resulting power requirements, the GCC countries have jointly thought about areas of cooperation, one of which being the development and interconnection of their power systems. The GCC regional power grid interconnection scheme was formally inaugurated in 1981 with a signed agreement between the GCC countries. This agreement was followed by a series of feasibility studies, but the project stalled for over two decades. It really got concrete with the establishment, through a Royal Decree issued in 2001,<sup>227</sup> of the Gulf Cooperation Council Interconnection Authority (GCCIA), which aims at constructing, operating and maintaining a GCC regional power grid (Figure 53). In 2003, an update of the previous feasibility studies was carried out, and in 2004, GCC states agreed to implement and finance the project.

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<sup>226</sup> Laura El-Katiri, "Interlinking the Arab Gulf...", cit.

<sup>227</sup> See GCCIA, CEO Statement, [http://www.gccia.com.sa/ceo\\_message.html](http://www.gccia.com.sa/ceo_message.html).

Fig. 53. The interconnection of the GCC regional power grid (GCCIA)

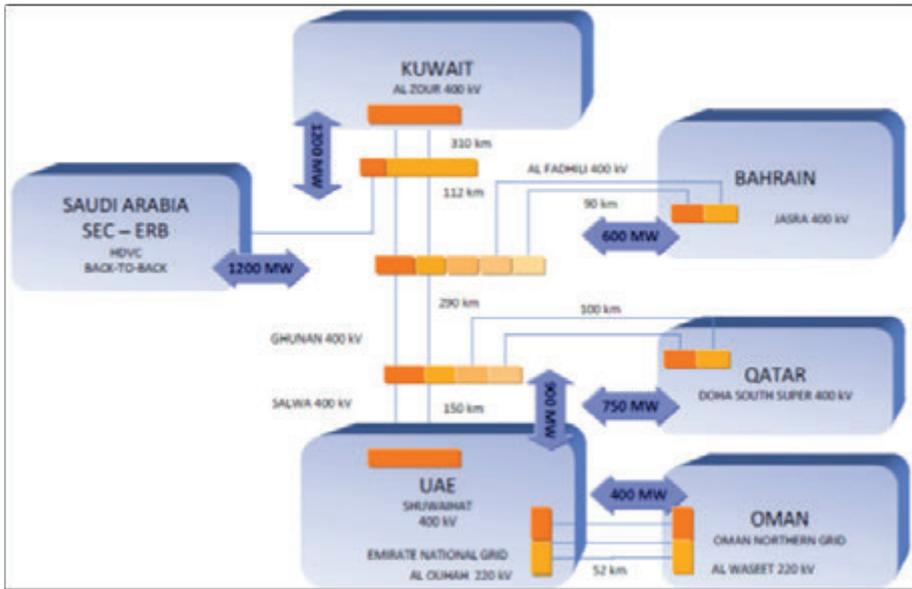


The benefits expected from integrating the GCC power systems are among others: (i) to reduce the investment costs required for new generation by reducing the level of reserves needed in each country; (ii) to improve the economic efficiency of the electricity power systems of each country; (iii) to provide mutual support in case of national power system failure; (iv) to enable energy trading.

The project has been implemented in three phases:

- Phase I: Interconnection of the power systems of Kuwait, Saudi Arabia, Bahrain, and Qatar, including HVDC back-to-back converter stations between the Saudi 380 kV 60-Hz system and the 400 kV 50-Hz system of the other GCC countries. This is the GCC North Grid.
- Phase II: The internal interconnection of the independent systems in the UAE and Oman. This is the GCC South Grid. The GCCIA was not involved in this phase.
- Phase III: Interconnection of the Northern and Southern Grids, forming the “Hybrid Link”.

Fig. 54. Block diagram of the GCC interconnection system (GCCIA)



The first phase was completed in 2009, and phases II and III were completed during 2012.<sup>228</sup> The GCC electricity grid allows for the possibility of exchange between countries following the technical specificities described in Figure 54. Thus, Kuwait and Saudi Arabia are both able to export or import up to 1,200 MW from the grid. Bahrain, Qatar and the UAE are able to trade 600 MW, 750 MW and 900 MW respectively. Oman has the lowest interconnector capacity at 400 MW. The GCC control center is located in Ghunan in Saudi Arabia.

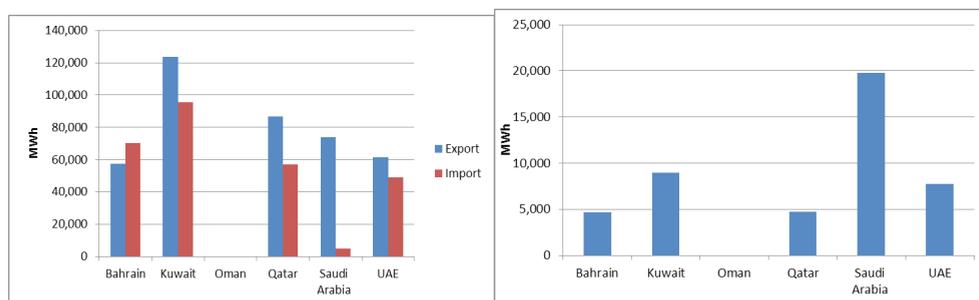
In parallel to this regional power grid development, the GCC countries have been undertaking transformational changes within their power sectors, mainly in order to overcome the financial burdens involved in constructing utility projects to meet growing demand. Thus several GCC countries intend to unbundle the generation, transmission and distribution functions in order to facilitate and encourage private investment. The GCC countries are thus on the way to reforming their electricity sectors and to initiating the gradual development of a competitive market. The GCCIA's role in this is to enhance cooperation between Member States' utilities in order to establish a common market in the region. Furthermore, the existence of the GCC interconnection will provide opportunities for the establishment of power and desalination plants close to resources, thus giving the freedom to IPPs and IWPPs to select strategic locations which

<sup>228</sup> King Saud University, CEO of Gulf Cooperation Council Interconnection Authority speaks at KSU, 6 May 2012, <http://enews.ksu.edu.sa/2012/05/06/ceo-of-gulf-cooperation-council-interconnection-authority-speaks-at-ksu>.

will allow them to operate in a larger market with reduced risks.

The completion of the GCC regional power grid has already allowed significant progress in both power trading and emergency support. According to the GCCIA, in 2011, before completion of the entire grid, the volume of electricity exchanged between the interconnected countries had already multiplied by 150.<sup>229</sup> The GCCIA also observed that simultaneous trading occurred among up to three Member States at once. Between July 2009 and the end of 2011, there were some 450 incidents of sudden loss of generation units connected to the network in various Member States, but thanks to the GCC interconnection, the systems managed to avoid supply interruption, and the need for programmed shutdown was avoided. In 2011 alone, the GCCIA observed around 180 incidents within local GCC grids which did not require load shedding, as a result of the compensation of the interconnection. This clearly highlights that the establishment of the regional power grid allows GCC countries to rely on the interconnector in case of emergency or unaccounted load increase. Electricity trading between GCC countries across the GCCIA interconnection increased from 308 MWh in 2010 to 46 GWh in 2011. In August 2011 alone, around 20 GWh were exchanged. The volume of electricity exchanged during emergencies and the size of the electric trade are described in Figure 55.

**Fig. 55. Electricity dispatched between the GCC countries during emergencies in 2011 and the size of the electric trade in 2011**



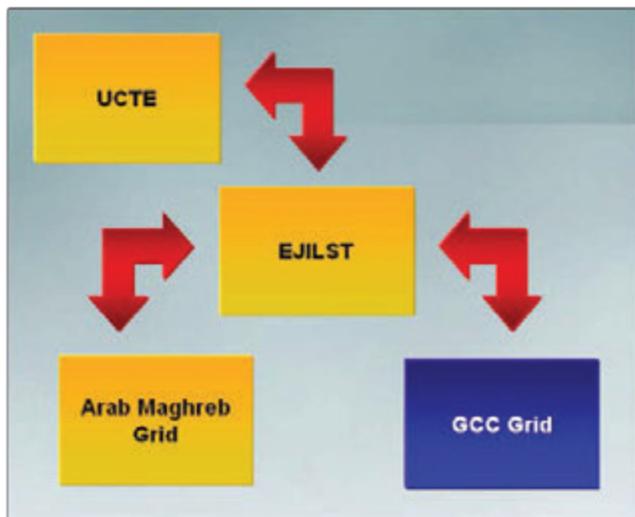
Source: OME based on GCCIA.

The GCCIA is now focusing on the development of simple trading tools in order to facilitate and promote power trading between the GCC countries (e.g. the GCCIA e-auction system), as well as the acceleration of the establishment of a competitive regional market. The GCCIA is also working on the development of an integrated Energy Market Management System (EMMS) to handle transactions.

<sup>229</sup> GCCIA, Annual Report 2011, Dammam, Gulf Cooperation Council Interconnection Authority, 2012, <http://www.gccia.com.sa/press.aspx?p=R>.

In the long-term, the GCCIA envisages expanding the GCC grid system to trade energy not only within the GCC, but also with other interconnected regions (Figure 56). The GCCIA is also involved in the Pan-Arab interconnection study. This study is looking at the feasibility of the interconnection of the regional power grids of the Arab countries, including the EIJLLPST grid (Egypt, Iraq, Jordan, Lebanon, Libya, Palestine, Syria, and Turkey) and the Arab Maghreb grid (Morocco, Algeria, Tunisia). Extending the GCC grid to other grids such as EIJLST or the Arab Maghreb Grid would provide an opportunity for the export of surplus power to other regions. For instance, during the winter, when demand for power is low in the GCC, it would be advantageous to export power to regions in Europe, where demand is high during the same period. The market will also encourage energy interchange at other times of seasonal diversity, for example when demand for power in the GCC region during the hot summer season is high and this high demand can be met by importing from regions where demand is low during the same period. Such a scheme would provide new opportunities in terms of regional markets and power exchange, given the complementarities of these different electricity markets. The GCC grid and the idea of a regional electricity market is a long-term project whose potential benefits will evolve over decades.

**Fig. 56. Potential regional interconnections (GCCIA)**



## **Box 2 Electrical. Interconnection of Three Continents Project**

The Electrical Interconnection of Three Continents or EITC (formerly EIJLLPST) Project has the purpose of interconnecting the electric power system networks of the countries participating in the EIJLLPST project. From the beginning of this project in 1989 until now, Turkey-Syria, Syria-Jordan, Jordan-Egypt, and Egypt-Libya interconnection lines have been built. Syria-Lebanon and Syria-Iraq interconnections lines are to be built, and the planning of a Jordan-Palestine line and upgrades to some existing interconnection lines are in progress. Some studies looking at the interconnection of all the EIJLLPST countries have been conducted, but due to the extraordinary situation in the region some of the work has been delayed. If the studies are successful, the ring created will enable EIJLLPST, Europe and the Gulf countries to cooperate on technical issues and renewable energy and trading.

The project began on 17 January 1989 with a document signed at ministerial level entitled “Interconnection of Egypt, Syria, Jordan, Iraq and Turkey Electricity Transmission Networks“. The purpose of the document was to establish the synchronous parallel connection of the electrical transmission systems of the countries involved. The study was also known as the “Five Countries Interconnection Project“. It became the “Six Countries Interconnection Project“ after Lebanon’s involvement in 2001. The last participant, Palestine, joined at the time of the Technical Committee and Ministerial Meeting held in Jordan on 22-28 October 2008, when the project acquired the name of the “Eight Country Interconnection Project (EIJLLPST)”.

Within the framework of the project, Turkey has signed Installation Agreements with Syria and Iraq for 400 kV electricity interconnection lines. The Turkish section of the Turkey-Syria interconnection line was finished at the end of 1997, the Syrian section was completed at the beginning of 2003, and the interconnection line became operational in mid-2003. At the Technical Committee meeting held in Damascus on 1 November 2003, the parties agreed to accelerate the construction of the Syria-Iraq and Iraq-Turkey lines.

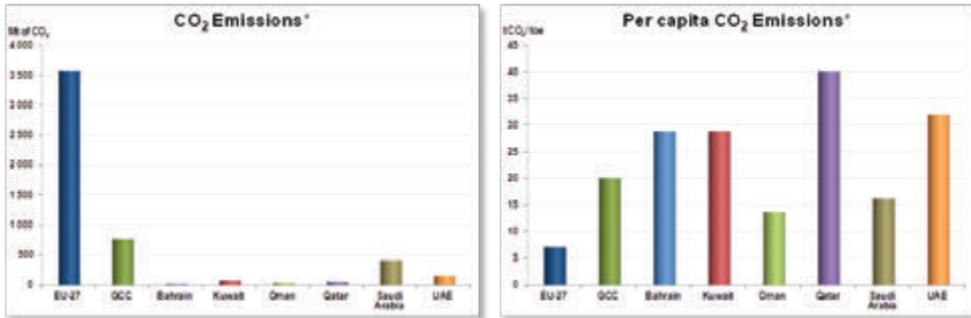
The European Network of Transmission System Operators for Electricity (ENTSO-E), formerly the European Union for the Coordination of the Transmission of Electricity, to which Turkey is currently in a trial period of parallel connection and which aims at the establishment of a possible Mediterranean ring, has always been taken an interest in EIJLLPST. For this reason, examining the structure of ENTSO-E is a priority of EIJLLPST. In June 2010, a General Meeting of the Planning Committee changed the name of the Eight Country Interconnection Project to the “EITC/Electrical Interconnection of Three

Continents". The studies for the Eight Countries Interconnection Project are carried out by the General Planning Committee, the Operation Committee and the Transit Fees Committee.

#### 4.1.6.5. CO<sub>2</sub> emissions

Due to the structure of the energy sector in the GCC countries, CO<sub>2</sub> emissions are among the highest in the world. Indeed, whereas the total volume of CO<sub>2</sub> emitted is not as high as the one in the EU-27, the GCC's per capita CO<sub>2</sub> emissions are three times higher than those of the EU-27. Qatar's rate, the highest rate of per capita CO<sub>2</sub> emissions among the GCC countries (40 tCO<sub>2</sub>/cap), is six times higher than that of the EU-27. The electricity sector across the GCC is inseparably linked to the water sector due to the use of desalination plants for the production of potable water. Thus the electricity and water sectors are by far the largest single producers of CO<sub>2</sub> emissions in the region. On average, the sector contributes to 40% of the region's total CO<sub>2</sub> emissions. In some GCC countries, emissions from the sector surpass 50%.<sup>230</sup>

**Fig. 57. CO<sub>2</sub> emissions in EU-27 and GCC countries, 2009 (left); per capita CO<sub>2</sub> emissions in EU-27 and GCC countries, 2009 (right)**



\* CO<sub>2</sub> emissions from fuel combustion only. Emissions are calculated using IEA's energy balances and the Revised 1996 IPCC Guidelines

Source: OME based on IEA, *Annual Database Statistics 2011*, cit.

More recently, the GCC countries have adopted a proactive approach to environmental issues. Legislation and medium- and long-term targets are being developed in the field of renewable energy. However, there are as yet no consistent strategies or policies.<sup>231</sup>

<sup>230</sup> Imen Jeridi Bachelierie, *Renewable Energy in the GCC Countries. Resources, Potential and Prospects*, Jeddah and Amman, Gulf Research Center and Friedrich Ebert Stiftung, March 2012, <http://library.fes.de/pdf-files/bueros/amman/09008.pdf>.

<sup>231</sup> Danyel Reiche, "Energy Policies of Gulf Cooperation Council (GCC) countries. Possibilities and limitations of ecological modernization in rentier states", in *Energy Policy*, Vol. 38, No. 5 (May

### 4.1.7. Non-fossil resources

#### 4.1.7.1. Nuclear

The GCC countries are also looking at developing nuclear energy in order to diversify their energy mix and to reduce their over-reliance on hydrocarbon resources. All countries are members of the Arab Atomic Energy Agency (AAEA), an Arab League organisation concerned with the peaceful uses of atomic energy and the development of nuclear sciences and their technological applications. This agency also looks at the international development of the peaceful uses of Atomic Energy and the methods and means to transfer that into the Arab Countries.

In December 2006, the six Member States of the GCC announced that the Council was commissioning a study on the peaceful use of nuclear energy. In 2007, the GCC countries agreed to cooperate with the IAEA on a feasibility study for a regional nuclear power and desalination programme. Saudi Arabia led the work, and thought that a programme might emerge in about 2009. In addition, all countries are signatories to the Non-Proliferation Treaty, and the UAE ratified a Safeguards Agreement with the IAEA in 2003. Beside the regional programme, each country has looked at the implementation of nuclear energy with greater or lesser degrees of interest.

#### **Bahrain**

In Bahrain, the Minister for Electricity and Water Affairs announced in December 2010 that Bahrain intended to have nuclear power by 2017.<sup>232</sup> The implementation of this plan, however, faced several problems, and in October 2012 it was announced that Bahrain's plans to adopt nuclear energy as source of power by 2017 had been postponed.

#### **Kuwait**

Kuwait has investigated the possibility of having its own nuclear programme for electricity generation and freshwater production as an alternative to fossil fuel. In March 2009, the Kuwait National Nuclear Energy Committee (KN-NEC) was established by Amiri decree. The committee was headed by the Prime Minister and 10 distinguished members. It implemented the country's nuclear energy programme, working through roadmap programmes to form an official

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2010), p. 2395-2403, <http://wupperinst.org/en/publications/details/wi/a/s/ad/1089>.

<sup>232</sup> Reuters, "Bahrain to have nuclear power by 2017 - minister", in *Arabian Business*, 22 December 2010, <http://www.arabianbusiness.com/bahrain-have-nuclear-power-by-2017-minister-368940.html>.

organizational structure (covering regulation, operations, and safety organizations). In December 2009, Kuwait signed its first Country Programme Framework (CPF) with the IAEA.<sup>233</sup> The CPF served as a frame of reference for the medium-term planning of technical cooperation between Kuwait and the IAEA in order to identify priority areas where the transfer of nuclear technology and technical cooperation resources would be directed to support national development goals. KNEEC conducted an economic feasibility study which showed that the establishment of a nuclear plant with capacity ranging from 4 to 6 GW was the optimum level of generation under various assumptions (oil/gas prices, demand, technology costs, etc.). After the Fukushima Daiichi nuclear accident in Japan in March 2011, an Amiri decree was issued in July 2011 cancelling the Kuwaiti nuclear energy programme for electric power generation. The Amiri decree transferred KNEEC's programme to the Kuwait Institute for Scientific Research (KISR).

## Oman

Oman has also investigated nuclear power. In June 2009, Oman signed a nuclear cooperation agreement with Russia. However, earlier in 2008 it said that since most of its demand was peak load, nuclear did not seem appropriate, though investment in a nuclear plant in a neighbouring GCC country was possible.<sup>234</sup>

## Qatar

Qatar has undertaken its own investigation regarding the viability of nuclear power, and late in 2008 announced that there was not yet a strong case for proceeding. Nevertheless, in 2010 Qatar raised the possibility of a regional project. In the same year it signed a nuclear cooperation agreement with Russia's Rosatom.<sup>235</sup>

## Saudi Arabia

Saudi Arabia announced in 2009 that it was considering a nuclear power programme. In April 2010 a royal decree stated that "the development of atomic energy is essential to meet the Kingdom's growing requirements for energy to generate electricity, produce desalinated water and reduce reliance on depleting hydrocarbon resources" and the King Abdullah City for Atomic and Renew-

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<sup>233</sup> IAEA, "Kuwait", in Country Nuclear Power Profiles 2012 edition, Vienna, IAEA, June 2011, [http://www-pub.iaea.org/MTCD/Publications/PDF/CNPP2012\\_CD/countryprofiles/Kuwait/Kuwait.htm](http://www-pub.iaea.org/MTCD/Publications/PDF/CNPP2012_CD/countryprofiles/Kuwait/Kuwait.htm).

<sup>234</sup> World Nuclear Association, *Emerging Nuclear Energy Countries*, May 2013, <http://www.world-nuclear.org/info/Country-Profiles/Others/Emerging-Nuclear-Energy-Countries>.

<sup>235</sup> *Ibidem*.

able Energy (K.A.CARE) was created to oversee nuclear and renewable energy development within the kingdom. In June 2011, the coordinator of scientific collaboration at K.A.CARE announced a plan to construct 16 nuclear power reactors over the next 20 years. In May 2012, K.A.CARE foresaw the generation of 17 GW of nuclear capacity by 2032. A National Atomic Regulatory Authority has also been set up<sup>236</sup>.

## UAE

The UAE has the most advanced nuclear energy plans of all the GCC countries. In 2008, it published a comprehensive policy on nuclear energy. Nuclear power was described as a “proven, environmentally promising and commercially competitive option which could make a significant base-load contribution to the UAE’s economy and future energy security”. 20 GW of nuclear power is foreseen, which implies the construction of 14 plants, with nearly one quarter to be built by 2020. At the recommendation of the IAEA, a Nuclear Energy Program Implementation Organization, namely the Emirates Nuclear Energy Corporation (ENEC), was set up as public entity to evaluate and implement these plans. In 2009, a federal law regarding the peaceful uses of nuclear energy was adopted which set up the independent Federal Authority for Nuclear Regulation (FANR) to oversee the entire nuclear energy sector of the UAE. In December 2009, ENEC announced that the Korea Electric Power Company (KEPCO) would construct four nuclear reactors, and in July 2012 licenses were approved for KEPCO to begin construction of the first two 1,400 MW reactors. The first reactor is scheduled to be operational by 2017, while the others are expected to be completed by 2020. To avoid concerns about its use of nuclear technologies, the UAE committed itself to forgoing the domestic enrichment and processing of nuclear fuel by adopting a law that banned its practice within the country.<sup>237</sup>

### 4.1.7.2. Renewable energy

#### *a) The current state of development and potential of renewable energy technologies in the GCC countries*

In general, renewable energy (RE) applications are still not very well developed in the GCC countries. Nevertheless, renewable energy technologies offer promising opportunities in the GCC, particularly solar energy technologies. The GCC countries lie in the so-called sunbelt, with global horizontal irradiance (GHI)

<sup>236</sup> World Nuclear Association, Nuclear Power in Saudi Arabia, June 2012, <http://www.world-nuclear.org/info/Country-Profiles/Countries-O-S/Saudi-Arabia>.

<sup>237</sup> World Nuclear Association, Nuclear Power in the United Arab Emirates, May 2013, <http://www.world-nuclear.org/info/Country-Profiles/Countries-T-Z/United-Arab-Emirates>.

values ranging from 1,900 kWh/m<sup>2</sup>/y in Kuwait to 2,160 kWh/m<sup>2</sup>/y in Bahrain, and direct normal irradiance (DNI) varying from 2,000 kWh/m<sup>2</sup>/y in Qatar to 2,500 kWh/m<sup>2</sup>/y in Saudi Arabia. This is one of the best endowed areas of the world with respect to solar energy, both for PV and CSP applications (Table 25). The wind potential is more moderate, with full load hours per year ranging from 1,176 in the United Arab Emirates to 2,463 in Oman. The greatest potential is for offshore wind along the coastline.

**Table 25. Solar resources and wind energy potential in GCC countries**

	DNI (kWh/m <sup>2</sup> /y)	GHI (kWh/m <sup>2</sup> /y)	Full load hours per year (h/y)
<b>Bahrain</b>	2,050	2,160	1,360
<b>Kuwait</b>	2,100	1,900	1,605
<b>Oman</b>	2,200	2,050	2,463
<b>Qatar</b>	2,000	2,140	1,421
<b>Saudi Arabia</b>	2,500	2,130	1,789
<b>UAE</b>	2,200	2,120	1,176

Source: Ali Al-Karaghoul et al., *Current Status of Renewable Energies in the Middle East North African Region*, Study for the German Ministry of Environment, Nature Conservation and Nuclear Safety, Nairobi, United Nations Environment Programme (UNEP), June 2007, [http://www.unep.org/pdf/rowa/Renewable\\_Energy.pdf](http://www.unep.org/pdf/rowa/Renewable_Energy.pdf).

Several studies have investigated the potential of different renewable energy technologies in the GCC, and in a wider context the MENA region, to supply a significant share of European energy needs through interconnected systems.

Within the framework of the Trans-Mediterranean Renewable Energy Cooperation (TREC),<sup>238</sup> the MED-CSP study carried out by the German Aerospace Centre (DLR)<sup>239</sup> has emphasised that the biggest resource in the MENA region is solar irradiance, with a potential that is by several orders of magnitude larger than the total world electricity demand. In fact, every 10 km<sup>2</sup> in the MENA region could yield the equivalent of 15 million barrels of oil fuel per year in the form of solar energy. Such solar resources could be used both in distributed photovoltaic systems and in large central solar thermal power stations. Thus both distributed rural and centralised urban demand could be met by renewable energy technologies.

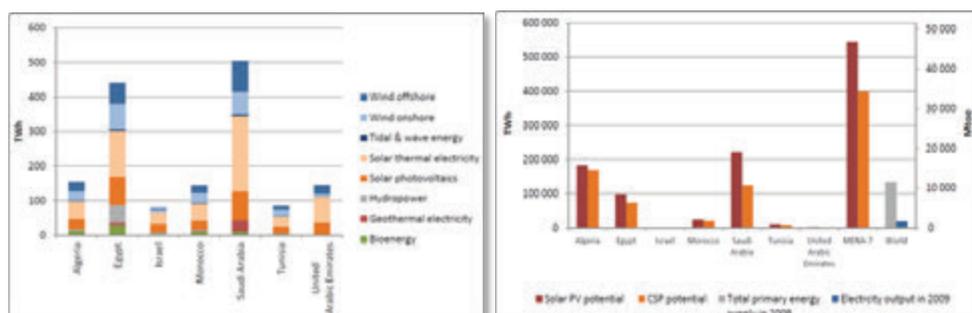
Moreover, the IEA has started looking at the MENA region to investigate the

<sup>238</sup> TREC was established in 2003 by The Club of Rome, the Jordanian NERC and the Hamburg Climate Protection Foundation. Its aim is to achieve fast climate, energy and water security by means of a joint effort undertaken by the EU-MENA regions, and it has laid the foundations of the DESERTEC concept.

<sup>239</sup> Franz Trieb et al., *MED-CSP: Concentrating Solar Power for the Mediterranean Region*, Study for the German Ministry of Environment, Nature Conservation and Nuclear Safety, Stuttgart, DLR Institute of Technical Thermodynamics, 16 April 2005, <http://www.dlr.de/tt/desktopdefault.aspx/tabid-3789>.

potential of several energy technologies. In a 2011 information paper,<sup>240</sup> the IEA looked at the long-term potential of several renewable energy technologies in selected MENA countries, including some GCC countries such as Saudi Arabia and the United Arab Emirates. The study's results show a high potential for RE technologies, especially for both PV and CSP technologies, particularly in Saudi Arabia (Figure 58).

**Fig. 58. 2030 renewable electricity potentials in MENA-7 countries (left); the long-term potential of CSP and PV in MENA-7 countries (right)**



Source: Simon Müller, Ada Marmion and Milou Beerepoot, *Renewable Energy*, cit., p. 71-72.

Other sources<sup>241</sup> report the very favourable framework conditions for solar technologies in the GCC, with three GCC countries (Oman, Saudi Arabia and the UAE) ranked among the top five countries in the MENA region in terms of ideal solar energy potential for both CSP and PV applications (Table 26). In particular, Saudi Arabia combines very high DNI and GHI values (2,500 kWh/m<sup>2</sup>/y and 2,130 kWh/m<sup>2</sup>/y respectively) with high availability of non-arable land (98.2%) and 9.3 daily hours of sunshine. Oman has a DNI of 2,200 kWh/m<sup>2</sup>/y, a GHI of 2,050 kWh/m<sup>2</sup>/y, 99.7% of non-arable land and 9.6 daily hours of sunshine. The UAE has a DNI of 2,200 kWh/m<sup>2</sup>/y, a GHI of 2,120 kWh/m<sup>2</sup>/y, 97% of non-arable land and 9.5 daily hours of sunshine.

<sup>240</sup> Simon Müller, Ada Marmion and Milou Beerepoot, *Renewable Energy: Markets and Prospects by Regions*, Paris, OECD/IEA, November, 2011, <http://www.iea.org/publications/freepublications/publication/name,20555,en.html>.

<sup>241</sup> Al Masah Capital, *Unlocking the Potential of Alternative Energy in MENA*, Dubai, Al Masah Capital, 2011, [http://ae.zawya.com/researchreports/p\\_2010\\_07\\_22\\_09\\_20\\_27/20110120\\_p\\_2010\\_07\\_22\\_09\\_20\\_27\\_065702.pdf](http://ae.zawya.com/researchreports/p_2010_07_22_09_20_27/20110120_p_2010_07_22_09_20_27_065702.pdf).

**Table 26. Top five countries in MENA with ideal physical resources for solar energy generation**

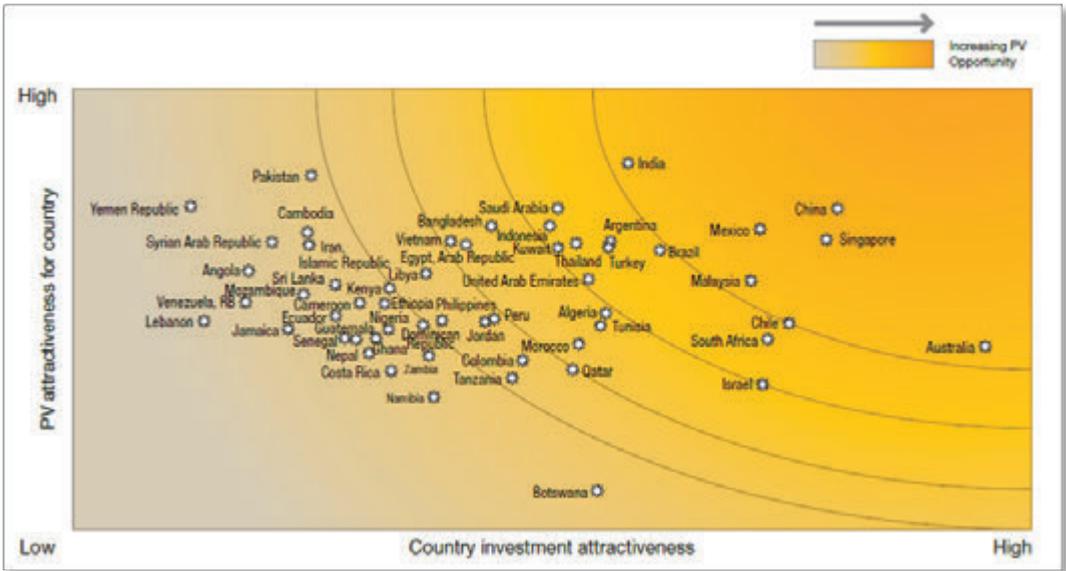
	<b>Direct normal irradiance KWh/m<sup>2</sup>/y (for CSP)</b>	<b>Global horizontal irradiance KWh/m<sup>2</sup>/y (for PV)</b>	<b>Non-arable land (%)</b>	<b>Daily hours of sunshine</b>
<b>Egypt</b>	2,800	2,450	96.6%	9.3
<b>Oman</b>	2,200	2,050	99.7%	9.6
<b>Saudi Arabia</b>	2,500	2,130	98.2%	9.3
<b>Jordan</b>	2,700	2,310	95.5%	9.3
<b>UAE</b>	2,200	2,120	97.0%	9.5

Source: Al Masah Capital, *Unlocking the Potential of Alternative Energy in MENA*, cit., p. 16.

A study by the European Photovoltaic Industry Association (EPIA)<sup>242</sup> presents an assessment of the opportunities for investing in PV technologies in selected sunbelt countries, based on a ranking of several factors affecting the likelihood of investing in the country, as well as of specific factors affecting the attractiveness of the PV industry. As shown in Figure 59, several GCC countries are clustered in the medium to higher categories for PV investment. There is a clear role for EU industry to play in establishing important industrial partnerships with the GCC countries, thus expanding their businesses in the GCC region. The report points to the contribution PV can make to the sunbelt countries' energy supply, and provides guidance on how existing barriers can be overcome.

<sup>242</sup> EPIA, *Unlocking the Sunbelt potential of Photovoltaics*, 3 edn, Brussels, European Photovoltaics Industry Association, March 2011, [http://www.epia.org/index.php?eID=tx\\_nawsecuredl&u=0&file=/uploads/tx\\_epiapublications/Sunbelt\\_Epia\\_MARCH2011\\_FINAL.pdf](http://www.epia.org/index.php?eID=tx_nawsecuredl&u=0&file=/uploads/tx_epiapublications/Sunbelt_Epia_MARCH2011_FINAL.pdf).

Fig. 59. PV opportunities in sunbelt countries



Source: EPIA, *Unlocking the Sunbelt potential of Photovoltaics*, cit.

Against this general framework, the current level of development and deployment of renewable energies in the GCC is below expectations. The GCC countries still lack specific frameworks for RE, but that does not imply that the region is inactive in the field. In fact, all GCC countries promote renewable energies through resource assessment, pilot demonstration plants and feasibility studies.

As Non-Annex I parties, the GCC countries are potential locations for Clean Development Mechanism (CDM) projects, but these projects are still overlooked in the GCC region, despite the enormous potential they present for energy efficiency, solar development, waste management and other CO<sub>2</sub> abatement solutions. As of 1 December 2012, only 6 CDM projects had been registered by the CDM Executive Board (Table 27), for a total CO<sub>2</sub>-eq saving of about 3.3 million tonnes through to 2020. Some 20 further projects are currently being validated. The United Arab Emirates is taking the lead in the implementation of CDM projects, followed by Saudi Arabia, Qatar and Oman. There are no CDM projects on the horizon in either Bahrain or Kuwait.<sup>243</sup>

<sup>243</sup> Emanuela Menichetti, "Will the UN climate conference in Doha boost EU-GCC cooperation on climate change?", in *Sharaka Commentaries*, No. 2 (July 2012), <http://www.sharaka.eu/?p=735>.

**Table 27. CDM projects in GCC countries**

ID	Ref.	Title	Host country	Status	Sub-type	Credit start	Credit start to 2020 ktCO <sub>2</sub> e	MWel
CDM09424*	7198	Sir Bani Yas Wind Farm Project	UAE	Request review	Wind	1 Jul 14	280	25,0
CDM03990**	2444	ADFEC 10 MW Solar Power Plant	UAE	Registered	Solar PV	8 Jun 09	174	10,0
CDM03644**	2534	Abu Dhabi solar thermal power project, Masdar	UAE	Registered	Solar thermal	1 Sep 11	1633	100,0
CDM08635**	6964	10MW Photovoltaic Plant in Dubai	UAE	Registered	Solar PV	1 Jul 13	96	10,0
CDM09427		Nour 1 PV Project	UAE	Under Validation	Solar PV	1 Jan 14	997	99,8
CDM10973		Solar Power Project at North Park Building	Saudi Arabia	Under Validation	Solar PV	1 Jul 12	92	10,5

\* means has requested registration

\*\* means registered

Source: OME on UNFCCC CDM projects database.

Another positive signal of the involvement of the GCC countries in the RE field is the fact that five countries (Bahrain, Oman, Qatar, Saudi Arabia and the UAE) are already members of the intergovernmental organization dedicated to renewable energy, namely the International Renewable Energy Agency (IRENA) based in Abu Dhabi, while Kuwait is currently applying for membership.

### *b) Main programmes by country*

#### **Bahrain**

There is no formal policy framework in place to support the development of RE in Bahrain, although it has been announced that Bahrain aims to produce 5 to 7% of its energy from renewable sources by 2030. Bahrain has been active in developing mobile solar water desalination units as part of small-scale research and development projects, and in carrying out assessment studies for solar and wind. However, as of today, the only renewable source project remains the installation of wind turbines at the Bahrain World Trade Centre. Assessment of

wind power potential has been conducted by the National Oil and Gas Authority (NOGA), and a wind atlas is available.

In early 2010, an official from Bahrain's Ministry of Finance stated that the priority of Bahrain's government was to focus on developing clean technology projects (using mature technologies), rather than to develop a specific RE scheme to support the deployment of new technologies.<sup>244</sup> In this context, a waste-to-energy plant of 25 MW is due to be commissioned in 2013, which will use domestic waste from Manama (390,000 tonnes/year) to produce electricity that will feed into Bahrain's electricity grid. In addition, during the Petrotech 2012 conference, Bahrain's Minister of Energy announced the implementation of two renewable projects of 5 MW each, including a solar energy project combined with smart grid technology. The first pilot system using solar for the production of sanitary hot water has been installed at the Alba Healthcare Center. In order to promote and better integrate renewable energy into the overall energy planning, the establishment of an Energy Agency is being considered. Finally, several organisations are in charge of conducting research and development activities in the field of renewable energy, including the University of Bahrain, Bahrain Petroleum Company (BAPCO), NOGA and Electricity and Water Authority (EWA).

### **Kuwait**

In 2011, Kuwait announced its aim of producing 10% of its electricity from renewable sources by 2030, with target values of 1.1 GW from CSP, 3.5 GW from PV, and 3.1 GW from wind, but neither legislative nor regulatory frameworks have been put in place. Although the government has repeatedly financed research in the RE field (mainly wind and solar), current RE installed capacity does not exceed 400 kW. Besides the target announced in 2011, a 70 MW RE complex is expected to be set up by KISR for the MEW (10 MW PV, 10 MW wind and 50 MW CSP).

A study conducted by KISR focused on developing a strategy for introducing renewable energy as a primary energy source to meet the future needs of the country for electrical power generation and water desalination. The study included an assessment of electricity and fresh water demand and the potential primary energy supplies that can be made available to meet electricity production requirements up to 2030. Build-up scenarios for the generation system were used to draft a national renewable energy policy that is expected to fill the emerging gaps between electric energy demand and supply. In addition to KISR, other institutions are involved in

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<sup>244</sup> Imen Jeridi Bachelier, *Renewable Energy in the GCC Countries*, cit.

studies and R&D in Kuwait, including the Kuwait University, the Kuwait Foundation for the Advancement of Sciences and the Kuwait Society of Engineers.

## Oman

In 2008, the Authority for Electricity Regulation (AER) was commissioned to investigate the potential for renewable energy projects in electricity generation. The study identified significant potential for solar and wind generation. However, limited potential was identified for generation from biogas, geothermal and wave-energy.<sup>245</sup>

The Public Authority for Electricity and Water (PAEW) is taking steps to implement solar and wind projects where the grid is not available. Five rural pilot projects with a total maximum capacity of 8 MW were planned for the period from 2009 to 2012. A mix of PV, hybrid, and wind technologies were planned to be put on trial by RAECO under the supervision of the AER. However, recent changes in the government resulted in a delay to the implementation of these projects until 2014/2015. Nevertheless, in March 2013 the AER adopted a new requirement for the promotion of renewable energy in rural areas. Under this scheme, a component of renewable energy technology (solar or wind) must be included in each new power project in rural areas. If no renewable energy component is included in a funding application, RAECO is required to explain why, and to provide the AER with supporting analysis to confirm that renewable technologies are either not technically feasible, or not economic for that particular project.

Furthermore, larger scale solar projects were planned for the period from 2011 to 2014, but also delayed. A feasibility study was conducted for grid-connected solar plant with capacity of 50 to 200 MW. The detailed study, led by the PAEW and supported by a leading international consultant, identified the best locations for building solar power plants in the Sultanate from a total of 23 reviewed sites. The study confirmed that the Sultanate has many potential solar energy resources which could be used to produce large-capacity electric power, and shortlisted Adam, Manah and Ibri as sites for future solar power plants.<sup>246</sup> Adam and Manah have been reserved for such projects, and preliminary environmental approval has already been granted. Both locations have also been used to establish, in cooperation with OPWP, meteorological stations to measure the necessary solar energy data and other factors that affect the design of plants, such as dust levels and temperature. The construction of the

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<sup>245</sup> AER, Study on Renewable Energy Resources, Muscat, Oman Authority for Electricity Regulation, May 2008, <http://www.aer-oman.org/pdf/studyreport.pdf>.

<sup>246</sup> "Evaluation of sites for solar power project in progress: OPWP", in Oman Daily Observer, 27 March 2012, <http://main.omanobserver.om/node/88376>.

power plants is on hold pending completion of the National Energy Strategy, which is expected in early 2015.

The government's position towards renewable energy has been positive to some extent. Implementation of renewable energy initiatives has gained support at different levels in the Sultanate. Support for renewable energy is reflected by the formulation of a ministerial committee to oversee and coordinate efforts in the field. A technical committee has also been formed, which is chaired by the PAEW. However, this support is most visible when it comes to powering rural areas that are highly dependent on diesel for electricity generation and in the development of local skills and expertise. The government seems to be less ambitious about pursuing grid-connected large scale RE projects or solar manufacturing. A steering committee is currently being formed to set out an overall RE generation strategy for the Sultanate. The committee consists of the Ministry of Oil and Gas, the PAEW, the Ministry of Environment and Climate Affairs, and the Ministry of Planning, and is expected to submit its findings by the end of 2014.

The government is active in engaging with stakeholders and in developing programmes for the education and training of local manpower and expertise. A policy framework is being developed to encourage the involvement of medium and small-sized businesses in RE projects. The decision-makers in the Sultanate are taking cautious but steady steps towards RE. They hope that RE penetration will add a sustainable value to the Sultanate. This does not necessarily mean that it will become a hub for research and development or manufacturing in RE. The human development aspect of RE investment in the Sultanate appears to be the main concern. One of the goals of investment in RE in Oman is for the country to become a supplier of manpower in the field of RE to the entire GCC region.

## **Qatar**

The Qatar National Food Security Programme (QNFSP) is the body coordinating energy and water security, as well as food security, across all different sectors. Through the Qatar Science and Technology Park (QSTP), the QNFSP aims to become a leading exporter of solar technology and knowledge both in the MENA region and internationally by establishing a solar technology industry in the country. Furthermore, there are plans to establish institutes of higher education, along with research and development centres, in order to keep up with developments in the sector. Moreover, the QNFSP will develop CDM projects to achieve its goals. These projects are planned to cover solar power generation, solar desalination, wind power generation, waste heat recovery and CO<sub>2</sub> usage in farming and food production.

The National Energy Strategy 2011-2016 states that RE technologies should

help to conserve gas and reduce carbon emissions. In 2012, an Amiri declaration set a 2% (640 MW) target for electricity generation by means of solar energy by 2020.<sup>247</sup> Several projects have been announced, such as the construction of a 3.5 GW integrated solar combined cycle plant (500 MW of CSP) by 2013. Another tender is scheduled for launch in 2014 for a 1,800 MW PV plant, which is expected to be completed by 2018.<sup>248</sup> Activities are being developed at the QSTP, among which is the construction of a testing facility of about 35,000 m<sup>2</sup> for all types of solar technology. The aim is to test the suitability of different solar technologies under local conditions, in particular dust and wind conditions. It was also announced in 2009 that a PV power plant of 100 MW would be built by 2014. The key components of this solar power plant will come from the Qatar-based polycrystalline silicon production facility to be constructed in 2012 by Qatar Solar Technologies (QSTec). Located in Ras Laffan Industrial City, the QSTec plant will initially produce 8,000 metric tonnes per year of polysilicon, which is sufficient to produce enough solar energy to power around 240,000 homes for an entire year.<sup>249</sup> In July 2012, QSTec signed a Memorandum of Understanding with KAHRAMAA for the distribution of solar energy in Qatar.

## Saudi Arabia

In Saudi Arabia, the ECRA produced a National Renewable Energy Plan (NREP) in 2009, which included recommendations to promote the growth of RE, and which stated that if the conditions are put in place, RE could account for between 7% to 10% of electricity by 2020.<sup>250</sup> In 2010, a royal decree established K.A.CARE, which was intended to contribute to the sustainable development of Saudi industries related to renewable and atomic energy. K.A.CARE is the designated lead organisation for the energy diversification process. The overall target is to generate a third of the Kingdom's electricity from renewable sources by 2032. The K.A.CARE programme foresees 54 GW of power generation capacity from renewable energy by 2032.<sup>251</sup>

<sup>247</sup> Statement by Emir of Qatar at the opening ceremony of the High-Level Segment of COP 18 / CMP 8, Doha, 4 December 2012, [http://unfccc.int/meetings/doha\\_nov\\_2012/statements/items/7324.php](http://unfccc.int/meetings/doha_nov_2012/statements/items/7324.php).

<sup>248</sup> Julia Chan, "Qatar seeks tender for 1,800MW PV plant in 2014", in PV-Tech, 3 December 2012, [http://www.pv-tech.org/news/qatar\\_seeks\\_tender\\_for\\_1800mw\\_pv\\_plant\\_in\\_2014](http://www.pv-tech.org/news/qatar_seeks_tender_for_1800mw_pv_plant_in_2014).

<sup>249</sup> Nilima Choudhury, "Qatar Solar Technologies secures US\$1 billion financing for polysilicon manufacturing", in PV-Tech, 29 May 2012, [http://www.pv-tech.org/news/qatar\\_solar\\_technologies\\_secures\\_us1\\_billion\\_financing\\_for\\_polysilicon\\_manu](http://www.pv-tech.org/news/qatar_solar_technologies_secures_us1_billion_financing_for_polysilicon_manu).

<sup>250</sup> A.J. Goulding and Neil Bush, Final Proposal for National Renewable Energy Plan for Saudi Arabia, Presentation to stakeholders prepared on behalf of ECRA, Riyadh, 12 December 2009, <http://www.ecra.gov.sa/upload/2nd%20workshop.pdf>.

<sup>251</sup> K.A.CARE, Proposed Competitive Procurement Process for the Renewable Energy Program, Riyadh, King Abdullah City for Atomic and Renewable Energy, 20 February 2013, p. 15, <http://www.kacare.gov.sa/cpp/downloads>.

Currently, K.A.CARE is developing the tools necessary to enable the achievement of its targets, such as the Competitive Procurement Process (CPP). Furthermore, the Sustainable Energy Procurement Company (SEPC) has been established as a stand-alone government-guaranteed entity that will be responsible for administering the procurement of power purchase agreements, as well as executing and managing them.

During the Saudi Solar forum week held in May 2012, officials from K.A.CARE announced a programme, to be adopted by the government, for the generation of 41 GW of solar by 2032 (16 GW PV and 25 GW CSP), plus 4 GW from geothermal and waste and additional 9 GW from geothermal. The solar programme is expected to cost \$109 billion, almost as much as the \$136 billion invested worldwide in solar energy in 2011.<sup>252</sup> Saudi Arabia was planning to launch its first solar tender early this year, covering 1.1 GW of PV and 900 MW of CSP,<sup>253</sup> with a second tender to follow in 2014. However, K.A.CARE is still drafting the CPP programme, which is expected to be the gateway into the Saudi market in RE. The CPP programme is expected to be completed by the end of this year. The Sustainable Energy Procurement Company (SEPC) will be responsible for the administration of the CPP.

Many solar pilot plants have been installed within the latest year, either in remote areas or connected to the grid. In addition, a solar manufacturing plant (Poly-Silicon Technology, PST) has been set up in Jubail II. In addition, the King Abdullah University of Science and Technology (KAUST) is currently constructing a sustainable campus which incorporates solar thermal and PV systems on the roof to provide hot water and power to the campus buildings.

## UAE

In the United Arab Emirates, Dubai set a target of producing 5% of its electricity from solar energy by 2030, and Abu Dhabi announced that 7% of its total energy would come from RE technologies by 2020, but no specific regulatory framework has been put in place. The UAE is active in the RE field, most particularly through the Masdar initiative. Established in 2006, Masdar is a subsidiary of Abu Dhabi's state-owned Mubadala Development Company, and is focused on being a leader in the development of renewable and sustainable energy technologies. Masdar City is the flagship project of the initiative, and aims to be the world's first zero-carbon city. It already houses the Masdar Institute, a joint

<sup>252</sup> Clint Steyn and Marc Norman, "Saudi Arabia: The Future Solar Leader", in *Infrastructure Journal*, 20 December 2012, [http://www.chadbourne.com/files/Publication/8a7ac77a-4c70-4474-b449-3fbb9b8be688/Presentation/PublicationAttachment/859b91e7-94a3-4e57-ac7b-47bb-c9345a94/IJ%20-%20Saudi%20Arabia\\_%20The%20future%20solar%20leader%20.pdf](http://www.chadbourne.com/files/Publication/8a7ac77a-4c70-4474-b449-3fbb9b8be688/Presentation/PublicationAttachment/859b91e7-94a3-4e57-ac7b-47bb-c9345a94/IJ%20-%20Saudi%20Arabia_%20The%20future%20solar%20leader%20.pdf).

<sup>253</sup> K.A.CARE, Proposed Competitive Procurement Process for the Renewable Energy Program, p. 17.

undertaking between the Massachusetts Institute of Technology and Masdar, and there are plans to bring hundreds of other high-technology and renewable energy businesses into the city over the coming years. Masdar city currently houses a 10 MW PV plant. Masdar has announced plans to develop the Sir Bani Yas wind farm with a target capacity of 25 MW, the Shams 1 CSP plant with a capacity of 100 MW, and the Noor 1 PV plant with a planned capacity of 100 MW. Masdar will continue to help the UAE to find new ways to diversify its energy mix. Furthermore, Masdar is developing a regional tool for solar resource mapping in desert and dusty environments, launching the UAE Solar Atlas and developing a solar resource forecasting tool adapted to the desert environment. A 13 MW PV plant in Dubai was commissioned in 2013.

#### *4.1.8. Energy efficiency*

The GCC countries have as yet not undertaken any concrete measures for the promotion of energy efficiency. A study of the energy policies and relevant initiatives in the GCC countries<sup>254</sup> shows that they have recently adopted a more proactive approach towards environmental sustainability, but it also points out that despite some relevant initiatives, no consistent or coordinated strategies or policies have yet been established.

##### **Bahrain**

Due to the accelerated depletion of its indigenous hydrocarbon reserves, Bahrain has moved its focus towards energy efficiency strategies as a way to meet local energy needs. Several market drivers are being introduced to facilitate the inclusion of energy efficiency strategies and measures in the Kingdom. The National Economic Strategy 2009-2014 promotes sustainability by implementing green solutions and by addressing key priority areas and identifying actions. It aims at reducing energy consumption, developing clean energy technology, enforcing pollution control laws, and improving water resources management and the conservation of biodiversity. It is estimated that 60-70% of total energy consumption in Bahrain is for building and construction, which in turn generates 55% of CO<sub>2</sub> emissions in Bahrain. In May 2010, the Bahraini Minister of Housing announced a Green Building initiative, with the aim amongst other to update the 1999 building code. Other efforts are foreseen in the development of district cooling, namely with the Tabreed Northshore District Cooling project. In October 2012, the World Bank signed an agreement with the Bahraini Government to provide technical support in the field of energy consumption reduction. The support will help replace traditional bulbs with the low energy

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<sup>254</sup>Danyel Reiche, "Energy Policies of Gulf Cooperation Council (GCC) countries", cit.

lighting technology Compact Fluorescent Lighting (CFL).

### **Kuwait**

Kuwait, where domestic buildings are estimated to consume more than 60% of electrical power, issued an energy conservation code in 1983 for new buildings, which however lacked certain technical guidance. A revised version of the code was issued in 2010, which however does not fix particularly ambitious energy efficiency requirements (220 kWh/m<sup>2</sup> against current average of 270 kWh/m<sup>2</sup>). Furthermore, the Kuwait Green Building Council has been established to promote green building programmes and best practices in the country.

In 2007, Kuwait witnessed its largest electricity shortage. As a response, the Emir of Kuwait announced a \$150 million grant for energy research and development. Additionally, in August of that year, the MEW initiated a \$35 million media campaign entitled *Tarsheed* to reduce electricity and water consumption. The campaign attempted to deliver its message through printed materials, television and radio advertisements, phone messages, and billboards. The campaign was initiated in six languages and attempted to reach the country's whole population. The campaign has raised a debate about the effectiveness of such an approach. Nevertheless, *Tarsheed* spinoffs have also been implemented in Saudi Arabia, UAE and Qatar, under the same name but with adjusted goals and targets. Among other measures, the MEW also planned to improve the efficiency of power generation by introducing combined cycle power generating systems for new installations or system upgradings. Finally, the Medium Term Development Plan 2010-2014 aimed at achieving long-term economic sustainability, targeted sectoral development and focused in particular on transport, water and energy resources efficiency.<sup>255</sup>

### **Oman**

In Oman, electricity companies have been trying to implement certain demand side management (DSM) programmes over recent years, but are facing difficulties.<sup>256</sup> However, during the Oman Power and Water Summit 2012, the chairman of the PAEW stated that enhancing energy efficiency is one of the major goals of the organization.<sup>257</sup> As demand for electricity in the Sultanate is expected to increase, in 2012 the government agreed with the Japan International Cooperation Agency (JICA) to create a master plan for the promotion of energy conser-

<sup>255</sup> Kuwait Environment Public Authority, Kuwait's Initial National Communications under the United Nations Convention on Climate Change, Kuwait City, KEPA, November 2012, <https://www.unfccc.int/resource/docs/natc/kwtnc1.pdf>.

<sup>256</sup> A. Papadopoulou et al., "Tools and Mechanisms Fostering EU GCC Cooperation on Energy Efficiency", cit.

<sup>257</sup> Cameron Chai, "Oman Invests in Energy Efficiency Projects", cit.

vation in the electricity sector. The PAEW requested Japan's support in improving the balance between the supply and demand for electricity by promoting energy conservation among users. The project started in February 2012 and is currently at the final drafting stage.<sup>258</sup>

## Qatar

Qatar has developed a strategy to address several sustainability issues, mainly regarding water conservation, but it has not yet been translated into concrete measures. The strategy has, however, promoted research on sustainable development through the construction of the "Energy City", which aims at incorporating the latest green energy technologies and solutions for energy efficiency and pollution reduction. In 2005, the United Nations Economic and Social Commission for Western Asia (UN-ESCWA) signed an agreement with KAHRAMAA to support energy efficiency in the power sector. The agreement also aimed at establishing a Cooperation Programme on Energy Efficiency for the Qatari Electricity Sector. Other initiatives in favour of energy efficiency are currently being implemented, such as for example in the aviation industry, where Qatar Airways is implementing its *Oryx Flies Green* programme, which includes among other components fuel optimization, a recycling programme, and sustainable development. In 2009, Qatar Airways carried out the world's first commercial flight from London to Doha fuelled by a gas-to-liquid (GTL) 50/50 fuel blend with kerosene. Furthermore, the Gulf Organization for Research and Development (GORD) is working on creating the Qatar Sustainability Assessment System (QSAS). QSAS is a customized regional sustainability rating system based on rating systems from the UK, US, Canada, Hong Kong and Japan, in addition to European and American energy standards.

The Qatar National Plan for Energy Efficiency, Optimization and Resource Utilization (QPEERU) is currently being developed to serve as a driver for energy efficiency projects within the framework of the United Nations Framework Convention on Climate Change (UNFCCC). The objectives of QPEERU are to establish policies and regulations to manage energy conservation, assist in energy efficiency improvement, and adjust the value structure of society in terms of energy use and utilization. The objectives are to be achieved by inviting investments in CDM projects.<sup>259</sup>

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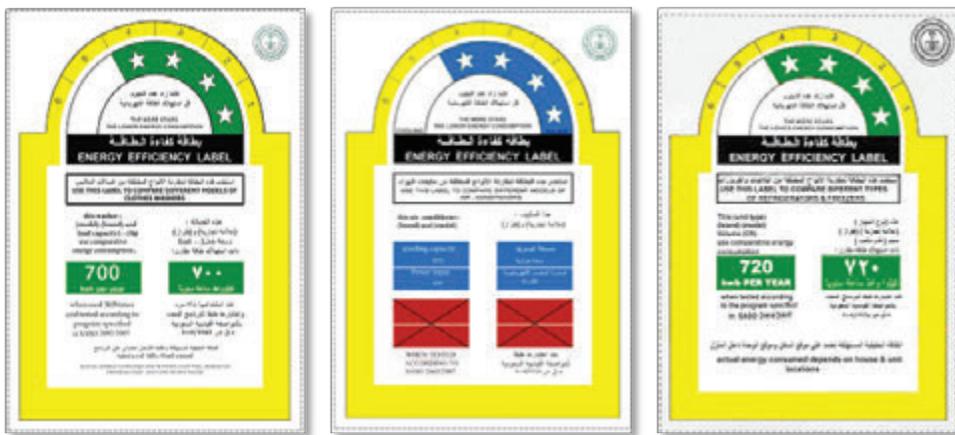
<sup>258</sup> JICA, "Industrial Development", cit., p. 109.

<sup>259</sup> Qatar Ministry of Environment, Initial National Communication to the United Nations Framework Convention on Climate Change, 20 June 2011, [http://unfccc.int/essential\\_background/library/items/3599.php?rec=j&preref=7508](http://unfccc.int/essential_background/library/items/3599.php?rec=j&preref=7508).

## Saudi Arabia

Established in 2000, Saudi Arabia's National Energy Efficiency Program (NEEP) defined in 2008 eight priority objectives to be achieved through the implementation of among other things energy audit services, the efficient use of oil and gas, energy efficiency labels and standards for appliances (Figure 60), constructions codes, training and public awareness. The NEEP focuses on four outcomes: regulation (the drafting of the first energy conservation law and national and regional regulations), information (a new database on energy supply and demand), capacity development of energy efficiency managers and public awareness.

Fig. 60. Energy efficiency labels for home appliances in Saudi Arabia



Source: Saudi Arabia Standard Organization.

The NEEP also contained a master plan for energy conservation in the power sector, which aims at cutting electricity intensity by 30% between 2005 and 2030 and at cutting the growth in peak demand by 50% compared with the average 2000-2005 increase. In October 2010, the Saudi Energy Efficiency Center (SEEC) was created, which is responsible for the development of energy efficient technologies and conservation policies. Among the proposed measures are the replacement of low-efficiency air conditioning units and the insulation of new buildings for residential customers, which would lead to significant energy savings.

## UAE

In addition to the so-called Masdar City, based in Abu Dhabi, which aims at being one of the most sustainable cities in the world, the UAE has been developing

a new green building code to save energy and reduce the environmental impact of construction. In 2007, Dubai adopted a new resolution on the implementation of green building specifications and standards. The Dubai Green Building Code came into force early 2009, and was based on the Leadership in Energy and Environmental Design (LEED)<sup>260</sup> rating system and tailored to conditions in the UAE. In addition, the Emirates Authority for Standardization and Metrology (ESMA) has been implementing an energy efficiency appliance labelling programme since the end of 2010. Other initiatives have been put in place in the transport sector, such as for example in Dubai, which has adopted a policy encouraging sustainable transportation in order to reduce vehicle pollution in the Emirate. Abu Dhabi is also carrying out studies on urban transport systems. DEWA is running an awareness campaign at schools, hotels, and public departments in order to encourage greater electricity and water conservation.

#### *4.1.9. Water desalination*

In the GCC countries, which are among the most water-scarce and arid regions in the world, water desalination is commonly used to cover national water demand. Indeed, improving the water supply is constantly at the forefront of the policy-making process in the GCC countries. Water demand is increasing rapidly, driven by a high population increase and rapid urbanization, with a high share coming from the agricultural and municipal sectors (Figure 61-left). Desalination remains the most feasible alternative to meet domestic supply requirements as a result of the relatively low cost, which is due to existing energy subsidies in most of the GCC countries. In response to shortages in naturally renewable water supplies, the GCC countries continue to develop desalination facilities. In consequence, the dependence of the GCC countries on the supply of desalinated water is very high (Figure 61-right).

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<sup>260</sup> LEED consists of a suite of rating systems for the design, construction and operation of high performance green buildings, homes and neighborhoods, and was developed by the U.S. Green Building Councils.

**Fig. 61. Water withdrawal share by sector in GCC countries (left); the share of potable water in MENA countries provided by desalination, 2010 [%] (right)**



Sources: OME based on FAO AquaStat data (left); Fichtner and DLR, *MENA Regional Water Outlook, Part II: Desalination Using Renewable Energy*, Study commissioned by the World Bank, Stuttgart, DLR Institute of Technical Thermodynamics, March 2011, [http://www.dlr.de/tt/Portaldata/41/Resources/dokumente/institut/system/projects/MENA\\_REGIONAL\\_WATER\\_OUTLOOK.pdf](http://www.dlr.de/tt/Portaldata/41/Resources/dokumente/institut/system/projects/MENA_REGIONAL_WATER_OUTLOOK.pdf) (right).

By 2007, 48% of the world’s water desalination capacity was installed in Middle East, and mainly in the Gulf region.<sup>261</sup> In 2010, 199 desalination plants were operating in the GCC countries,<sup>262</sup> of which 50% are installed in Saudi Arabia and 25% in the UAE.

In most of the GCC countries, the authorities have foreseen plans to develop water desalination capacity in the coming years in order to cover water demand, which is expected to increase dramatically over the coming decades. For instance, Kuwait is planning to develop its water desalination capacity within the framework of its 2010-2014 development plan from around 1.9 million cubic meters per day (MCM/d) in 2008 to reach around 3.1 MCM/d by 2016. In Oman, the total production of desalinated water reached 129 million cubic meters per year (MCM/y) in 2010. In early 2000, assessments of water availability versus future water demand pushed the government to adopt a National Water Resources Master Plan 2001-2020, which stated that to cover the increased demand, an additional capacity of about 330 MCM/y will be required. In Qatar, desalination covers 50% of water demand in the country, representing in 2008 a total production of 312 MCM. It is expected that water production will rise

<sup>261</sup> Sabine Latteman, *Development of an Environmental Impact Assessment and Decision Support System for Seawater Desalination Plants*, PhD thesis, Leiden, CRC Press, 2010, <http://repository.tudelft.nl/view/ihe/uuid%3A0a684765-bc85-48cb-8a18-833c8fa94037>.

<sup>262</sup> Mohamed A. Dawoud and Mohamed M. Al Mulla, “Environmental Impacts of Seawater Desalination: Arabian Gulf Case Study”, in *International Journal of Environment and Sustainability*, Vol. 1, No. 3 (2012), p. 22-37, <http://www.sciencetarget.com/Journal/index.php/IJES/article/view/96>.

yearly by 9% up to 2015. The Qatar National Development Strategy 2011-2016 developed by the General Secretariat for Development and Planning identifies a range of initiatives in the water sector to tackle technical and economic inefficiencies in the production, distribution and use of water. By 2014, Qatar will enact a National Water Act in order to develop a set of policies and regulations aiming at covering future needs. Saudi Arabia, which is the world's biggest producer of desalinated water, produced 1,013 MCM in 2009 and, according to the Saline Water Conversion Corporation (SWCC), the main Saudi desalinated water provider, an additional capacity of 5.9 MCM/d will be required by 2024 in order to meet the growing demand. In 2011, the UAE's water demand reached 4,500 MCM and is expected to be twice that figure by 2030, with a large part supplied by desalination. According to ADWEC, in 2010 Abu Dhabi produced 3 MCM of desalinated water, and it is expected that desalinated water demand will reach more than 4.5 MCM by 2020. It is estimated that 95% of the demand for potable water will be met by desalination in 2010. In the other Emirates, the importance of desalination in the water supply is likely to be the same as in Abu Dhabi, i.e. 95%, covering most of the demand.

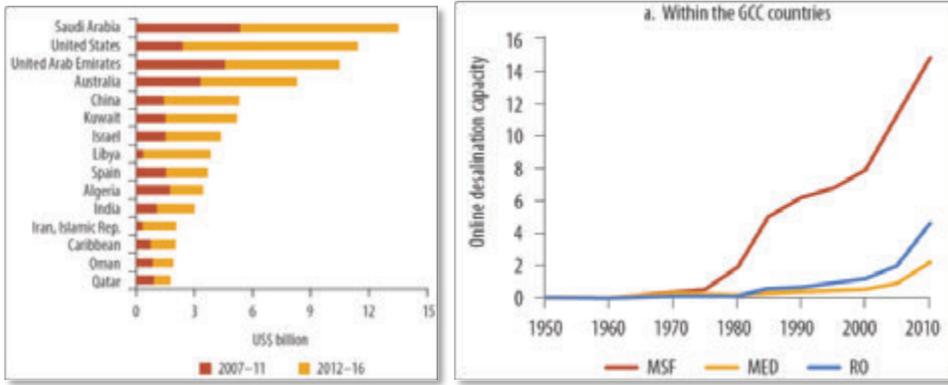
Water desalination is also related to the food security issue in the region. Most of the GCC countries are from 45 to 90% reliant on non-renewable brackish groundwater resources for the agricultural sector along with desalinated water.<sup>263</sup> In 2008, Saudi Arabia abandoned its 30-year policy of large-scale irrigated wheat cultivation after decades of unsustainable water withdrawals. As a result, domestic wheat production declined by over half between 2005 and 2006, and is expected to be completely depleted by 2016.

Given the above, one can see that the GCC countries are, and will remain, among the world's biggest desalination markets during the period 2007-2016, offering great business opportunities. Indeed, five GCC countries (Saudi Arabia, the UAE, Kuwait, Oman and Qatar) are ranked within the top 15 desalination markets for the period up to 2016 (Figure 62-left).

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<sup>263</sup> Bernice Lee et al., "Resources futures", in Chatham House Reports, December 2012, <http://www.chathamhouse.org/publications/papers/view/187947>.

**Fig. 62. Top 15 desalination markets, 2007-2016 (left); the growth of on-line desalination capacity in the GCC, 1950-2010 (right)**



Source: World Bank, *Renewable Energy Desalination. An Emerging Solution to Close the Water Gap in the Middle East and North Africa*, Washington, World Bank, 2012, <http://hdl.handle.net/10986/11963>.

Whereas in the 1960s-80s, Multi-Stage Flash units (MSF, a thermal process) were the only commercially viable large-scale technology for desalination, later, Multi Effect Distillation (MED, a thermal process) and Reverse Osmosis (RO, an electrical process) technologies became viable for large-scale units thanks to major technological improvements. Thermal desalination plants use heat sources as the driving force. These heat sources can be hot water or steam from a turbine. Therefore, thermal desalination is ideal for co-generation with power plants. Given that the power and water sectors of most of the GCC countries have the same regulators and utilities, and that Gulf water has high salinity and a high temperature, thermal processes suit such conditions better than RO. Thus, MSF has historically been the privileged technology in the GCC (Figure 62-right).

**Table 28. Main characteristics of desalination technologies**

Desalination technology	MSF	MED (Plain)	MED-TVC	RO	UF/MF/NF	Electro-dialysis reversal (EDR)
Energy source/type	Thermal	Thermal	Thermal	Electricity	Electricity	Electricity
Typical energy consumption (kWh/m <sup>3</sup> ) electricity	3-5	1.5-2.5	<1.0	3-5	3-5	3-5
(MJ/m <sup>3</sup> ) heat	233-258	233-258	233-258	No heat energy needed	No heat	No heat
Capacity range	Current modular capacity up to 90,000 m <sup>3</sup> /day	Current modular capacity up to 38,000 m <sup>3</sup> /day	Current modular capacity up to 68,000 m <sup>3</sup> /day	Current modular capacity up to 10,000 m <sup>3</sup> /day	Current modular capacity up to 10,000 m <sup>3</sup> /day	Current modular capacity up to 34,000 m <sup>3</sup> /day

Source: World Bank, *Renewable Energy Desalination*, cit.

Desalination processes, either thermal or electrical, require a significant amount of energy (Table 28). The impact of the expansion plans of desalination units in the GCC countries will be important for both the power sector and the fossil fuels balance. Hence, sustainability of power and water are closely-linked challenges in the GCC countries. Several research studies are currently being carried out to look at the feasibility of renewable energy desalination. Technologies such as CSP can provide steam to be used either for electricity generation or water desalination. Future desalination capacity expansions will be heavily determined by how energy policy is developed. At the moment, there are considerable inefficiencies in the water sector. These inefficiencies can be observed all along the production, distribution and consumption chain. They range from energy-inefficient production methods to inefficient water consumption. Just as with electricity consumption, water consumption conservation is politically difficult, but offers development opportunities. As a result of the water subsidies offered to consumers (residential, agricultural and industrial), customers have little incentive to conserve water.

## 4.2. IDENTIFICATION OF HOT SPOTS AND IMPLICATIONS FOR EU-GCC COOPERATION

### 4.2.1. *The EU-GCC partnership in energy*

Relations between the EU and the GCC are not recent. Economic cooperation was started from the very beginning after the creation of the GCC in 1981. On 22 July 1985, the Council of Ministers of the then EEC expressed its deep-seated interest in developing economic and political links with the GCC, and decided in principle on a meeting between the Community and the Gulf states.

The meeting, described by both parties as a historic landmark in their relations, took place in Luxembourg on 14 October 1985. The two parties decided to speed up discussions for the conclusion of a comprehensive agreement aimed at stepping up economic and trade cooperation between the Gulf States and the Community. The EU-GCC cooperation agreement, which encouraged trade and economic cooperation, was signed in 1988.<sup>264</sup> It established various important bodies: on the strategic level, an annual Joint Council and Ministerial Meeting between EU and GCC foreign ministers, and a meeting of senior officials at the Joint Cooperation Committee; and on the operational level, an Energy Experts Group that started its work early in the 1990s.

Since the signing of the Cooperation Agreement, the partnership between the two regional alliances has laid a greater emphasis on economic aspects, since the Gulf countries are major oil and gas producers. During the subsequent Joint Councils and Joint Cooperation Committee meetings, leaders agreed to re-inforce cooperation in the field of energy and on the conclusion of a Memorandum of Understanding on energy cooperation.

More recently, on the occasion of the 20th session of the Joint Council held in Luxembourg on 14 June 2010, officials of the EU and the GCC states endorsed the EU-GCC Joint Action Programme 2010-2013,<sup>265</sup> which had been negotiated during the senior officials' meeting held in Riyadh on 9-10 February 2010. The Joint Action Programme has the aim of strengthening cooperation in areas of strategic mutual interest over the 2010-2013 period. It specifically includes energy, electricity and water, and nuclear safety among the main topics for cooperation between the EU and the GCC. In particular, regarding energy, the pro-

<sup>264</sup> European Union, Cooperation Agreement between the European Economic Community, of the one part, and the countries parties to the Charter of the Cooperation Council for the Arab States of the Gulf...(21989A0225(01)), 25 February 1989, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=celex:21989a0225%2801%29:en:not>.

<sup>265</sup> Gulf Cooperation Council, Joint Action Programme for Implementation of the GCC-EU Cooperation Agreement of 1988: 2010-2013, June 2010, [http://eeas.europa.eu/gulf\\_cooperation/docs/joint\\_action\\_programme\\_en.pdf](http://eeas.europa.eu/gulf_cooperation/docs/joint_action_programme_en.pdf).

gramme foresees:

- exchanging views, information and experience on oil and gas market developments, energy policies, and policies, frameworks, best practices and techniques in the upstream, midstream and downstream fields;
- cooperation in the field of energy equipment, machinery and spare parts manufacturing, especially those used in the oil and gas industries;
- cooperation on clean and renewable energy technologies, on energy efficiency policy and measures, and on solar energy technologies and policy frameworks.

In the field of electricity and water, the programme foresees:

- technical cooperation in all stages of electricity and water production (generation, transport, energy transfer distribution and service providers), including technology transfer;
- benefit to the GCC from the EU's experience in power interconnection, load management, the regulatory framework and the creation and development of regional markets for the trade in, and exchange of, electricity;
- exchange of best practices in RDT (research, development and technology) regarding the integrated management and sustainable development of water in order to achieve water security in the GCC states, and of best practices and techniques in the efficient use of power and water consumption.

Finally, in the field of nuclear safety, the programme foresees:

- Cooperation in the field of atomic energy as well as nuclear safety and security;
- Exchange of information and experience in matters such as the legal framework for protection against radiation, nuclear security and safety, radioactive waste, warranties and appropriate systems and surveillance.

Three main mechanisms to carry out such activities are put forward, namely ad-hoc working groups, events such as seminars, workshops, and exhibits, and training and capacity building.

The follow-up to the Joint Action Programme has, however, not been complete. At the 22nd session of the Joint Council and Ministerial Meeting held in Luxembourg on 25 June 2012, delegates evaluated progress achieved so far, and agreed to prepare a joint work programme for the next period (2013-2016) and to identify priorities and objectives.<sup>266</sup>

Nowadays, energy remains central to relations between the GCC and the EU.

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<sup>266</sup> Co-Chairs' statement, 22nd GCC-EU Joint Council and Ministerial Meeting, Luxembourg, 25 June 2012, [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/er/131196.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/er/131196.pdf).

In fact, fossil fuels remain the most traded product between the two regions. This is mainly due to regional proximity and the complementarity of the regions' energy production and consumption patterns, which create favourable conditions for exchange between the EU and the GCC. These exchanges are regulated chiefly by Article 6 of the GCC-EU Cooperation Agreement, which states that "[i]n the field of energy, the Contracting Parties shall strive to encourage and facilitate, *inter alia*: cooperation in the two regions by energy undertakings [... and] exchanges of views and information on matters relating to energy in general and respective energy policies, without prejudice to the parties' international obligations".

Within the Joint Action Programme, particular attention is paid to the issue of energy diversification through the development of alternative energy technologies (such as renewable energy technologies and the development of energy efficiency for conventional energy technologies), as well as the issue of the development of energy infrastructure. Indeed, since the beginning of the cooperation, the Joint Councils and Joint Cooperation Committee meetings have stressed the need for policy support for the promotion of renewable and energy efficiency options in the GCC countries. Several EU-GCC expert meetings' conclusions have underlined the importance of enhancing cooperation in energy, with particular focus on energy efficiency and conservation, clean energy, climate change, and technology transfer. More particularly, the workshop entitled *Enhancing the EU-GCC Relations within the New Climate Regime: Prospects and Opportunities for Cooperation*, held in Brussels on 26 February 2009,<sup>267</sup> underlined the importance of EU-GCC cooperation on issues related to energy and the environment.

Taking into consideration the conclusions of the expert meetings, the Directorate-General of the European Commission responsible for external relations commissioned a project entitled *Creation and Operation of an EU-GCC Clean Energy Network*. The project aimed at creating and facilitating the operation of an EU-GCC network so as to act as a catalyst and element of coordination for the development of cooperation on clean energy, including the related policy, research and technology aspects, among various stakeholders in the EU and GCC countries. The overall objective of this initiative is to enhance EU-GCC energy relations by developing the appropriate structures and instruments for practical cooperation activities of common interest in the area of clean energy technologies.

The Network's current objectives are: i) exchange of experience and know-how; ii) coordination and promotion of joint actions between EU and GCC stakeholders; iii) the facilitation of joint research; iv) demonstration and develop-

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<sup>267</sup> See more in the Al-Jisr Project website: <http://aljisir.ae/?q=node/42>.

ment of clean energy in the GCC through joint projects; and v) policy support to promote the above<sup>268</sup>.

The Network's activities target: i) knowledge sharing; ii) training programmes; iii) research articles; iv) technical visits; and v) discussion group meetings.

The Network is organized around the following five thematic discussion groups, which contribute to enhancing EU-GCC clean energy cooperation:

- renewable energy sources;
- energy demand side management;
- clean natural gas and related clean technologies;
- electricity interconnections and market integration;
- carbon capture and storage.

These discussion groups meet on a regular basis to exchange views, best practices, and experience on the different related topics. In addition, the discussion groups cover most of the topics identified by the Joint Action Programme, as they deal not only with cooperation in natural gas and electricity interconnection, but also with water as sub-topic.

The 2nd Annual Conference of the EU-GCC Clean Energy Network was held in Abu Dhabi, UAE from 17 to 19 January 2012, as a side event of the *World Future Energy Summit 2012*. During the 2nd Plenary Meeting of the EU-GCC Clean Energy Network, held on 18 January 2012, the European Commission highlighted the importance of making every effort to guarantee the transformation of the Network into a sustainable entity that will continue to catalyze EU-GCC cooperation in the field of sustainable energy<sup>269</sup>. Network stakeholders had the opportunity to discuss the structure and organization of the Network, as well as to elaborate on the Network's sustainability strategy and activity plan, thus enhancing stakeholders' ownership and commitment to creating a useful and viable mechanism for supporting clean energy cooperation between the two regions.

#### 4.2.2. Identified area of cooperation: fossil fuels

Energy flows between the EU and the GCC are still very much focused on fossil fuels, mainly petroleum and gas. The OPEC 2012 report underlines that 12.3% of Saudi Arabia's crude oil exports go to Europe. In the case of Kuwait, this figure is 4.4%, while for the UAE it is just 0.1%. Saudi Arabia therefore remains the

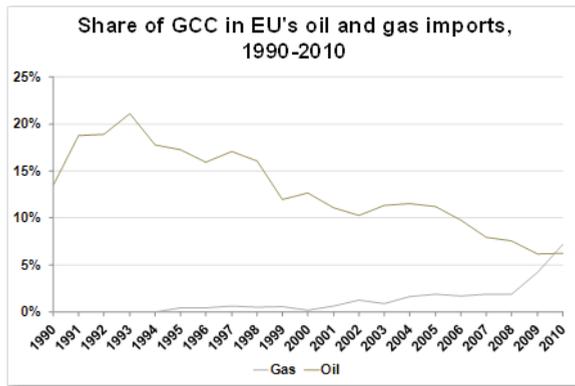
<sup>268</sup> See the EU-GCC Clean Energy Network website: <http://www.eugcc-cleanenergy.net/TheNetwork.aspx>.

<sup>269</sup> EU-GCC Clean Energy Network 2nd Annual Conference Press Release, [http://www.eugcc-cleanenergy.net/LinkClick.aspx?fileticket=rbV2PuL\\_WKw%3d&tabid=253](http://www.eugcc-cleanenergy.net/LinkClick.aspx?fileticket=rbV2PuL_WKw%3d&tabid=253).

biggest GCC exporter of oil towards Europe, with 890 thousand barrels per day transferred in 2011 alone. According to BP,<sup>270</sup> 42% of Qatar’s Liquefied Natural Gas (LNG) exports go to Europe, representing 43 billion cubic metres, while for Oman the figure is 2%.

Statistics on the EU’s fossil fuels imports from 1990 to 2010 show that the EU maintains a privileged relationship with the former Soviet Union; imports from this region increased from 35.7% in 2005 to more than 41% in 2011. Another main supplier is Africa, with Algeria and Libya in the leading positions. Imports from the African region grew from 18% in 2005 to 20.6% in 2010 (with a slight decline in 2011 due to political instability). According to EUROSTAT, the share of EU’s oil imports coming from the GCC countries decreased from 13.5% in 1990 to 6.2% in 2010 (Figure 63). The share was near 20% in the middle of the 1990s. Gas imports from the GCC have shown the opposite trend, growing from 0% in 1990 to 7.2%, mainly due to the increase of the Qatari share in LNG imports. According to BP, the share of LNG coming from Qatar has reached 50% of total LNG imports to Europe in 2011.

**Fig. 63. The GCC’s share in the EU’s oil and gas imports, 1990-2010**



Source: OME based on EUROSTAT.

There are clear opportunities for improving cooperation between the two regions in the natural gas sector. There is also scope for possible projects of common interest, bearing in mind the future possibilities for linking the natural gas markets of the two regions, which would require the development of adequate infrastructures. Indeed, the EU is expected to increasingly rely on gas to cover its energy needs. Diversifying the sources of the supply of gas is of paramount importance in order to ensure energy security.

To enhance cooperation in this field, the Joint Action Programme focuses on

<sup>270</sup> BP, Statistical Review of World Energy 2012, cit.

information exchange on oil and gas markets; policies, frameworks and best practices; and techniques for upstream, midstream and downstream infrastructure development. The Joint Action Programme foresees that ad hoc groups should address the various areas of cooperation, holding seminars and workshops, as well as organising training and capacity building programmes when appropriate.

In addition, issues related to natural gas have been fully integrated into the Clean Energy Network as one of the themes of the discussion groups. During the discussion group meeting dedicated to natural gas held in Abu Dhabi in January 2012, several areas of cooperation in the natural gas field in the EU-GCC context were identified,<sup>271</sup> as follows:

- cooperation and research on more economic, effective and environmentally-friendly means of transporting gas, either piped or in liquid form;
- emphasis on new and innovative technologies for LNG regasification;
- cooperation and research on the potential development of unconventional natural gas in the GCC countries, following similar developments in some European countries;
- emphasis on new and innovative technologies for dealing with sour gas reserves found in some GCC countries;
- exchange of information on a research and development project aiming at enhancing the environmental-friendly use of natural gas in the different economic sectors, such as the transport sector (LNG, Gas-To-Liquid, Compressed Natural Gas), the power sector and the residential and commercial sectors.

Furthermore, the development of Integrated Solar Combined Cycle (ISCC) electric generation plants might be an interesting option for the GCC countries, both those which are net gas importers and those which are net gas exporters.

#### *4.2.3. Identified area of cooperation: electricity*

EU and GCC cooperation in the electricity field is already quite advanced, as a result of regular exchanges and meetings at the technical level organized by producers, transmission system operators, distributors and their associations.

The Arab Union of Electricity (AUE), which includes members from GCC countries, has established relationships with the European Network of Transmission System Operators for Electricity (ENTSO-E). The establishment of the

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<sup>271</sup> Mohsen Assadi, Clean Natural Gas & Related Technologies, Presentation at the EU-GCC Clean Energy Network 2nd Annual Conference, Abu Dhabi, 17-19 January 2012, <http://www.eugcc-cleanenergy.net/LinkClick.aspx?fileticket=CpUpJ8jvrJk%3d&tabid=296&mid=1028>.

GCCIA is also a step towards the creation of more effective, harmonized and stable systems, which should be able to meet the growing demand for electricity.

The knowledge exchange between these organizations is very beneficial both for the EU and for the GCC, particularly within the framework of recent strategies highlighting the need for more closely interconnected electricity systems to support increased exchange of power, with a significant role to be played by renewable energy.

The development of big infrastructure projects requires addressing a series of issues related to a variety of technical, institutional and market aspects, which should accompany the current process of liberalization of electricity markets in the GCC countries. Over the last decade, most Gulf countries have launched reform programmes to create independent power production, decentralisation, privatisation and the unbundling of generation from transmission and distribution.

Such enhanced cooperation would complement the activities that the EU is already carrying out with many neighbouring countries in the framework of its external energy policy, which offer relevant examples, best practices and lessons to be learned.

For example, within the Mediterranean region and in the framework of Euro-Mediterranean cooperation, MEDREG (Mediterranean Regulators for Electricity and Gas) was established in 2007 to promote a transparent, stable and harmonized regulatory framework in the Mediterranean region, fostering market integration and infrastructure investment through a permanent exchange of know-how, data collection and expertise. MEDREG carries out its activities through collaboration with energy stakeholders in the Mediterranean basin with the objective of creating the conditions for the establishment of a future Mediterranean Energy Community, based on a bottom-up approach. MEDREG has five main missions:

- ensure greater harmonization of energy markets and legislation, and to seek progressive market integration in the Euro-Mediterranean region;
- foster sustainable development in the energy sector through greater efficiency and integration of energy markets based on secure, safe, cost-effective and environmentally sustainable energy systems;
- support initiatives of common interest in key areas such as infrastructure development, investment financing and research;
- provide capacity building activities such as training, seminars and working groups;
- foster co-operation, information exchange and mutual assistance among members by providing a permanent discussion framework.

More recently, METSO (Mediterranean Transmission System Operators) was

established as an association gathering the electricity transmission system operators of the Mediterranean region. METSO aims to build a link between market regulation functions and electrical system operations, thus facilitating dialogue and cooperation between transport system operators and the institutions in order to promote the coordinated and proactive development of electricity grids and connections in the Mediterranean.

Similarly, the Energy Regulators Regional Association (ERRA) is a voluntary organization comprised of independent energy regulatory bodies primarily from the Central European and Eurasian region, with affiliates from Africa, Asia, the Middle East and the USA. The UAE and Saudi Arabia are members of ERRA.<sup>272</sup>

As far as electricity interconnection is concerned, the completion of the GCC regional power grid opens new perspectives for the establishment of a wider electricity market. The EU has a long experience in the establishment of a common electricity market, and there is clear room for cooperation between the EU and the GCC in terms of knowledge transfer in this field. In addition, through the Pan-Arab interconnection study, common research could be carried out in order to examine the benefits and challenges of the interconnection of multiple regional power grids.

#### *4.2.4. Identified area of cooperation: nuclear*

While most of the GCC countries have confirmed their commitment to develop nuclear power over the medium-term, the implementation of nuclear technology remains challenging. Five essential issues have to be addressed in order to consider nuclear energy as a source of sustainable energy, namely nuclear safety, proliferation resistance, a minimal production of radioactive waste, the availability of natural resources, and economic competitiveness.<sup>273</sup>

Several EU Member States have longstanding experience of nuclear power. EU-GCC cooperation could build on best practices to enable the transfer of this knowledge from EU to GCC countries. The following measures are as much prerequisites as areas for EU-GCC cooperation in the promotion of nuclear power:<sup>274</sup>

- training of highly technically skilled personnel;
- development of a strategy for future investment in the exploration of uranium and relevant processes in the nuclear fuel cycle;
- development of a strategy for nuclear waste;

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<sup>272</sup> See ERRA website: <http://www.erranet.org>.

<sup>273</sup> A.J. Koning and D. Rochman, "Towards sustainable nuclear energy: Putting nuclear physics to work", in *Annals of Nuclear Energy*, Vol. 35, No. 11 (November 2008), p. 2024-2030.

<sup>274</sup> John Psarras, Alexandros Flamos and Kostas Patlitzianas, *Enhancing the EU-GCC Relations within a New Climate Regime: Prospects and Opportunities for Cooperation*, Background Paper for Al-Jisir Project Workshop, Brussels, 26 February 2009, <http://aljisr.ae/?q=node/209>.

- establishment of effective research and development infrastructure;
- development of a regulatory, safety and licensing board, with government oversight and assistance from the IAEA.

Nuclear energy could contribute to the GCC electric system interconnection for the benefit of Member States where the production of nuclear energy is not feasible.

#### *4.2.5. Identified area of cooperation: renewable energy*

RE technologies offer perhaps one of the greatest opportunities for enhanced cooperation between the EU and the GCC, given the high potential for RE in the region, the prominent role of the EU in the development of renewables at the global level, the substantial industrial capacity and degree of innovativeness displayed by EU companies in the field, and the availability of capital in the GCC countries for profitable RE investments.

Within RE technologies, solar is one key option, given the abundance of the resource, which means that the development of both PV and CSP technologies is a concrete opportunity. The development of solar is also being encouraged by several ongoing initiatives in the Euro-Mediterranean and the EU-MENA regions, such as the Desertec concept and the Mediterranean Solar Plan.

However, in addition to solving market integration and system interconnection issues, the implementation of such ambitious projects needs to take into account and overcome a series of technical aspects, mostly related to the intermittent nature of the resource and the harsh climate conditions, which reduce the efficiency of systems.

Joint cooperation should focus on technology development and innovation, as well as research and development, including the development of new materials.

In addition, the business plans for the various RE projects should be evaluated, taking into account in particular the structure of the electricity market in the GCC countries, and the amount of subsidies granted to fossil-generated electricity.

Resource assessment is another area which deserves further investigation. Whereas for solar and wind, estimates and maps have been produced, much less information is available on other sources, such as geothermal and waste-to-energy.

In addition to the study of these technical aspects, the GCC countries could particularly benefit from the experience of the EU in the development of effective policy and regulatory frameworks for renewables. An impact assessment of incentive mechanisms and of the main technical and non-technical barriers which need to be addressed when designing RE policies would certainly be of

benefit to the GCC countries in order to allow them to learn from previous experience in the EU and at international level, and to avoid repeating the same mistakes.

Finally, knowledge sharing is a fundamental aspect which would encourage increased investment in renewables, both in the GCC and in the EU, through new business opportunities and joint ventures. In this regard, in September 2012, a consortium led by ACWA Power International, the Saudi Water and Power giant, in partnership with Aries Ingeniería y Sistemas SA and TSK Electrónica y Electricidad (Spain), was announced as preferred bidder to develop the 160 MW Ouarzazate CSP Independent Power Project, valued at \$1 billion.

This is a significant example of the possibility to pull together financial and technical expertise from different actors from the EU and the GCC to work on renewable energy development.

#### *4.2.6. Identified area of cooperation: energy efficiency*

On 25 October 2012, the EU adopted Directive 2012/27/EU on energy efficiency.<sup>275</sup> This Directive establishes a common framework of measures for the promotion of energy efficiency within the Union in order to ensure the achievement of the Union's 2020 20% headline target on energy efficiency and to pave the way for further energy efficiency improvements beyond that date. It lays down rules designed to remove barriers in the energy market and overcome market failures that impede efficiency in the supply and use of energy, and provides for the establishment of indicative national energy efficiency targets for 2020.

In the GCC, the institutional and regulatory framework is less developed, and efforts have been undertaken in a rather fragmented way. The GCC countries would benefit from cooperation with the EU in several ways:

- institutionally, by taking advantage of the experience accumulated in the EU in the preparation of several directives on energy efficiency (covering for example ecodesign and energy labeling, and energy building codes), as well as in the preparation of the National Energy Efficiency Action Plans (NEEAPs);
- as regards demand-side management, through the development of models for energy service companies (ESCOs) and market-based mechanisms to support energy efficiency.

In addition, the establishment of national agencies for energy efficiency would represent a significant step towards the implementation and monitoring of concrete energy savings measures in the GCC countries.

<sup>275</sup> Directive 2012/27/EU on energy efficiency ..., 25 October 2012, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=celex:32012l0027:en:not>.

EU-GCC cooperation on energy efficiency would benefit from the establishment of a regional association, along the lines of the experience gained in the Euro-Mediterranean area, where the Mediterranean Association of National Agencies of Energy Conservation (MEDENER) was created in 1997. MEDENER brings together 12 organizations in charge of energy efficiency and renewable energy development policies from both shores of the Mediterranean. It aims at exchanging experience, know-how and best practices. The development of synergies between its members allows for the strengthening of the regional partnership on issues of energy conservation specific to the Mediterranean.

#### *4.2.7. Identified area of cooperation: water*

The impact of climate change will contribute to increased pressure on water resources in both regions. Desalination processes will therefore become essential for providing water in southern EU countries, as is already the case in the GCC. For instance, several regions in Spain are facing dramatic water shortages.

In the GCC, the cost of thermal desalination has increased rapidly as result of global oil price rises in recent years, which means that the cost of water subsidies for the GCC governments has increased substantially and is now considered uneconomic. This has led to the expansion of reverse osmosis seawater desalination on a larger scale, since they are grid-connected and often run on gas-fired turbines.

However, the lower gas-to-coal price ratio has led to a global increase in gas consumption. This increase has been stimulated by global investment in gas-fired power plants, whose role may further expand due to the current public perception of nuclear power.

At the moment, and due to demand for electricity and water, the UAE has become a net gas importer, as has Kuwait. Furthermore, according to a recent Citigroup report, Saudi Arabia is at risk of becoming a net oil importer in the next 20 years due to local levels of demand for energy.<sup>276</sup>

Based on these considerations, it becomes evident that there is clear room for cooperation as regards desalination, mainly in terms of research and development which could be conducted in order to find ways to reduce the energy intensity of such processes. In particular, desalination powered by renewable energy (and specifically solar) is an area which deserves further investigation, given the high potential of solar energy in the GCC countries. A number of EU research projects have been carried out in this field. They highlight some funda-

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<sup>276</sup> Ayesha Daya and Dana El Baltaji, "Saudi Arabia May Become Oil Importer by 2030, Citigroup Says", in Bloomberg, 4 September 2012, <http://www.bloomberg.com/news/2012-09-04/saudi-arabia-may-become-oil-importer-by-2030-citigroup-says-1-.html>.

mental barriers to solar desalination, both for decentralized systems and large-scale plants. As for the former, the main obstacle is the fact that the main technology which is commercially available today for capacities below 1,000 m<sup>3</sup>/day (photovoltaic reverse osmosis) is limited when it comes to treating high-salinity water. Alternative technologies existing in the region are not energy efficient and are insufficiently developed. Therefore, novel technologies must be deployed which are capable of working with high salinity and sufficient energy efficiency to be coupled with solar energy.

On the other hand, large-scale solar desalination is constrained by the intensive energy consumption associated with desalination and the high investment costs associated with solar energy. To improve the financial picture, synergies can be exploited by coupling desalination with power generation. There are different ways of combining CSP generation with desalination. Several scenarios have been compared which consider the two main industrial technologies for large-scale desalination, i.e. RO and MED. However, the studies have been made on a theoretical basis using thermodynamic analysis, and further investigation is needed of the engineering to identify the most suitable case for each framework condition.

Given the proximity of the water and power sectors in the GCC countries and the growing tensions regarding these two essential commodities, implementation of pilot projects (such as combined CSP desalination plants) would enhance the development of these promising technologies.

Another area of study is nuclear desalination. According to the World Nuclear Association,<sup>277</sup> the BN-350 fast reactor at Aktau (Kazakhstan) successfully produced up to 135 MW of electricity and 80,000 m<sup>3</sup>/day of potable water for some 27 years until it was closed down in mid-1999. About 60% of its power was used for heat and desalination and it established the feasibility and reliability of cogeneration plants of this type. There are also combined plants operating in Japan, India, Pakistan, and China.

Nuclear desalination could be another option worth developing. However, public concerns expressed after the Fukushima accident have led to delayed development plans in the GCC region.

## CONCLUSION

The GCC countries show good potential for cooperation and partnership with the EU over a vast and diversified range of issues. The renewable energy sector

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<sup>277</sup> World Nuclear Association, Nuclear Desalination, March 2013, <http://www.world-nuclear.org/info/Non-Power-Nuclear-Applications/Industry/Nuclear-Desalination>.

presents an excellent opportunity for cooperation and partnership given the current perception of RE in the region. Despite its slow development in the GCC countries, interest in RE is increasing among the governments of different GCC countries. The level of interest varies from one country to another, and the type of targeted investment also varies. In general, interest is motivated by the desire to achieve both a sustainable energy mix and economic development. There is a clear potential for the GCC countries to become leading players in the RE business, in the same way as they are prominent actors in the hydrocarbon industry. However, this cannot occur without putting in place the necessary policy and market reforms which would ensure profitability of renewable energy projects.

Despite the similarities between the Gulf states, there are also significant differences between them on a variety of issues. Energy security is a subject of common interest between all six Gulf states. However, the approach towards the subject varies from one country to another. This is particularly true of RE. Having a third of the world's oil reserves, the GCC countries have had little incentive to review their local consumption of energy. However, the rising cost of electricity production and the relative shortage in gas production are changing the governments' strategies.

The GCC countries are indeed facing great energy challenges, and only recently have GCC governments acknowledged this. There is no common approach to electricity and water security issues. In fact, effort fragmentation is common at country level, with most GCC countries splitting the work between research institutes, government agencies and the private sector. Nevertheless, it can be observed that some GCC countries are already taking measures to consolidate their efforts.

The GCC governments recognize the importance of diversifying local energy supplies, and are moving towards market reform and a sustainable energy mix. This move is beset by many challenges. These challenges can be traced back to the size of the demand for electricity. It is argued that electricity and water subsidies have resulted in rapid demand growth in a sector which has, as a consequence, experienced little progress in terms of efficiency improvement and conservation. The current political atmosphere and the constraints this atmosphere imposes on GCC governments make putting in place some of the foundations for market reform rather challenging. It is unlikely that subsidies will undergo any significant change. When it comes to electricity and water, top-down initiatives with low political cost (such as building codes) may be more feasible than subsidy removal. Most GCC countries are still at an early stage in the development of their building codes.

The GCC countries are working actively on expanding existing production capacities in order to meet current and future electricity and water demands.

Finding secure non-fossil fuel alternatives, developing a regional energy market and creating conditions which stimulate energy saving are essential. Delaying investment in this field can undermine the sustainability and security of supply. In addition, a clearly-defined strategy is key to achieving sustainable and secure electric and water supplies. Yet it is evident that most GCC countries still lack clear strategies in this regard. Plans to develop nuclear energy met with public concern in at least one GCC country following the Fukushima incident, which eventually led to the cancelation of the nuclear programme in that country. However, nuclear energy may still be a viable alternative for some GCC countries, with their different social and political systems. Additionally, nuclear energy could contribute to the GCC interconnection to the benefit of countries where nuclear energy is not feasible. The contribution of nuclear energy to the future GCC energy mix must be addressed openly and objectively. With the exception of Dubai, nuclear energy plans are not being moved forward at the moment at the same pace as RE.

Renewable energy technologies offer one of the greatest opportunities for enhanced cooperation between the EU and the GCC. The prominent role of the EU in the development of renewables at the global level and the substantial industrial capacity and degree of innovativeness displayed by EU companies, together with the availability of capital in the GCC countries, represent a profitable RE investment opportunity which could contribute to energy security for both sides. Furthermore, the EU has long experience of dealing with energy market reform and establishing transparency and accessibility. This has contributed to the security of energy supply by allowing electricity companies to grow beyond national borders.

The EU is already carrying out activities with many countries neighboring the GCC in the framework of its external energy policy. The EU-Mediterranean partnership provides a good example of how EU-GCC cooperation and partnership could be developed. The incorporation of energy efficiency, clean technologies and safe and sustainable low-carbon energy in EU-GCC cooperation and partnership plans will emphasize the global role of the EU in a low-carbon energy future.

# 5.

## Maritime Security: Challenges and Opportunities for EU-GCC Cooperation

*Natalino Ronzitti*

### INTRODUCTION

The notion of maritime security covers different elements, ranging from freedom of navigation, to the ability to counter threats posed by piracy, terrorism, drug trafficking, trafficking in persons and the proliferation of weapons of mass destruction (WMD). Marine pollution should be added. It goes without saying that freedom of navigation is paramount.

The GCC is fully aware of the potential threats to maritime security harbouring off the coasts of its members. In fact, recent developments in maritime security concern the Gulf region in a specific manner, most notably due to piracy, drug trafficking and to some extent trafficking in persons. Alongside these non-state actor threats, there are risks associated with state issues, in particular regarding the Strait of Hormuz and the controversy over Abu Musa and the other islands between the UAE and Iran. To meet these threats, the GCC countries are determined to enhance their naval capability. For instance, on 29-30 April 2012, naval exercises were held in the Gulf to flag that GCC Member States are ready to build up a naval force.<sup>278</sup>

Legal issues are the necessary point of departure for a sound assessment of maritime security. For this reason, the present chapter focuses on legal problems involved in sea use and management. After having assessed the regulatory framework of maritime security, we will concentrate on issues of particular relevance for the Gulf, taking into account piracy, including the establishment of ad hoc tribunals for the punishment of pirates/terrorists, the maritime relevance of the proposed WMD Free Zone (WMDFZ) in the Middle East for the GCC, the settlement of current maritime controversies and other soft security threats

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<sup>278</sup> For a comment on GCC naval capability, see the interview with Kristian Coates Ulrichsen, "With Gulf Tensions High, GCC Naval Capabilities Remain Limited", in *World Politics Review Global Insiders*, 1 May 2012.

such as drug trafficking and trafficking in persons. Given the narrow limits of the Gulf and the fragile ecosystem, marine pollution is another source of concern for the Gulf states. At the end, some concrete lines of policy action for GCC-EU cooperation will be suggested, taking the GCC-EU Joint Action programme as the starting-point.

## 5.1. THE REGULATORY FRAMEWORK OF MARITIME SECURITY

The main instrument in this connection is the 1982 United Nations Convention on the Law of the Sea (UNCLOS). It has been ratified by most of the international community. However, even those states which are not party consider the main UNCLOS provisions to be declaratory of customary international law, creating duties and rights for non-contracting states as well. This is particularly true for norms on rights of navigation on the high seas, innocent passage through territorial waters and passage through international straits. All GCC states except the UAE have ratified UNCLOS. The UAE has only signed it and is not party to the 1958 Geneva Conventions. Thus, the UAE is entitled to exercise the rights and obliged to observe the duties stemming from customary international law of the sea.

### *5.1.1. Innocent passage through the territorial sea*

Both the 1958 Geneva Convention on the Territorial Sea and the Contiguous Zone and UNCLOS allow innocent passage through the territorial sea, but do not specify whether warships may engage such passage. Since both Conventions contain rules on measures which may be taken against warships violating the rules on passage, they would be deprived of their purpose if passage were denied in this way. It is however controversial whether the passage of warships is made conditional upon the consent of the coastal state or, at a minimum, whether previous notification is required. The existence of a right of passage for warships under customary international law is likewise controversial. The point was not clarified by the International Court of Justice (ICJ) in its judgment in the Corfu Channel case (1949), since the Court dictum refers only to the right of passage through an international strait and does not consider the right of passage through territorial waters.

Third world countries continue to assert that passage of warships is subject to the consent or previous notification of the coastal state. According to a learned opinion, which had already been stated in the Sixties,<sup>279</sup> a norm of cus-

<sup>279</sup> Myres S. McDougal and William T. Burke, *The Public Order of the Oceans. A Contemporary*

tomary international law allowing the passage of warships through territorial waters is already in existence, or at least emerging. Consequently, a number of states has changed its position. However, Oman and the UAE still require prior permission for the innocent passage of warships.

### *5.1.2. Innocent passage through straits*

Article 16(4) of the 1958 Geneva Convention on the Territorial Sea and the Contiguous Zone grants a right of passage in straits used for international navigation connecting two parts of the high seas, or one part of the high seas and the territorial sea of a foreign state. Passage cannot be suspended. Overflight is not allowed without the consent of the riparian state/states, unless specifically granted, as is stated by the 1979 peace treaty between Egypt and Israel, which preserves the right of navigation for all flags through the strait of Tiran and the Gulf of Aqaba, the waterway allowing entry into the Israeli port of Eilat. Freedom of passage is enjoyed both by merchant vessels and warships, and this rule – as far as straits connecting two parts of the high seas are concerned – is a codification of customary international law, as can be inferred from the Corfu Channel judgment referred to above.

UNCLOS, while introducing the regime of transit passage for straits connecting two parts of the high seas or two Exclusive Economic Zones (EEZs), or an EEZ and the high seas, maintains the regime of innocent passage with no suspension for international straits connecting the territorial sea and the high seas, or the territorial sea and an EEZ.

### *5.1.3. Passage through international straits and archipelagic waters*

UNCLOS is highly innovative as concerns passage through international straits connecting two parts of the high seas, or two EEZs, or an EEZ with the high seas. Transit passage allows for more navigational rights than innocent passage, since it allows: a) an unimpeded right of transit for both civilian ships and warships; b) the right to overfly the straits with civilian or military aircraft; c) the right of submarines to submerged passage along all the waters of the strait. Ships and aircraft in transit should refrain from any threat or use of force, and in general from any activity not directly connected to their normal mode of operation. The normal mode of operation of warships entails transit singularly or in squadron. Aircraft carriers are allowed to transit, and aircraft on board

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*International Law of the Sea*, New Haven, Yale University Press, 1962, p. 221.

may take off and deck during transit.

The Strait of Hormuz, which is the only waterway allowing entry into the Persian Gulf, should be subject to the regime of transit passage. However, one of the states bordering the Strait (Iran) is not party to UNCLOS, and does not recognize the regime of transit passage as belonging to customary international law. Consequently, Iran claims that its territorial waters lying in the Strait are only subject to the regime of innocent passage, and warships are admitted to passage only after having duly notified the Iranian authorities. In times of crisis, Iran has threatened to close the Strait, or at least the part belonging to its territorial waters. During the Iran-Iraq war (1980-1988), Iran initially declared that it would leave the Strait open to navigation. Subsequently it changed policy, and declared the part lying within its territorial waters to be a war zone, thus obliging neutral states to navigate along the coastal belt lying under Oman's sovereignty. Threats by Iran to close the Strait of Hormuz are often repeated, even recently, but not implemented.

It should be noted that the right of transit passage was inserted into UNCLOS as a result of the need to allow for the mobility of fleets, and was promoted by the then superpowers. It serves their interests, and is recognized, together with other military navigational rights, by the US, even though it is not party to UNCLOS.

#### *5.1.4. The proliferation security initiative and the WMD threat*

The Proliferation Security Initiative (PSI) is a soft law instrument aimed at countering the proliferation of WMDs by sea, land and air. The PSI is a Bush-era initiative which has been endorsed by President Obama. With a few exceptions, all PSI states are parties to UNCLOS. According to its Statement of Principles, PSI states should take action in the following sea areas: internal waters, including ports used for transshipment, the territorial sea, the contiguous zone and the high seas. Action should be taken to the extent allowed under international law, including UN Security Council resolutions.

The inspection of ships in the ports of the territorial state does not raise any particular problem of international law, unless the foreign ship is a warship. But this would not be the case in point, since the PSI is aimed at merchant vessels, and warships are allowed in port only after admission by the port state. The case contemplated by the PSI is that of transshipment, an activity usually carried out by merchant vessels anchored in a port or in a sea terminal.

The same rules apply, *mutatis mutandis*, to vessels entering or leaving internal waters or the territorial sea. Suspected vessels should be subject to boarding, search, and the seizure of prohibited cargo.

A problem arises when a ship enters a territorial sea with the intention of traversing it without proceeding into internal waters or into a port of the territorial state. The ship is in lateral passage, and the question then is whether it may be stopped by the coastal state. This depends on whether transit with a PSI-prohibited cargo is considered contrary to the rules of innocent passage on the grounds that the activity is prejudicial to the peace, good order and security of the coastal state. A number of authors, while recognizing that the transport of WMDs is not an activity listed in Article 19(2) of UNCLOS, which exemplifies activities in contravention of innocent passage, argue that UNSC Resolution 1540 (2004) has rendered the proliferation of WMDs and their means of delivery a threat to international peace and security, with the consequence that the peace and security of the coastal state are also threatened.<sup>280</sup> This conclusion is not exempt from criticism. In effect, while it is true that the preamble to Resolution 1540 deals with the proliferation of WMDs without specification, in its operative part it addresses “non-state actors”. Following this line of reasoning, a cargo destined for a non-state actor should be considered a threat to peace, while a cargo destined for a state should not. Moreover, it has rightly been stated that it is difficult to see a latent threat, constituted by a cargo destined elsewhere, as a threat to the security of the coastal state,<sup>281</sup> in particular when the cargo is made of “related materials”, for instance schedule 3 chemicals under the 1993 Chemical Weapons Convention (CWC), which are usually employed in agriculture.

The above conclusion should be applied, *a fortiori*, to transit passage and archipelagic passage, both of which give the coastal state fewer rights of interference. In these cases as well, a latent threat cannot be considered an actual threat against the sovereignty, territorial integrity or political independence of the territorial state, such as would allow it to take action (Article 39(1)(b) of UNCLOS). The question of transit or archipelagic passage is not addressed by the PSI principles.

On the contrary, the contiguous zones of those states that have instituted them are taken into consideration. States are requested to take action. According to Article 33 of UNCLOS, states are allowed, within their 24-mile contiguous zone, to exercise the control needed to prevent infringement of their customs, fiscal, immigration or sanitary regulations within their territory or territorial sea, and to punish any infringement of those regulations committed within their territory or territorial sea. Even though the power of exercising control is less than stop-

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<sup>280</sup> Wolff Heintschel von Heinegg, “The Proliferation Security Initiative: Security vs. Freedom of Navigation?”, in Thomas McK. Sparks and Glenn M. Sulmasy (eds.), *International Law Challenges. Homeland Security and Combating Terrorism*, Newport, Naval War College, 2006, p. 55-76, at p. 64-65, <http://www.usnwc.edu/getattachment/e72cbc46-8888-4217-867b-9c12d4d77dc5/The-Proliferation-Security-Initiative--Security-vs.aspx>.

<sup>281</sup> Douglas Guilfoyle, “Maritime Interdiction of Weapons of Mass Destruction”, in *Journal of Conflict & Security Law*, Vol. 12, No. 1 (Spring 2007), p. 1-36, at p. 16-17.

ping a ship and bringing it into port, the majority of states consider the contiguous zone a zone with special rights of jurisdiction, where the power of boarding, inspection and seizure can be exercised against foreign vessels.<sup>282</sup> On this point, the PSI principles, which call upon participant states to stop and search vessels and to seize prohibited cargoes, are in keeping with international law.

The Statement of Interdiction Principles does not address EEZs. For the purposes of the Interdiction Principles, this is a zone of the high seas, and states are not allowed to take action against foreign vessels, unless an exception to the freedom of the high seas can be invoked. Article 110 of UNCLOS, which lists those exceptions, is not of much help. The only two relevant exceptions are related to ships without nationality and the right of approach (*vérification du pavillon*), with the latter giving only limited rights unless it is discovered that the ship is without nationality or has the same nationality as the visiting ship. The right of hot pursuit should be added (which pursuit may start from internal waters, the territorial sea or the contiguous zone).

Terrorism and WMD proliferation are not valid excuses for boarding a foreign vessel transporting a PSI-prohibited cargo on the high seas. Terrorism cannot be equated to piracy, and proliferation is not contemplated as an autonomous exception. The Protocol additional to the SUA Convention, for instance, which will be considered below, does not list the transport of nuclear material as an exception to the freedom of the high seas. UNSC Resolution 1540 does not grant the right to board foreign vessels, and Resolutions 1718 (2006), concerning North Korea, and 1737 (2006), concerning Iran, do not confer the right to stop North Korean and Iranian vessels on the high seas. The same is true of Resolutions 1874 (2009) and 1929 (2010), concerning again North Korea and Iran respectively, which allow states to visit ships suspected of having a prohibited cargo only with the consent of the flag state. Consent of the holder of jurisdiction is a valid title for boarding a vessel.

On the high seas, consent should be given by the flag state, and may be expressed *ad hoc* or consigned by an international agreement. For instance, the United States has concluded several treaties with states having large numbers of merchant shipping without a genuine link for the attribution of their nationality (states having an open registry policy and flag of convenience). The states that have concluded boarding agreements account for over 60% of world tonnage.<sup>283</sup> The PSI counts about a hundred participants, including all permanent

<sup>282</sup> Ian Brownlie in James Crawford (ed.), *Brownlie's Principles of Public International Law*, 8th ed., Oxford, Oxford University Press, 2012, p. 268-269.

<sup>283</sup> The boarding agreements dictate a standard procedure for arresting the vessel, with some small differences. If a US warship encounters a suspected ship on the high seas, it may ask the flag state to confirm the ship's nationality. The requested party, once nationality has been established, may decide to inspect the ship, or may authorize the requesting party to board and visit it. The procedure is rapid. Each party designates the authority competent for administering the

members of the Security Council except China, which considers the PSI to be at variance with the law of the sea.

It is not permitted to enter foreign territorial waters to carry out police operations. Such an activity would run counter to the provisions on innocent passage that allow states to enter territorial waters only in order to traverse the territorial sea. This is equally true for warships, even though they are entitled to exercise the right of passage. Consent of the coastal state is required in order to carry out a police activity in foreign territorial waters. Moreover, a foreign vessel may be arrested as long as it is in violation of the right of innocent passage, for instance if a ship in the hands of terrorists performs any activity prejudicial to the coastal state.

As at 20 November 2012, all six GCC states were PSI members, and some have joined PSI exercises in the Gulf with the US. The US and the UAE took part in operation Leading Edge in 2010, which was a PSI exercise. The US naval presence is centred around the Fifth Fleet, based in Bahrain, which covers the areas of the Arabian Gulf, the Arabian Sea and the Gulf of Oman.

### 5.1.5. *Maritime terrorism*

The 1988 Convention for the Suppression of Unlawful Acts of Violence against the Safety of Maritime Navigation (SUA Convention) was negotiated in Rome under the auspices of the International Maritime Organization (IMO) with the 1985 *Achille Lauro* incident in mind. It covers acts of maritime terrorism. The Rome Conference negotiated not only the SUA Convention, but also a Protocol on Fixed Platforms. All GCC Member States have ratified the SUA Convention and the Protocol on Fixed Platforms. This is very important for oil platforms in the Gulf. Oil platform are very fragile, as shown by an accident which occurred to an Iranian platform on 11 February 2012, which sank in a few seconds. A terrorist attack would result in a major disaster. Neither instrument properly covered WMD terrorism, so an Additional Protocol (2005) was negotiated to fill that lacuna. The Additional Protocol does not deal only with nuclear weapons, but also with all three classes of WMDs: bacteriological, chemical and nuclear weapons (BCN weapons).

The Additional Protocol establishes a number of offences that states are obliged to insert into their penal codes, and contains provisions on legal co-operation, such as extradition. The use of a BCN weapon against or on a ship,

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procedure, which should be concluded in two hours. If the requesting party receives no answer, consent is presumed to be given, and the requesting party may proceed to arrest and inspect the suspected vessel. The boarded vessel remains under the jurisdiction of the flag state, which may renounce jurisdiction in favour of the boarding state.

causing or likely to cause death or serious injury or damage, is considered an offence “when the purpose of the act, by its nature or context, is to intimidate a population, or to compel a Government or an international organization to do or to abstain from doing any act”. This motive is not required when BCN weapons are transported on board a ship. The mere transport is in itself an offence, provided that it is carried out “unlawfully and intentionally”. In addition, the transport of fissile material constitutes an offence if that material is destined to build nuclear weapons or to be employed for any other nuclear activity not allowed under the International Atomic Energy Agency (IAEA) safeguard agreement. Transport in compliance with the Non-proliferation Treaty (NPT) is not an offence: the shipment of fissile material coming from or destined for an NPT state is not forbidden.

The Additional Protocol does not apply to the activities of armed forces in time of armed conflict or of peace, and thus military transport does not fall within its scope. The Additional Protocol does not add new causes for boarding besides those established by the traditional law of the sea. Boarding thus requires the consent of the flag state, and a mechanism to facilitate consensus has been drafted. Rules have also been developed to ensure that boarding takes place in conformity with human rights provisions, and to provide for the possibility ask for compensation if the visit does not uncover any prohibited items. The SUA Convention has widely been ratified (161 states), while the 2005 Protocol has been ratified by 28 states only.

## 5.2. BRINGING TERRORISTS TO JUSTICE: NATIONAL/INTERNATIONAL/HYBRID TRIBUNALS

International terrorism is not a crime which falls *per se* under the jurisdiction of the International Criminal Court (ICC). The lack of general definition of it made it impossible to insert it in the Rome statute on the ICC. Acts of terrorism constituting war crimes or crimes against humanity do, however, fall under the jurisdiction of the ICC.

The same applies to maritime terrorism. There is no international criminal court which deals with maritime terrorism, and in this author’s view an ad hoc tribunal or a hybrid tribunal should not be established for this purpose, as this would increase the proliferation of international courts, a phenomenon which is also affecting criminal tribunals. The current discussion on the institution of international/hybrid criminal tribunals is related to piracy and not to maritime

terrorism.<sup>284</sup> It should also be pointed out that there is no consensus to treat terrorism as a crime falling under the principle of universal jurisdiction, which empowers any state to punish the crime, even if there is no connection between the crime and the legal order of the state that intends to punish the wrongdoer.

Acts of terrorism regulated by international treaties are considered as treaty crimes, and they are prosecuted by the national jurisdictions, unless the territorial state, i.e. the state where the wrongdoer is present, prefers to extradite the wrongdoer to a requesting party claiming jurisdiction, i.e. its competence to bring the wrongdoer to trial.

The model adopted by the maritime terrorism conventions is the following: under the 1988 IMO Convention, the offences established therein are deemed to be extraditable offences, and the state party in the territory of which the offender is located is obliged to extradite the wrongdoer to the requesting state. If the extradition is not carried out, the state of refuge is obliged to submit the case to the competent authorities for prosecution, even though the offence was not committed in its territory.<sup>285</sup> The obligation to extradite or prosecute is also set out under the 2005 Additional Protocol to the SUA Convention.<sup>286</sup> Needless to say, the correct application of the two instruments requires the enactment of the proper legislation at the domestic level.

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<sup>284</sup> See the report by the UN Secretary-General on *Possible options to further the aim of prosecuting and imprisoning persons responsible for acts of piracy and armed robbery at sea off the coast of Somalia...* (S/2010/394), 26 July 2010, <http://undocs.org/S/2010/394>.

<sup>285</sup> Article 10 of the SUA Convention.

<sup>286</sup> See Articles 10, 11 and 13.

### 5.3. NW/WMD FREE ZONES: MARITIME ISSUES

All Nuclear Weapons Free Zone (NWFZ) treaties have as states parties littoral or archipelagic states (e.g. the Treaty of Tlatelolco, 1967; the Treaty of Rarotonga, 1985; the Treaty of Bangkok, 1995; the Treaty of Pelindaba, 1996), with the exception of the Treaty of Semipalantisk (2006) relating to the Central Asia states, which comprise only inland countries. These treaties forbid states parties to install nuclear weapons on their territories, including their territorial and archipelagic waters. Problems may arise as regards the navigational rights of third states' vessels having on board nuclear armaments in the zone covered by the NWFZ treaty, in particular when the zone in question encompasses archipelagic states or states that control important international straits. As a rule, NWFZ treaties guarantee freedom of navigation for third states' vessels which are carrying nuclear weapons. The Treaty of Pelindaba, however, prohibits the transportation of nuclear weapons in inland waters. Overflying of EEZs by NWFZ states is covered by the freedom of the seas, and thus is also allowed for aircraft with nuclear weapons. The same is true for those marine areas where transit or archipelagic transit is allowed, since this also covers air transit (Article 5 of the Treaty of Rarotonga; Article 2 of the Treaty of Bangkok; Article 2 of the Treaty of Pelindaba). The overflying of territorial waters and of straits not subject to transit passage is conditional upon the consent of the territorial sovereign. Usually NWFZ treaties authorise littoral states to allow overfly aircraft carrying nuclear weapons.

A new idea is the establishment of a Weapons of Mass Destruction Free Zone (WMDFZ), encompassing all three categories of WMDs: biological, chemical and nuclear. A WMDFZ has been envisaged for the Middle East. The idea dates back to 1974 and UNGA Resolution 3263 of 9 December 1974. It was endorsed by the 1995 NPT review and extension Conference, and again by the 2010 review Conference and the appointment of a Facilitator, the Finnish Ambassador Jaakko Laajava. One of the problems with this idea is the geographical reach of the zone. There is no doubt that all six GCC countries should be part of it, and they were the addressees of a communication sent to this effect by the UN Secretary-General. The maritime aspects of a WMDFZ in the Middle East have not yet been adequately examined in the relevant fora. A Conference on WMDFZ in the Middle East was scheduled to take place in Helsinki in 2012, but this date passed without it being convened. The Syrian conflict and the question of the use by Iran of its nuclear facilities to build a nuclear arsenal did not help, and these issues are still a major source of concern. Nevertheless, the idea of a Conference on WMDFZ in the Middle East has not yet been discontinued, and the Facilitator is continuing his consultations with the Middle Eastern capi-

tals. Should the idea of such a Conference fail, this would create a major problem for the next NPT Review Conference, scheduled to be held in 2015. The EU Non-Proliferation Consortium held two Conferences in Brussels, in 2011 and 2012, with the participation of interested stakeholders. The GCC countries took part in both Conferences, even though the second one was not attended by Egypt or the Arab League. The collaboration between the EU and the GCC should continue, and be implemented with regional conferences and seminars. For instance, the GCC countries might host a track-two conference/seminar devoted to the problem of the maritime aspects of a future WMDFZ in the Middle East. A more ambitious plan might be a unilateral declaration proclaiming the GCC a zone free from WMDs, a good-will move that could enhance the prospects for a Conference in 2014, as well as a positive outcome therefrom.<sup>287</sup> Note that Syria has acceded to the CWC on 14 September and this is an important step not only for impeding the use of such weapons in the ongoing conflict, but also for the prospect of a WMDFZ in the Middle East.

#### 5.4. CONFIDENCE AND SECURITY BUILDING MEASURES (CSBMs) AND MARITIME SECURITY

Navigation and military exercises are often sources of naval incidents. Thus, “rules of the road” for navies are important. The most relevant document in this field is the US-Soviet Treaty of 25 May 1972. This model was followed by subsequent treaties concluded with the Soviet Union by the UK (1986), France (1989) and Italy (1989). After the brief parenthesis of Russia’s absence from the Mediterranean, those treaties have regained their strategic importance. Greece and Turkey concluded a memorandum of understanding concerning military activities on the high seas and in the international airspace in 1988. Two agreements were concluded between Italy and Tunisia on 10 November 1988: an Executive Protocol on cooperation between the Italian navy and the Tunisian navy, and Technical Arrangements on practical measures, which aimed at avoiding incidents at sea and facilitating cooperation between the Italian and Tunisian navies. For the Middle East, maritime CSBMs were envisaged in the context of the Arms Control and Regional Security Working Group (ACRS), which followed the Madrid Plan of Action aimed at the settlement of the Palestinian-Israeli conflict. Given the intractability of the conflict, the ACRS has not met since 1995. However, its findings may be studied in order to see if they can be applied to

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<sup>287</sup> The interest in such a project is still alive; see the report of the “Amman Security Colloquium - Maintaining the Momentum and Supporting the Facilitator (Prospects for a Weapons of Mass Destruction Free Zone in the Middle East)”, in *The Non-Proliferation Monthly*, No. 86 (November 2013), p. 9, <http://www.cesim.fr/observatoire/eng/86>.

maritime security.

CSBMs might play an important role in the Persian Gulf. Up till now, no treaty or memorandum of understanding regulating rules of the road for navies has been agreed. The GCC countries could examine the rules already in existence in other waters to see whether it is possible to apply them to the Gulf.

## 5.5. ENCLOSED AND SEMI-ENCLOSED SEAS AND THE PERSIAN GULF

The notion of enclosed and semi-enclosed seas is an innovation of UNCLOS. According to Article 122 thereof, there are two definitions. The first takes into account geographical factors, and defines an enclosed or semi-enclosed sea as “a gulf, basin or sea surrounded by two or more States and connected to another sea or the ocean by a narrow outlet”. The second definition given by Article 122 takes into account legal elements, defining an enclosed or semi-enclosed sea as a gulf or sea “consisting entirely or primarily of territorial seas and exclusive economic zones of two or more coastal States”.

The Gulf falls under the first definition since it is connected to the Indian Ocean by a narrow outlet, i.e. the Strait of Hormuz. UNCLOS refers to economic cooperation as a field of action of littoral states, and lists as examples of economic cooperation such items as living resources, the marine environment and scientific research. The list is merely illustrative; however, arms control and military issues in general are not necessary ingredients of the generic duty of cooperation which littoral states are obliged to fulfil under Article 123 of UNCLOS. EEZs have been established in the Gulf by Iran, Oman and the UAE.

The notion of enclosed or semi-enclosed seas does not encompass, as a necessary ingredient, the institution of a zone of peace. This was proposed by the Soviet Union for the Mediterranean in an attempt to secure the removal of the US navy. This idea was never implemented for obvious reasons. Iran would like to remove outsider naval powers from the Persian Gulf, a proposal that runs counter to the defence agreements concluded with the Gulf states.<sup>288</sup> Moreover, foreign navies are not ready to abandon the Gulf, given the strategic and commercial importance of the region.

The formal endorsement of the notion of a zone of peace goes back to UNGA Resolution 2831 (XXVI) of 16 December 1971, which declared the Indian Ocean a zone of peace. It was repeated in subsequent resolutions. The latest resolution

<sup>288</sup> Mustafa Alani, “Toward a Comprehensive Maritime Security Arrangement in the Gulf”, in Ellen Laipson and Amit Pandya (eds.), *The Indian Ocean. Resource and Governance Challenges*, Washington, Stimson Center, 2009, p. 31-41, at p. 39-40, [http://www.stimson.org/images/uploads/research-pdfs/Indian\\_Ocean-Chapter\\_3\\_Alani.pdf](http://www.stimson.org/images/uploads/research-pdfs/Indian_Ocean-Chapter_3_Alani.pdf).

was adopted on 2 December 2011,<sup>289</sup> and it was decided to include an item entitled “Implementation of the Declaration of the Indian Ocean as a zone of peace” on the provisional agenda of the 68th session of the General Assembly.

Though there is not only one notion of a zone of peace, its implementation would entail a prohibition on granting military facilities and the exclusion of fleets not belonging to the littoral states, or at least their limitation in number. As a rule, a zone of peace should also be a nuclear weapon free zone. The proposal to institute zones of peace has been in principle opposed by the major naval powers, since its enforcement would curtail the principle of freedom of navigation on the high seas, as well as that of collective self-defence. For non-littoral states, the freedom of the high seas would be limited to non-military navigation. This is why France, the United Kingdom and the United States, which have naval interests in the Indian Ocean, voted against UNGA Resolution 47/59, while the positive vote of the Russian Federation was nothing but lip-service to the idea of zones of peace. In 2012, Sri Lanka announced that it would like to pursue a new approach to turning the Indian Ocean in a zone of peace. The proclamation of the Indian Ocean as a zone of peace would have a negative impact on the security of the Gulf and GCC countries, since the Gulf is separated from the Indian Ocean by a narrow outlet. It would impede Western navies from honouring their defence commitments with the states bordering the Gulf countries. As we shall see, the same negative result would be achieved by transforming the Gulf into a zone of peace.

## 5.6. MARITIME-TERRITORIAL CONTROVERSIES

As land dominates waters, so do territorial controversies have an impact on maritime delimitations. One prominent controversy belonging to that category concerns sovereignty over Abu Musa, which is claimed both by the UAE and Iran. The island was occupied by the UK in 1921, and was subsequently given in administration to the Emirate of Sharjah. In 1971 a memorandum of understanding was signed by Sharjah and Iran, establishing a joint administration, and oil revenues were equally shared by the two parties. Contrary to the memorandum, Iran occupied the island. In April 2012 it was visited by a high-profile Iranian parliamentary delegation and the Iranian President. These events raised protests from the UAE. Therefore it can be seen that there is no acquiescence to Iranian occupation on the part of the UAE, and the UAE’s claim has not been dismissed, but indeed has been reiterated several times. On 17 April 2012,

<sup>289</sup> UN Assembly, *Implementation of the Declaration of the Indian Ocean as a Zone of Peace* (A/RES/66/22), 2 December 2011, <http://undocs.org/A/RES/66/22>.

the GCC Member States condemned Iran's continued occupation of Abu Musa, Greater Tumb and Lesser Tumb.<sup>290</sup>

The dispute should be solved in a peaceful way under Chapter VI of the UN Charter. Article 33 thereof lists a number of methods, ranging from negotiation to judicial settlement. Article 36 gives preference to the ICJ for the settlement of legal disputes. Ad hoc arbitration, however, should also be taken into consideration, since it would also allow for a solution to the controversy. While the UAE is ready to bring the matter before the ICJ, Iran has refused this option.

## 5.7. THE DELIMITATION OF SEA AREAS

The Gulf states abide in principle by the law of the sea conventions, even though they are not all parties to UNCLOS. This is why the main provisions on sea limits and the delimitation of sea areas derive from customary international law. The same is true for outside users, for instance the US, which is not party to UNCLOS. The delimitation of sea areas in the Gulf is very important, since its maximum width (coast to coast) is about 210 nautical miles. As has been said, all GCC states with the exception of the UAE have ratified UNCLOS. The UAE has only signed it. Iran has also signed but not ratified UNCLOS. A number of provisions are abided by as a matter of customary international law. Gulf countries have a territorial sea of a width of 12 nautical miles, and also a contiguous zone. Saudi Arabia and the UAE have also established a security zone beyond the territorial sea (of respectively 18 and 24 nm). They have also drawn straight baselines. Iran established a system of a straight baseline along its coast in the Persian Gulf and Gulf of Oman, bringing protests from the US. As far as the delimitation of the continental shelf is concerned, the six countries have concluded delimitation agreements: UAE-Qatar (1969: Abu Dhabi-Qatar), Kuwait-Saudi Arabia, Bahrain-Saudi Arabia (1959), and Oman-Yemen. The maritime frontier between Bahrain and Qatar was defined by the ICJ by judgment given in 2001. The delimitation followed the principle of the median line, adjusted according to the existing special circumstances. This criterion is generally applied in the other delimitation agreements referred to. Delimitation agreements have also been concluded by Iran with Bahrain, Qatar, Saudi Arabia and Oman. A partial agreement has been concluded between Iran and the UAE, a full agreement being impossible to reach pending resolution of the controversy over the sovereignty of Abu Musa. It is also worth noting that some of these delimitation agreements have also solved sovereignty disputes concerning territory (for instance

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<sup>290</sup> "Q&A: Iran President's Controversial Visit to Abu Musa", in *BBC News*, 23 April 2012, <http://www.bbc.co.uk/news/world-middle-east-17770111>.

islands) covered by the maritime delimitation in question.

In the words of Stuart Kaye, in his conclusion in an article devoted to the entire Indian Ocean but which may also be applied to the GCC Member States, “[w]hat may be described as unusual is the fact that periodic disputes and poor relations do not appear to have impeded the majority of states from concluding maritime boundaries. What may also be remarkable is the proportion of regional states who purport to restrict freedom of navigation in some fashion. Were all of these claims to be actively asserted, they might restrict international trade to a not insignificant extent”.<sup>291</sup>

## 5.8. PIRACY

Piracy is an old crime committed against commercial shipping. The law on piracy belongs to customary international law and has been codified both in the 1958 Geneva Convention on the High Seas and UNCLOS (Articles 100-107 and Article 110(1)(a)). By definition, piracy is a crime committed on the high seas. If committed in territorial waters, it should be qualified as armed robbery.

The elements of the crime of piracy are the following:

- An illegal act of violence or depredation committed by the crew of one ship against another ship (two-ship requirement);
- The act of violence or depredation should be committed for private ends. This distinguishes piracy from terrorism, even if nowadays the distinction is often blurred.

By definition, an act of piracy cannot be committed by a warship, unless the crew has mutinied and fitted the warship to conducting acts of piracy.

On the high seas, every state has jurisdiction over piracy. It is entitled to capture a pirate ship, to seize the goods on board and to punish pirates. Only warships, or other ships clearly marked and identifiable as being on government service and authorized to that effect, are entitled to seize a pirate ship.

There is a duty of cooperation in the repression of piracy. There is a right to visit a ship suspected of engaging in piracy. However, if the suspicion proves to be unfounded, the ship should be compensated for any damage sustained. The law of the sea gives the power to seize a pirate ship only on the high seas. In territorial waters the consent of the coastal state is needed. An authorization by the UN Security Council may replace the consent of the coastal state, or supplement the consent by a government the powers of which are merely nominal, as happened in the case of Somalia. A number of Security Council resolutions have

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<sup>291</sup> Stuart Kaye, “Indian Ocean Maritime Claims”, in *Journal of the Indian Ocean Region*, Vol. 6, No. 1 (June 2010), p. 113-128, at p. 127, <http://dx.doi.org/10.1080/19480881.2010.489674>.

been passed since 2008, giving the power to outside navies to enter Somali waters. Resolution 1851 (2008) authorizes, in its paragraph 6, Member States to take action on land in order to suppress pirates' sanctuaries. These resolutions have not change the law of piracy. China, for instance, pointed out at the time of voting that entering foreign territorial waters was permitted only by Security Council resolutions, and that the traditional law of piracy was not changed.

Piracy has become a real danger for commercial trafficking and oil exporting countries. It is mostly concentrated in the Indian Ocean, but this criminal phenomenon is expanding to other areas, for instance the Gulf of Guinea. According to statistics given by the International Maritime Bureau (IMB), there were 406 piracy attacks in 2009 (world-wide), 219 in 2010, and 236 in 2011, the years in which piracy reached its peak. Since 2012 piracy has been decreasing. It dramatically dropped in 2013<sup>292</sup>. This is due to the success of counter-piracy measures, such as dispatching navies to the hot spots, and fitting ships with armed personnel on board.

States may operate either singly or under the aegis of an international organization or under the leadership of a naval power.

- 1) China, the Russian Federation and other states have dispatched ships to the Indian Ocean on anti-piracy missions;
- 2) Combined Task Force 151 operates under US leadership, and it is stationed in Bahrain;
- 3) Operation Ocean Shield is conducted under the aegis of NATO;
- 4) Operation Atalanta is a European Union mission in the Indian Ocean, authorized by the Council of the European Union to take action on the Somali coastline in order to destroy pirate shipping.

In an interview reported by *The National* on 5 July 2012<sup>293</sup>, Rear Admiral Ibrahim Al Musharrakh of the UAE naval staff said that the Joint Peninsula Shield, mainly based on land forces, should have a naval component, ready to patrol the shipping lanes of the Arabian sea against pirates. The GCC countries appear to be very concerned by piracy, and want to play an active role. The UAE organized the first Counter Piracy Conference in 2011, the second in 2012 and the third in 2013.<sup>294</sup>

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<sup>292</sup> See the proceedings of the conference on "The Threat of Contemporary Piracy and the Role of the International Community", Rome, 28 November 2013, edited by Chiara Altafin in *Documenti IAI*, No. 14|01 (January 2014), <http://www.iai.it/pdf/dociai/iai1401.pdf>.

<sup>293</sup> Awad Mustafa, "UAE Navy chief seeks GCC alliance on piracy", in *The National*, 5 July 2012, <http://www.thenational.ae/news/uae-news/uae-navy-chief-seeks-gcc-alliance-on-piracy>.

<sup>294</sup> UAE Counter Piracy Conference, *A Regional Response to Maritime Piracy: Enhancing Public-Private Partnership and Strengthening Global Engagement*, <http://www.counterpiracy.ae>.

### 5.8.1. Hostage-taking

The International Convention against the Taking of Hostages, adopted by the General Assembly of the United Nations on 17 December 1979, which now counts 167 parties, is also relevant. All GCC countries are parties. Modern piracy differs from the older version. There is no more gold bullion to take, and the capture of the crew proves to be a lucrative affair. The Convention applies whenever the crime has a transnational feature, and does not apply in the case of domestic hostage-taking. According to Article 1, the crime is committed whenever a person seizes or detains and threatens to kill, injure or continue to detain another person in order to compel a third party, namely a state, an international intergovernmental organization, or a natural or legal person or group of persons, to do or to abstain from doing any act as an explicit or implicit condition for the release of the hostage. Taking hostages in order to compel a shipping company to pay a ransom falls within the scope of the Convention. States parties are obliged to enact penal legislation in order to implement the Convention, to cooperate as far as extradition is concerned, and to make hostage-taking an extraditable offence. If a ransom is paid, the state where the ransom is located is obliged to return it to the legitimate owner. The Convention does not prohibit ransom-paying. In order to do so, an amendment to the Convention, or a Security Council resolution, is required. However, up till now ship-owners have opposed such a policy.

### 5.8.2. Bringing pirates to justice

One of the most serious problems in fighting piracy is the punishment of offenders. Often pirates are captured and subsequently abandoned on the coast, since the capturing vessel is unwilling to keep them in custody or hand them over to the authorities of the flag state. Pirates, after having been left free, engage again in criminal enterprises. Cooperation with bordering states is essential. One possibility for GCC countries might be to set up a regional tribunal to try pirates captured by navies operating in the Indian Ocean and the Gulf of Aden. Up till now such an idea has not yet been developed. The Final Statement of the second UAE Counter Piracy Conference held in Dubai (2012) recognized the need to strengthen the judicial response to piracy. However, it did not raise the idea of setting up regional international tribunals. It commended Kenya and the Seychelles on their readiness to try captured pirates, and also underlined the efforts of Mauritius and Tanzania in ensuing that pirates face trial.<sup>295</sup>

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<sup>295</sup> UAE Counter Piracy Conference, *Final Ministerial Statement*, 28 June 2012, <http://www.counterpiracy.ae/media>.

### 5.8.3. *The Djibouti Code of Conduct*

The Djibouti Code of Conduct is one of the most prominent instruments adopted by the states of the region in order to fight piracy. Even if it is not a treaty but only an instrument of soft law, the Code, which was adopted in January 2009, establishes a number of measures that states may adopt. It was concluded under the auspices of the IMO and defines piracy and armed robbery against ships, enacting provisions against piracy on one hand and armed robbery on the other. The establishment of a special regime for armed robbery is important, since this is lacking from UNCLOS. Measures adopted against piracy include:

- Incident reporting;
- Sharing and reporting relevant information;
- The protection of ships;
- Prosecuting pirates;
- Law enforcement officers on board ships;
- Review of national legislation;
- Setting up coordination and information centers.

The signatory states are free to draft legal instruments providing for more stringent measures.

Oman, Saudi Arabia and Yemen, together with other Indian Ocean states and France, are signatories to the Djibouti code of conduct. The UK and the US are observer states.

### 5.8.4. *The privatization of maritime security*

I have addressed the issue of Private Military and Security Companies (PMSCs) in an article published in a book on PMSCs edited by myself and a colleague.<sup>296</sup>

The main findings were as follows:

- After the 1856 Paris Declaration on the abolition of privateering, control of violence at sea is in the hands of states;
- Both the 1958 Geneva Convention on the High Seas and UNCLOS entrust the function of policing the seas to warships and other government vessels licensed to perform such services. The conventional provisions are regarded as declaratory of customary international law;
- International law prohibits arming private vessels for pirate-hunting. To

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<sup>296</sup> Natalino Ronzitti, "The Use of Private Contractors in the Fight against Piracy: Policy Options", in Francesco Francioni and Natalino Ronzitti (eds.), *War by Contract. Human Rights, Humanitarian Law, and Private Contractors*, Oxford, Oxford University Press, 2011, p. 37-51.

do so, a private ship should be converted into a warship in accordance with the requirements established by Hague Convention No. VII of 1907. However, in this case, a fully-commissioned officer should be in command, and the crew should be under military discipline;

- The above provisions regard the law of armed conflict at sea, including the law of neutrality;
- However, the monopoly of force by states in counter-piracy operations has been reaffirmed both by the Geneva Convention on the High Seas and by UNCLOS;
- There are no specific prohibitions against the use of security guards for protecting private shipping and using force in self-defence;
- This affirmation, which opens the way for employing PMSCs against pirates, should be reconciled with the law of the sea and the possibility for PMSCs to be on board private ships in territorial waters – when such ships are in innocent passage through the territorial sea or international straits – or on the high seas. An additional question is whether it is possible to dispatch an escorting vessel with PMSCs on board in order to protect transiting private shipping.

I answered these questions in the following way in the article:

- A merchant ship with an armed team on board is entitled to traverse foreign territorial waters, and the presence of the armed team does not constitute an infringement of the rules on innocent passage;
- The same is true (and even more so) for transit passage through an international strait;
- PMSCs are forbidden to arm vessels for pirate-hunting. However, they are permitted to arm a vessel to escort merchant shipping. If attacked by pirates, they are entitled to react;
- The rationale for using force is the law of self-defence.

UNCLOS establishes a duty of cooperation in fighting piracy on the high seas, and states are the holders of rights and obligations in this regard (Article 100). The provisions on the right of visit impose duties in the case of the unjustified stopping of a vessel suspected of piracy. Provisions are set out as regards the right to punish pirates and the restitution of property to its lawful owners.

There is no international convention regulating PMSCs. There is however an instrument of soft law, i.e. the Montreux Code of Conduct, which addresses this important issue.<sup>297</sup> The Montreux document is not tailored to the employment of PMSCs at sea. The same is true for the International Code of Conduct for Security Companies (ICoC) adopted on 9 November 2010 under the auspices of the

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<sup>297</sup> *Montreux Document on Pertinent International Obligations and Good Practices for States Related to Operations of Private Military and Security Companies during Armed Conflict*, Montreux, 17 September 2008, <http://undocs.org/A/63/467>.

Swiss Government, even though a broad reading of this document may lead to a different conclusion. The draft convention on PMSCs currently being negotiated within the Human Rights Council does not seem to be an instrument applicable to PMSCs providing security services at sea.

The use of armed personnel on board private shipping to fight piracy is gaining currency among shipping companies. Some flags employ private guards, while others employ military personnel. Spain only allows private guards, while French trawlers stationed in the Seychelles have military people (*fusiliers marins*) on board. Italian law allows both the use of military teams and private guards (*guardie giurate*).<sup>298</sup>

The IMO was initially against the employment of armed personnel on board ships, and was of the opinion that non-lethal defences were preferable (for instance, barbed wire along the external side of the ship, powerful hydrants, water cannons, a citadel where the crew could seek refuge pending the intervention of a warship in the vicinity). The International Parcel Tanker Association (IPTA), an umbrella organisation for ship owners, has requested the IMO safety Committee to enact provisions concerning the employment of armed guards on board commercial shipping. The IMO has published three circulars clarifying, however, that it does not officially endorse the practice of having armed personnel on board.<sup>299</sup> States and ship owners are invited to set out proper rules if they deem it necessary to employ Privately Contracted Armed Security Personnel (PCASP), the jargon used for armed guards on board instead of the acronym PMSCs. The latest IMO circulars are 1405/rev. 2 and 1443, both of 25 May 2012<sup>300</sup>. The latter contains “Interim Guidance to Private Maritime Security Companies Providing Privately Contracted Personnel on Board Ships in the High Risk Area”. The Baltic and International Maritime Council (BIMCO) has published a model contract for the employment of security guards (Guardcon), which includes *Guidance on the Rules for the Use of Force (RUF)*, released in 2012.<sup>301</sup> There is, therefore, enough material for drafting a code of conduct along the lines of the Montreux document, including a commentary and a collection of best practices. Uniform rules on self-defence, the master’s responsibility, rules of engagement, the stowing of weapons, the status of armed guards at ports of call, and the

<sup>298</sup> See Article 5 of Law No. 130, 2 August 2011, <http://www.normattiva.it/uri-res/N2Ls?urn:nir:stato:legge:2011;130>.

<sup>299</sup> IMO circulars MSC.1Circ./1405/Rev. 1, 1406/Rev. 1, and 1408, of 16 September 2011. All IMO circulars are available in the IMO website: <http://www.imo.org/OurWork/Circulars/Pages/IMODOCS.aspx>.

<sup>300</sup> *Ibidem*.

<sup>301</sup> BIMCO, *Guidance on the Rules for the Use of Force (RUF) by Privately Contracted Armed Security Personnel (PCASP) in Defence of a Merchant Vessel (MV)*, March 2012, [https://www.bimco.org/Chartering/Documents/Security/~/\\_media/Chartering/Document\\_Samples/Sundry\\_Other\\_Forms/Sample\\_Copy\\_Guidance\\_on\\_the\\_Rules\\_for\\_the\\_Use\\_of\\_Force.ashx](https://www.bimco.org/Chartering/Documents/Security/~/_media/Chartering/Document_Samples/Sundry_Other_Forms/Sample_Copy_Guidance_on_the_Rules_for_the_Use_of_Force.ashx).

custody of captured pirates during navigation and their handing over to coastal states would need to be clarified. The issue of self-defence deserves to be accurately assessed. The relevant law is that governing police action at sea, rather than the right of self-defence as embodied in Article 51 of the UN Charter. In this connection one very important point to be clarified is whether self-defence may be resorted to only for protecting persons from attack, or also to protect property, for instance, the ship and the cargo on board. It is necessary to compare domestic legislations in order to find a common approach. The use of lethal force should be avoided and used only as a last resort. This is stated, for instance, in the BIMCO document, which contains detailed provisions on the issue. Reference should also be made to a number of relevant instruments, including law of the sea conventions (for instance, Article 22 of the 1995 UN Fish Stocks Agreement), soft law documents (for instance, the ICoC) and the case law of the Law of the Sea Tribunal.

Another important issue is the status of military personnel on board private shipping. As mentioned earlier, France employs military personnel on board fishing boats, and Italian law allows both military teams and private contractors to be on board. Do military personnel enjoy functional immunity/immunity *ratione materiae* - which I would deem to be the case - on the grounds that they have the status of law enforcement officers (under Italian law) and are performing a task in the interests of the international community? The issue is the crux of a dispute between Italy and India in connection with the incident which took place involving the *Enrica Lexie* transiting off the coast of Kerala<sup>302</sup>. In addition, the responsibility of states to license private armed guards should be clarified. Is there is an obligation of due diligence incumbent on the licensing state, even when the armed team is made up exclusively of private persons who are not state officials?

## 5.9. DRUG TRAFFICKING AND TRAFFICKING IN PERSONS

Both are criminal phenomena, but are not considered international crimes as piracy is. Coastal states are entitled to stop ships engaged in these kinds of trafficking in their territorial sea or in the contiguous zone, but not on the high seas if the ship is flying a different flag from that of the boarding vessel. However, states may conclude agreements for stopping their vessels.

As regards drug trafficking, the 1988 Vienna Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances does not regulate maritime

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<sup>302</sup> See Natalino Ronzitti, "The Enrica Lexie Incident. Law of the Sea and Immunity of State Officials Issues", in Italian Yearbook of International Law, Vol. 22., 2012, p. 3-22.

issues. Article 108 of UNCLOS only establishes a duty of cooperation in the suppression of the illicit traffic in narcotic drugs or psychotropic substances. This duty of cooperation should be implemented by bilateral or regional agreements. One example of such is the treaty concluded between Italy and Spain on 23 March 1990 allowing both parties to stop each other's vessels which are suspected of being engaged in drug trafficking. The US and other Central America states have concluded the 2003 Caribbean Maritime and Counter Narcotics Agreement, which allows US coastguards to stop foreign vessels with the consent of the flag state.<sup>303</sup> As for the Gulf region, the First Regional Anti-Narcotics Conference was held in Kuwait in March 2006.<sup>304</sup> According to research carried out by the Gulf Research Center, "the Gulf states have traditionally been a hub for illicit transit trafficking of opiates and cannabis intended for European markets".<sup>305</sup> The UAE, for instance, has become the hub of transshipment of drugs coming from Afghanistan via Iran and Pakistan. A sound counterdrug policy requires strict cooperation with the relevant international agencies. The UN Office on Drugs and Crime (UNODC) has divided the Arab states into three sub-regions, one of which is composed of the Gulf states. Its draft regional programme for 2011-2015 addresses all GCC countries.

As far as trafficking in persons is concerned, Article 99 of UNCLOS embodies the time-honoured prohibition on the transport of slaves. More pertinent is the Protocol against the Smuggling of Migrants by Land, Sea and Air, supplementing the 2000 UN Convention against Transnational Organized Crime. The Protocol entered into force in 2004, and has been ratified by Bahrain, Oman and Saudi Arabia. States parties are obliged to establish the smuggling of migrants and producing false travel or identity documents as criminal offences. Measures may be taken against traffickers by warships or other governmental vessels. Stopping foreign vessels is permitted only by the flag state or by the state of permanent residence. Otherwise consent is required. The Protocol provides for a mechanism to facilitate consensus. Each state party should re-establish a focal point to which the request may be addressed. Another important provision is that on returning immigrants (Article 18). Migrants should be returned to their country of nationality or permanent residence. It is to be noted that the Protocol is aimed at preventing smuggling and punishing persons committing this crime, and not at eliminating illegal immigration. For instance, it does not regulate the question of the right of asylum and the status of refugees. There is an obligation

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<sup>303</sup> See the list of bilateral agreement concluded by the US in J. Ashley Roach and Robert W. Smith, *Excessive Maritime Claims*, 3rd ed., Leiden and Boston, Nijhoff, 2012, p. 583.

<sup>304</sup> Faryal Leghari, "Narcotics Trafficking to the Gulf States", in *Security & Terrorism Research Bulletin*, No. 4, November 2006, p. 19, [http://www.grc.net/download\\_generic.php?file\\_name=M-jM3Mzg%3D](http://www.grc.net/download_generic.php?file_name=M-jM3Mzg%3D).

<sup>305</sup> *Ibidem*.

on states parties to accept the return of their nationals or of persons having permanent residence in their territory. The return should be carried out in orderly manner and with due regard for the safety and dignity of persons. UNODC has issued a Model Law Against the Smuggling of Migrants that might be a voluntary source of inspiration for national legislations. The EU Member States, and in particular the Mediterranean Member States, have considerable experience in combating illegal immigration. For instance, Italy has concluded repatriation agreements with Albania and Libya, as has Spain with Morocco, while Malta has also engaged in bilateral talks with its neighbours. These policies fall within the competence of the EU, namely Article 79 of the Treaty on Functioning of the European Union. The EU *acquis* includes a number of directives, which should be implemented by Member States, as well as a number of re-admission agreements concluded with countries from which illegal immigration occurs. The EU agency competent for implementing a common policy at the maritime borders is Frontex. Frontex carries out joint operations to combat illegal immigration at sea, and also cooperates with UNODC in connection with the issue of the smuggling of migrants. It signed a working arrangement with the UN Agency on 17 April 2012.

## 5.10. MARINE POLLUTION

The Gulf is one of the busiest sea routes in the world due to its energy-related shipping. Oil spills have contributed to the increased levels of pollution, which are also due to land sources. The legal landscape aimed at the prevention of pollution is both universal and regional. The 1973 International Convention for the Prevention of Pollution from Ships (MARPOL) has widely been ratified, and all GCC countries are party to it. Moreover, the Convention contains six annexes dealing with special causes of pollution. The Marine Environment Protection Committee (MEPC) of the IMO (and its revised regulations of marine pollution by ships carrying oil or chemicals) designated the Oman Sea of the Arabian Seas as a special area (11-15 October 2004). Annexes I and II to the Marpol deal with oil and other dangerous substances. Special areas designated by the Marpol system include the Oman area of the Arabian Seas as well as the Gulf of Aden area. Indeed, the Oman long coastline is one of the busiest sea-route for ships traversing the Gulf of Aden and entering the Suez Canal. The problem with the Oman special area is whether it is really operational because of the issue of reception facilities.

Oil spills are one of the major dangers. For instance, the EU has adopted regulations obliging oil tankers to be built with a dual hull, which apply to EU flag

ships and foreign shipping calling at EU ports or off-shore terminals. UNCLOS contains numerous provisions regulating the protection and preservation of the marine environment. They are contained in its Part XII, and Article 192 lays down the general principle according to which "States have the obligation to protect and preserve the marine environment".

There are two provisions which may be a source of contention. The first is Article 221 of UNCLOS, which authorizes coastal states to take unilateral measures on the high seas against foreign ships to avoid pollution arising from maritime casualties. The consent of the flag state is not required. The second is military navigation. According to Article 236 of UNCLOS, the provisions regarding the protection and preservation of the maritime environment do not apply to warships. Generally speaking, military activities are not regulated by marine conventions.

Wrecks on the sea-bed may be both a source of pollution and a danger for navigation. This is particularly true of the Gulf, after the Iran-Iraq war. The 2007 Nairobi International Convention on the Removal of Wrecks contains provisions on the removal of wrecks resulting from a maritime casualty. The definition given by the Nairobi Convention is very broad. It refers to sunken and stranded ships, to any objects that are or have been on board, and even to ships that are adrift at sea and ships expected to sink or to strand. However, the definition is centred around the notion of the ship, and consequently fixed platforms and installations as well as pipelines are excluded. The Convention has not yet entered into force, since ten ratifications are necessary. As of 9 January 2014, only nine states had ratified or acceded, including Iran, but not Iraq.

The 1991 Gulf war caused a huge oil spill off the Kuwaiti coast, which polluted the Saudi Arabian coastline and other regions of the Gulf. Oil spills are the major concern. Other sources of pollution include the high degree of urbanization in coastal regions, as well as desalination plants. Regional cooperation is not lacking. In 1978, the Kuwait Regional Convention for Co-operation on the Protection of the Marine Environment from Pollution was agreed, and five related Protocols have been concluded. The Regional Organization for the Protection of the Marine Environment (ROPME) has been created. Its membership includes Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia and the UAE. Pollution is a very serious problem for a fragile environment such as the Gulf, with its scarcity of fresh water. A major incident might cause great harm to the desalination plants and endanger their production. The autonomy of the reservoirs in the region is very low.

## CONCLUSION

The Joint Action Programme (2010-2013) for Implementation of the GCC-EU Cooperation Agreement of 1988 (JAP) lists several areas of cooperation. With the exception of one, they are not specifically devoted to the maritime security, even though they may be adapted to cover it.

Item No. 5 (Transport) is dedicated to cooperation in maritime affairs, specifically as regards passengers, vessel inspection, maritime legislation, safety regulations and navigation security. The other items in by the JAP deserve a broad interpretation and should also cover maritime issues. For instance, item No. 8, concerning money laundering and terrorist financing, should be enlarged to address specific issues related to maritime crimes, particularly piracy.

An enhanced EU-GCC cooperation in the field of maritime affairs should in particular cover the following sectors:

### a) Maritime Transport and Marine Affairs

EU Member States have respectable commercial shipping, and both the EU and its Member States have adopted a wide range of legislation covering all aspects of maritime transport. The legislation is reviewed and revised if the need arises. It has been adopted either autonomously or in order to implement the international conventions to which the EU Member States are parties. It consists of national and EU legislation (directives, regulations and decisions). The EU could help the GCC countries to draft maritime legislation, including the laws and regulations necessary to implement the relevant international conventions. It could act in cooperation with other international organizations, for instance the IMO and the International Labour Organization (ILO). Pollution is an issue of major concern for the GCC countries. A significant maritime collision could create problems for drinking water, which depends on the desalination plants. Fresh water reserves would last for a short time. The EU has experience in dealing with pollution in semi-enclosed seas like the Mediterranean, and a number of conventions have been concluded in this regard under the auspices of the Council of Europe. The EU could advise on coastguards and help to train personnel and integrate naval resources. This aim could also be met for the blue navy, drawing on EU experience. Other possible areas for collaboration are assistance in establishing and consolidating coastal state maritime zones and in implementing international legislation originating both from treaty law (UNCLOS) and customary international law, including in relation to navigation through territorial seas, contiguous zones and EEZs.

Drug trafficking and trafficking in persons also are potential areas for cooperation. As far as the former is concerned, the GCC countries could benefit from

the experience of the bilateral treaties concluded between EU Member States, such as the Treaty between Italy and Spain of 1990; as regards the latter, the GCC countries should benefit from the experience of the Frontex and the measures that EU Member States have taken in the Mediterranean to deal with illegal immigration. Collaboration with UNODC to implement the Protocol against the Smuggling of Migrants by Land, Sea and Air, supplementing the 2000 UN Convention against Transnational Organized Crime, is of paramount importance. The GCC countries could benefit from EU experience in this connection as well. The experience of EU Member States in implementing the PSI should also be taken into account.

#### b) Piracy

Piracy is still an issue of major concern for the international community, even though the threat has recently decreased. The Indian Ocean and the Gulf of Aden remain the most dangerous areas. Oman, Saudi Arabia and particularly Yemen are the countries most involved on account of their coastlines and sea routes. Cooperation between the GCC and the EU in combating piracy could take various forms.

In 2009, eleven states from the Gulf and the Red Sea agreed to establish a Joint Navy Task Force. However, this experiment lasted just one year and was discontinued. Action is currently being taken by Saudi Arabia and Yemen, mostly with coast guards. The GCC countries are not taking part in the operations off the Somali coast, as they lack a blue navy. However, they do support the trust fund for Somalia with financial help.

Taking as a starting-point the proposals presented by Real Admiral Ibrahim Al-Musharrakh at the 2011 Counter Piracy Conference in the UAE,<sup>306</sup> the EU could cooperate with GCC in helping:

- In establishing a GCC Counterpiracy Force;
- In providing expertise on how sea-lane communications can be protected;
- In providing the appropriate technology for the protection of merchant vessels from assault by pirates;
- In providing examples of legislation regulating the carrying of vessel protection detachments (VPDs) or contractors on board GCC commercial flags or foreign flags requesting the necessary assistance.

Bahrain already hosts an information-sharing centre. This could be strengthened, and EU companies could provide the relevant technology (as for instance Selex, an Italian company, is doing in Yemen).

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<sup>306</sup> Ibrahim Al Musharrakh, "Constructing a Robust GCC Response at Sea: Reviving the Arab Counter-piracy Force", in *UAE Counter Piracy Conference Briefing Papers*, May 2012, <http://www.counterpiracy.ae/upload/Briefing/Ibrahim%20Al%20Musharrakh-Essay-Eng-2.pdf>.

EUCAP Nestor is a capacity building mission which has been providing assistance with the maritime security of states in the Horn of Africa and Western Indian Ocean (Djibouti, Kenya, Somalia, Seychelles and Tanzania) since mid-July 2012 as part of the EU's Common Security and Defence Policy. In itself EUCAP Nestor is not tailored to the GCC countries. However, a similar mission could be conceived for the GCC.

Hostage-taking and ransom requests have proven to be a lucrative affair for pirates. The GCC and the EU should cooperate in changing this state of affairs, and collaborate effectively to exhaust the finances of pirates.

#### c) Security at Sea and Counterterrorism

Cooperation is already in existence with Combined Task Force 152 created in 2004 and operated in the framework of Enduring Freedom. At present its task is to promote security and counterterrorism surveillance in the Gulf, but its role should be increased both in terms of ships and missions. It is made of the GCC countries assisted by the US and the UK. The EU countries might have a say.

#### d) WMDFZ in the Middle East

Last but not least, the EU could advise on the maritime issues involved in a WMDFZ in the Middle East. On that point, Europe has taken the lead. The Facilitator appointed by the UN Secretary-General is a Finnish diplomat. The EU holds a number of regional seminars, and seminars attended by diplomats and scholars of the Middle East region have been hosted in Brussels at the initiative of the EU. The maritime issue is of vital importance, covering aspects such as the passage of nuclear-powered ships and warships carrying nuclear armaments through the Strait of Hormuz; overflying the Strait with aircraft carrying nuclear weapons; and warships with nuclear armaments traversing the Suez Canal. A track-two regional seminar on these topics could be held in one of the GCC capitals. Subscribing to CSBMs, such as the Hague Code of Conduct against Ballistic Missile Proliferation (HCoC), would be important. As of 19 August 2013, Iraq is the only Middle East subscribing country.



## 6.

# EU-GCC Cooperation in the Fields of Higher Education and Scientific Research: The Way Forward

*Ahmed Ali M. Al-Mukhaini\**

## INTRODUCTION

This chapter seeks to understand the factors that have inhibited significant progress in relations between the European Union (EU) and the Gulf Cooperation Council (GCC), with particular focus on higher education and scientific research (HESR). A literature review covering the period 2002-2012 suggests that little progress has been made in successfully concluding the EU-GCC Free Trade Agreement (FTA). Interest in this FTA has kept oscillating over the last decade. Moreover, progress in the HESR field has also been slow. Very little data is available on the Internet or from government agencies. In fact many of the recommendations put forth over the period 2002-2009 are yet to be implemented.<sup>307</sup>

Part of the disappointment or lack of satisfactory progress is attributable to the GCC countries' having different expectations from the EU countries in terms of priorities, fields, level and outcomes of cooperation. For example, the GCC, as a bloc, views the EU as a source of technology, advanced know-how and high standards of education. They hope to see EU technologies and education sys-

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\* This chapter relies heavily on private discussions held with officials and scholars from Europe and Oman. Names have been withheld as per the request of respondents.

<sup>307</sup> See Giacomo Luciani and Felix Neugart (eds.), *The EU and the GCC. A New Partnership*, Updated version, Gütersloh, Bertelsmann Stiftung, February 2005, <http://www.cap-lmu.de/publikationen/2005/eu-gcc.php>; Michael Bauer and Christian Koch, "Promoting EU-GCC Cooperation in Higher Education", in *Al-Jisr Policy Briefs*, May 2009, [http://www.cap.lmu.de/download/2009/2009\\_EU-GCC\\_Higher\\_Education.pdf](http://www.cap.lmu.de/download/2009/2009_EU-GCC_Higher_Education.pdf); Ahmed Ali M. al-Mukhaini, *EU-GCC Cooperation*, MA Dissertation, University of Durham, 2002; Christian Koch, "Make Education the Focus of the GCC-EU Relations", in *Arab News*, 6 September 2005, <http://www.arabnews.com/node/272563>; Anais Faure Atger and Elspeth Guild, "Reinforcing Interregional Cooperation between the EU and the GCC. Scenarios for a Modification of Visa Policies", in *CEPS Liberty and Security in Europe Papers*, January 2011, <http://www.ceps.be/node/4112>.

tems replicated in the Gulf.<sup>308</sup> The EU on the other hand is driven by its pursuit of economic sustainability, seeking more favourable access to GCC fossil fuel and markets. As one further example, the philosophy of *modus operandi* within the GCC countries does not see the link between EU-GCC co-operation and the politics of human rights. Meanwhile the EU as a bloc is obliged to mainstream human rights in all its processes and procedures, and its foreign relations. Policies pertaining to higher education institutions, in particular, in both blocs have not yet delivered a systematic approach to enhancing forms of co-operation such as grants and administrative procedures, particularly from the GCC side.

It is imperative to note here that, in our assessment, the EU-GCC FTA has been fraught with challenges ever since its inception. This has largely been due to the two blocs having two different political and economic evolutionary processes, in addition to having two different sets of expectations as explained earlier. For example, differences over unfair competition (resulting from subsidies and tariffs) and political interference (related to civil society development and human rights) have led to fluctuating interest in the EU-GCC FTA and rendered it incapable of providing the framework for the desired co-operation.<sup>309</sup>

The above has been compounded by the lack of specific indicators that measure the degree and nature of success achieved in each of the desired co-operation fields. In this chapter, we will briefly address the factors we opine to be the underpinnings of this lack of progress in co-operation. These factors can be classified into the following categories:

- a) structural/ institutional challenges;
- b) political challenges;
- c) philosophical challenges; and
- d) logistical challenges.

While significant progress has been made in the energy dialogue<sup>310</sup>, investment, trade and archaeological expeditions, cultural exchange and exhibitions, little is perceived as having been achieved in the HESR fields.

However, in 2010 an interesting breakthrough came about in the form of the Joint Action Programme (JAP). This matrix of areas of cooperation and proposed mechanisms was drafted by senior officials from both sides in Riyadh in 2010 and was endorsed at the 20<sup>th</sup> Joint EU-GCC Council Meeting in Luxemburg in June 2010. The JAP was meant to provide a road map to EU-GCC cooperation.

In order to facilitate streamlining the outcomes of this chapter into policy

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<sup>308</sup> Ahmed Ali M. al-Mukhaini, *EU-GCC Cooperation*, cit.

<sup>309</sup> See Ahmed Ali M. al-Mukhaini, *EU-GCC Cooperation*, cit.; Christian Koch, "Make Education the Focus of the GCC-EU Relations", cit.

<sup>310</sup> Please refer to Abdulaziz Al-Shalabi, Nicolas Cottret and Emanuela Menichetti, "EU-GCC Cooperation on Energy", in *Sharaka Research Papers*, No. 3 (June 2013), <http://www.sharaka.eu/?p=1255>.

making and implementation, we will be examining the HESR component of the JAP as well as other relevant documents, wherever that is practicable. Due to lack of access to comparable data from the EU or the GCC, most of the statistics used in this chapter come from the *Global Education Digest* (GED) published by the UNESCO Institute for Statistics to ensure comparability of data and objectivity of analysis. However, the 2012 GED contains data up to 2010 only.<sup>311</sup>

Conclusions drawn from informal discussions held with opinion leaders and government officials in Oman as well as insights from meetings and discussions held in Brussels in 2011 with representatives of the EU Commission, European Parliament and NGOs are incorporated into this chapter.

Based on the premise that progress in economic development and scientific research is highly dependent on progress in higher education, as higher education builds up human capital, it is logical to position co-operation in higher education as the locomotive leading the way for EU-GCC co-operation.

Moreover, higher education could provide an experiential route for understanding the EU *modus operandi* and assist the GCC countries in addressing challenges with youth and extremism (or monolithism). Over two thirds of the GCC population is under the age of 25. Finally, as the EU's own experience suggests, cooperation in higher education is highly conducive to integration, stability and economic growth<sup>312</sup>, all of which are valid concerns for the EU and GCC alike, and constitutes an area in which the two blocs can develop a greater sense of complementarity.

In this chapter, we will be paying closer attention to higher education than scientific research. This chapter will first briefly examine the status quo in the GCC human development situation to deduce the impact of higher education capacities, or lack thereof, on human development index ratings. Then it will identify challenges and suggest steps to enhance co-operation.

## 6.1. STATUS QUO

Over the last few decades, the GCC countries have experienced great developments as captured by the Human Development Index (HDI) and its sub indices.<sup>313</sup> The GCC composite Human Development Indicators have benefited greatly from expanded health care services, high admission rates at the primary

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<sup>311</sup> UNESCO, *Global Education Digest 2012*, <http://www.uis.unesco.org/Education/Pages/global-education-digest.aspx>.

<sup>312</sup> Ahmed Ali M. al-Mukhaini, *EU-GCC Cooperation*, cit. Also, discussion with some EU sceptics in the UK and Oman.

<sup>313</sup> United Nations Development Programme (UNDP), *Human Development Index (HDI) database*: <http://hdr.undp.org/en/data/profiles>.

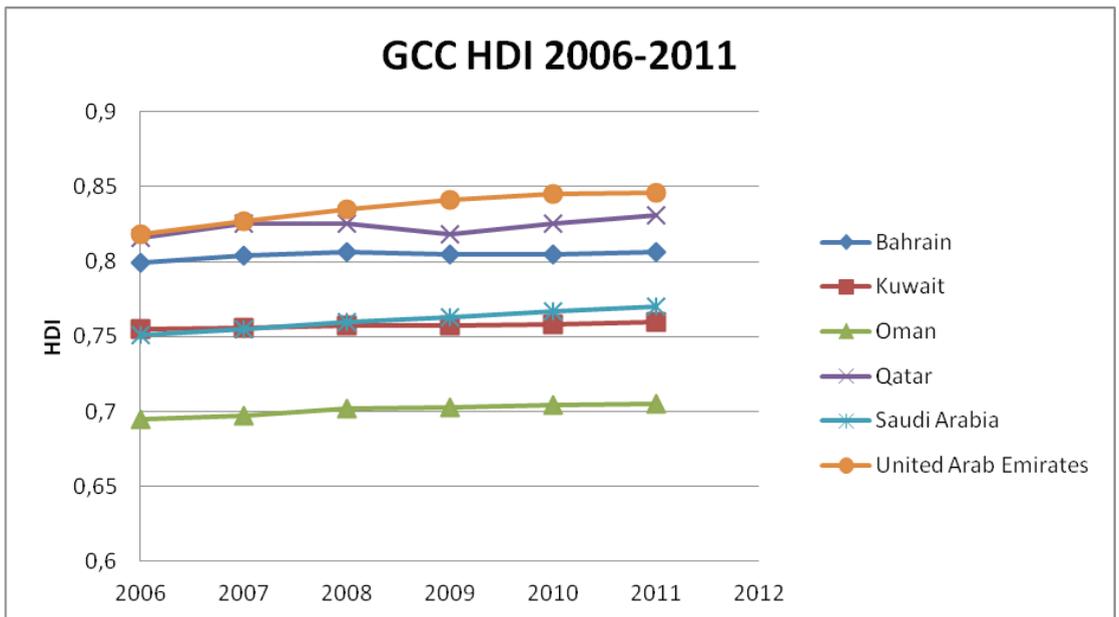
education level, and the high prices of fossil fuel, which makes up at least two thirds of their gross national income. However, the overall ranking of the GCC countries is kept down by their low figures for higher education facilities and educated population compared to others. Table 29 below shows the values of HDI for the GCC countries between 2006 and 2011.

**Table 29. Human Development Index for GCC countries (2006-2011)**

Year	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
2011	0.806	0.760	0.705	0.831	0.77	0.846
2010	0.805	0.758	0.704	0.825	0.77	0.845
2009	0.805	0.757	0.703	0.818	0.76	0.841
2008	0.806	0.757	0.702	0.825	0.76	0.835
2007	0.804	0.756	0.697	0.825	0.76	0.827
2006	0.799	0.755	0.695	0.816	0.75	0.818

*Note:* The value “1” means fully or mostly developed while the value “0” means least or not developed.  
*Source:* UNDP, *Human Development Index (HDI) database*, 2013.

**Fig. 64. Human Development Index for GCC countries: trends (2006-2011)**



*Source:* UNDP, *Human Development Index (HDI) database*, 2013.

Majlis ash-Shura of Oman issued policy papers a few years ago arguing for

a strong causal relation between education index values and HDI.<sup>314</sup> Examining the arguments put forward, and the Education Index value compared to HDI values, we could only deduce a high level of correlation, but not a categorical causation.

Table 30 below shows potential correlations between low education index and low HDI. Values have been colour coded to facilitate comparison of education index values, and to highlight correlation between education and the composite HDI. The green colour signifies the higher end of the index value spectrum. Darker green indicates a higher value. The red colour represents the lower end of the value spectrum. Similarly, darker red indicates a lower value. For example, Oman has scored the lowest in both the Education index and the HDI. Bahrain, on the other hand, despite limited oil wealth compared to Qatar and the UAE, is competing with these two countries' HDI due to its high education index.

**Table 30. Correlating education index to HDI through colour coding**

		Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
<b>Education index</b>	2011	0.747	0.577	0.539	0.623	0.689	0.741
	2010	0.747	0.577	0.539	0.623	0.689	0.741
	2009	0.744	0.576	0.539	0.621	0.684	0.733
	2008	0.741	0.575	0.537	0.638	0.676	0.718
	2007	0.737	0.574	0.535	0.649	0.669	0.702
	2006	0.734	0.572	0.533	0.655	0.66	0.686
	<b>HDI</b>	2011	0.806	0.76	0.705	0.831	0.77
2010		0.805	0.758	0.704	0.825	0.767	0.845
2009		0.805	0.757	0.703	0.818	0.763	0.841
2008		0.806	0.757	0.702	0.825	0.76	0.835
2007		0.804	0.756	0.697	0.825	0.755	0.827
2006		0.799	0.755	0.695	0.816	0.751	0.818

Source: UNDP, *Human Development Index (HDI) database*, 2013.

Furthermore, an examination of the education sub-indices of the GCC countries suggests that the low education index is due to low enrolment rate at the tertiary education level, with less than 50% of the population aged 18-24 in a higher education institution. Admission rates in primary and secondary education, however, are quite high (approximately 97%).<sup>315</sup> It is expected then for the GCC countries to divert their attention to tertiary education issues, having

<sup>314</sup> Oman's Majlis ash Shura, Preparatory policy papers on education in Oman for the sixth and seventh development plans.

<sup>315</sup> Ibid.

focused sufficiently on the countries' infrastructure. Improving access to higher education has become essential due to its linkage to attracting foreign investment, providing human resources for the economy and minimising the expatriate presence in the GCC.

## 6.2. TOP HE DESTINATIONS FOR GCC

After having highlighted the status quo of higher education and development in the GCC countries, We will highlight in this section the top higher education destinations for GCC students. The objective is to ascertain whether EU countries are on the list, and if not what the reasons could be.

Table 31 below shows the top ten destinations for GCC students undertaking higher education.<sup>316</sup> It is interesting to note that of the EU countries only the UK features strongly among the top ten destinations, followed by a modest presence by France, Ireland, Germany and Slovakia.

**Table 31. Top destinations of GCC students**

Rank	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
1	UK	Bahrain	UK	UK	USA	UK
2	Jordan	USA	Jordan	USA	UK	USA
3	India	Jordan	Australia	Jordan	Australia	Australia
4	USA	UK	India	India	Jordan	India
5	Saudi Arabia	Australia	USA	Bahrain	Bahrain	France
6	Australia	India	Malaysia	Saudi Arabia	Canada	Canada
7	Qatar	Saudi Arabia	Qatar	Australia	Malaysia	Oman
8	Malaysia	Slovakia	Morocco	Canada	Kuwait	Ireland
9	Canada	Canada	Saudi Arabia	France	New Zealand	Morocco
10	Kuwait	Malaysia	Canada	Oman	India	Jordan
11	New Zealand	Oman	New Zealand	Ireland	France	Germany

Source: UNESCO Institute for Statistics, 2012.

Several factors lie behind the choice of destinations, namely (not in any particular order of precedence): language of instruction; funding opportunities; quality of life in the area of prospective study; and historical links and familiarity with the culture.<sup>317</sup>

In terms of language of instruction, most GCC students are conversant with

<sup>316</sup> See UNESCO Institute for Statistics website: Global Flow of Tertiary-Level Students, 2012, <http://www.uis.unesco.org/Education/Pages/international-student-flow-viz.aspx>.

<sup>317</sup> Meeting with students pursuing higher education abroad.

English as a medium of instruction and communication. This has definitely had a bearing on the choice of destination. This is probably why GCC students opt for the UK and, later, other countries where English is used as a medium of instruction and communication.

In terms of funding opportunities and support through grants and scholarships, GCC students are often not considered for such grants and scholarships. This position has been mainly based on the premise that GCC countries are not entitled to assistance or aid due to their high GDP. GCC students are expected to be taken care of by their own governments or families.<sup>318</sup> The above point has to be considered in tandem with the higher tuition fees for non-EU students when compared with the fees paid by EU students. It is worth noting that students' living expenses and associated costs in the UK can be much higher than in some other EU countries, including France and Germany. Moreover, tuition fees in the UK for international students are very high compared with France and Germany.<sup>319</sup> However, the language factor seems to mitigate the cost issue. Moreover, UK scholarships and grants seem more visible and pursuable by the public radar than those of other countries in the EU. It is logical perhaps to deduce that EU countries can attract more GCC students if funding opportunities are provided, even partially. EU countries would need to maximise their presence in the public sphere through proper awareness campaigns and study travel shows.

In terms of quality of life, quite a few international students in the EU (including GCC students) care more about the quality of city life and their ability to integrate with the culture than about the academic standing of the university.<sup>320</sup>

Finally, historical links between the GCC and some EU countries seem to play a role in the choice of education and research partners, as evidenced by the above and by trade relations.<sup>321</sup>

### 6.3. TERTIARY EDUCATION IN THE GCC AND EU

The education sector in the GCC is growing. It is expected that the total number of students at all education levels will grow from 9.5 million students in 2010 to

<sup>318</sup> Discussion with faculty members responsible for admission in some UK universities.

<sup>319</sup> Expert Council of German Foundations on Integration and Migration (SVR), *Mobile Talent? The Staying Intentions of International Students in Five EU Countries*, Berlin, SVR, April 2012, p. 11, [http://www.svr-migration.de/content/wp-content/uploads/2012/04/Study\\_Mobile\\_Talent\\_Engl.pdf](http://www.svr-migration.de/content/wp-content/uploads/2012/04/Study_Mobile_Talent_Engl.pdf).

<sup>320</sup> Hannah Ellis, Joran van Aart, *Key influencers of international student satisfaction in Europe 2013*, Eindhoven, StudyPortals, August 2013, p. v, <http://www.studyportals.eu/research/student-satisfaction>.

<sup>321</sup> Lena Odgaard, "EU-Arab trade relations after the Arab Spring: The EU wants stability", in *Arab-EU Quarterly*, Autumn 2012, p. 1-2, <http://di.dk/SiteCollectionDocuments/DIBD/AE-Network/Newsletters/Arab-EU%20Quarterly%20Autumn%202012.pdf>.

11.3 million students in 2020 at CAGR<sup>322</sup> of 1.8% under normal scenario conditions.<sup>323</sup> The number of students in tertiary education is expected to witness the highest growth. This is attributed to an increased awareness of the importance of tertiary education, job market challenges and the need to participate fully in the private sector where a tertiary education diploma is needed. The growth rate in tertiary education is estimated to be CAGR of 5.5%.<sup>324</sup>

Addressing this potential growth can lead to one of three possible scenarios:

- 1 Optimistic: where the growth of tertiary education surpasses its historical trend;
- 2 Neutral: where the growth of tertiary education meets its historical trend; and
- 3 Pessimistic: where the growth of tertiary education falls short of matching its historical trend.

In an optimistic scenario, the number of students enrolled in private education is expected to increase from 1.3 million students in 2010 to 1.9 million students in 2020 at a CAGR of 3.3% during the period 2010-2020. It is estimated that the share of tertiary education will rise from 11% in 2010 to 15% in 2020, while the share of primary education will decline from 46% to 43% during the same period.<sup>325</sup>

Tertiary education is often viewed from a mobility perspective, i.e. examining origin and destination of students in tertiary education, which is the second largest global industry after health care. The share of students studying in North America and Western Europe has fallen from almost 50% in 1970 to about 20% in 2007, indicating a growing popularity of tertiary education in other regions of the world such as Asia and Central and Eastern Europe.<sup>326</sup> The figures have picked up again moderately due to high intake of “local” students, resulting from recent waves of immigrants to this cluster of countries.<sup>327</sup>

In 2010, as shown in Table 32 below, origins of students in tertiary education in North America and Western Europe were broken down as follows<sup>328</sup>:

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<sup>322</sup> CAGR: compounded annual growth rate, which is the rate of increase in the value of a quantity (such as an investment), compounded over several years. A firm’s CAGR, for example, is one of the main numbers tracked by security analysts. See <http://www.businessdictionary.com/definition/compound-annual-growth-rate-CAGR.html>.

<sup>323</sup> Alpen Capital, GCC Education Industry, Dubai, Alpen Capital, September 2010, p. 7, <http://www.alpencapital.com/Me-educationgcc.htm>.

<sup>324</sup> Ibid.

<sup>325</sup> Ibid., p 7

<sup>326</sup> Ibid, p.11

<sup>327</sup> UNESCO, Global Education Digest 2012, cit., p. 130.

<sup>328</sup> Ibid., p. 133.

(a) East Asia & Pacific	25%
(b) North America & Western Europe	23%
(c) South and West Asia	12%
(d) Central & Eastern Europe	11%
(e) Arab states	8%
(f) Latin America & the Caribbean	7%
(g) Sub-Saharan Africa	7%
(h) Unspecified	6%
(i) Central Asia	1%

**Table 32. Tertiary education: internationally mobile students by host country and regions of origin**

REGION	Students from abroad studying in given country (inbound mobile students)			Mobile students by region of origin								
	MF (1)	% F (2)	Inbound mobility rate (%) (3)	Arab States (4)	Central and Eastern Europe (5)	Central Asia (6)	East Asia and the Pacific (7)	Latin America and the Caribbean (8)	North America and Western Europe (9)	South and West Asia (10)	Sub-Saharan Africa (11)	Unspecified (12)
<b>REGIONAL AVERAGES<sup>a</sup></b>												
<b>WORLD</b>	3,572,840	47	2.0**	249,277	367,245	120,795	1,006,732	196,866	542,654	343,377	257,099	466,772
Arab States	219,389	40	2.7**	44,925	951	1,815	3,124	123	4,711	4,436	8,173	151,131
Central and Eastern Europe	321,270	45	1.5**	15,672	133,542	72,041	28,925	1,470	26,123	15,059	7,445	20,993
Central Asia	43,782	42	2.1**	409	12,141	21,203	3,774	24	137	4,972	33	1,089
East Asia and the Pacific	752,253	47	1.4**	21,678	4,962	5,706	446,049	6,422	33,318	67,407	20,693	146,018
Latin America and the Caribbean	65,306	49	0.3**	391	226	31	4,093	40,931	8,457	1,315	6,553	6,309
North America and Western Europe	2,060,749	49	5.6**	161,796	235,260	19,776	520,795	147,867	468,614	243,965	149,585	113,073
South and West Asia	17,629	40	0.1**	4,171	102	222	1,829	47	788	6,181	1,998	2,291
Sub-Saharan Africa	89,462	45	1.7**	235	62	1	143	4	507	22	62,619	25,869

Source: UNESCO, *Global Education Digest 2012*, cit., p. 133.

Unfortunately, official statistical sources have not yet managed to amalgamate Eastern European countries into the North American and Western Europe cluster as evidenced above.

GED 2012 suggests that Asia and Eastern Europe are attracting more Arab and GCC students and filling the gap in tertiary education outside the GCC. This trend has been facilitated by the GCC political and economic shift towards these countries, and building economic and commercial partnerships in the fast growing economies of these two regions. Moreover, available success models in human resource development in Asia, perceived to be more comparable and realisable vis-à-vis the GCC context, have aided this move. Finally, use of English as a teaching medium coupled with affordable tuition and living expenses made tertiary education in Asia an irresistible temptation for GCC students.

## 6.4. AREAS OF JOINT SCIENTIFIC RESEARCH

Despite repeated calls and apparent needs, the presence of long term and well established EU studies programmes or centres in the GCC remain very limited. Only two programmes are available in Kuwait and the UAE. There are legislative, economic and structural challenges. For example, there is not an appropriate legal framework to establish study centres or think tanks outside universities or government agencies. This is further compounded by some structural challenges, whereby universities in the GCC would establish EU studies centres and programmes if they could attract sufficient numbers of students at the undergraduate level. In all cases they require funding. Energy study centres are facilitated by funds provided from oil companies.

The EU on the other hand has expressed sustainable interest in Middle Eastern studies, though very few centres or programmes specialise in the GCC region. This is often subject to funding constraints and political motivations. Nevertheless, EU knowledge of the GCC seems consistent and at a higher level than GCC knowledge of the EU, as evidenced by the number of study centres and area study programmes examining the Middle East, including the GCC.<sup>329</sup>

## 6.5. HIGHER EDUCATION AND SCIENTIFIC RESEARCH IN THE EU-GCC JAP AND RELATED ACTIVITIES

This section of the chapter examines activities pertaining to co-operation in higher education and scientific research (HESR) as outlined in the Joint Action Programme (JAP). In Annex 27 we discuss the proposed mechanisms of cooperation in the areas of higher education and scientific research provided for in the JAP.<sup>330</sup> Overall the language used is non-committal and does not show clear responsibilities, accountability or measureable indicators. One can only conclude that the JAP was designed using an effort-driven (activities) model rather than an object-oriented (outcomes) model. This in a way reflects the structural and philosophical challenges outlined in a later section of this chapter. Despite the above-mentioned observations, the EU and the GCC have managed to conduct several successful activities and attain some results. What remains to be done is mapping these outcomes and results and putting them in the context of the objectives set for the EU-GCC cooperation.

<sup>329</sup> See Giacomo Luciani and Felix Neugart (eds.), *The EU and the GCC. A New Partnership*, cit., p. 14; Ahmed Ali M. al-Mukhaini, *EU-GCC Cooperation*, cit.

<sup>330</sup> Annex 27 is an excerpt from the EU-GCC-approved JAP showing the areas of desired co-operation and proposed mechanisms. We have added a third column to share our assessment of each of the items mentioned in the table.

Furthermore, the JAP's proposed mechanisms have often intersected, leading to vagueness over funding and operational responsibilities. Perhaps one source of confusion, or rather intersection between Energy and Scientific Research as outlined in the JAP, is the reliance of both areas on the 7th Community Framework Programme for Research and Development (FP7) to share knowledge and perhaps conduct joint research. This has naturally led to a gravitation of efforts exerted towards powerful or resource-rich players. For example, the literature addressing progress in cooperation over energy has often referred to scientific research interchangeably.

The following paragraphs will outline two prominent initiatives in the energy and scientific research areas to highlight two things. Firstly: to show the extent of interest and dedication accorded to energy and related issues. Second: to showcase them as examples of successful co-operation when political will and interest join hands. Energy remains a major concern for EU policies.

### *6.5.1. EU–GCC Clean Energy Network*

The first of these two initiatives is the EU-GCC Clean Energy Network.<sup>331</sup> The Network was created following the adoption of the JAP to facilitate the establishment of a long-term strategic relationship between the EU and the GCC regions. This relationship aims to focus on sustainable, clean and renewable energy, and to create a means (and a practically useful tool) for developing tangible cooperation activities among various actors in the sector, across the EU and the GCC. The Network, therefore, has been designed to respond to the common interests of various actors in the field of clean energy in the EU and GCC. Energy is pivotal to the GCC economies as a source of revenue and to the EU economies as a means to sustain growth. Both blocs are concerned with environmental hazards associated with fossil fuels.

The Network has been focusing on the following areas:

- renewable energy sources;
- energy demand side management & energy efficiency;
- clean natural gas & related clean technologies;
- electricity interconnections & market integration; and
- carbon capture and storage.

Some of the activities and services offered by the network included:

- experts meetings;
- thematic discussions;
- seminars;

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<sup>331</sup> See the website: <http://www.eugcc-cleanenergy.net>.

- training sessions;
- high-level conferences;
- preliminary studies in the area of clean energy;
- research exchanges between the GCC and the EU;
- clean energy discussion groups to facilitate collaboration among EU and GCC experts;
- joint demonstrations and pilot projects being implemented with the participation of EU and GCC entities in the area of clean energy;
- support for the publication of articles in scientific journals on clean energy in EU and GCC regions; and
- a web-area to facilitate discussion, dialogue and collaboration among EU and GCC stakeholders on technology, research and policy aspects of clean energy.

These goals have not been fully satisfied, however, some progress has been achieved.

### *6.5.2. EU-GCC INCONET*

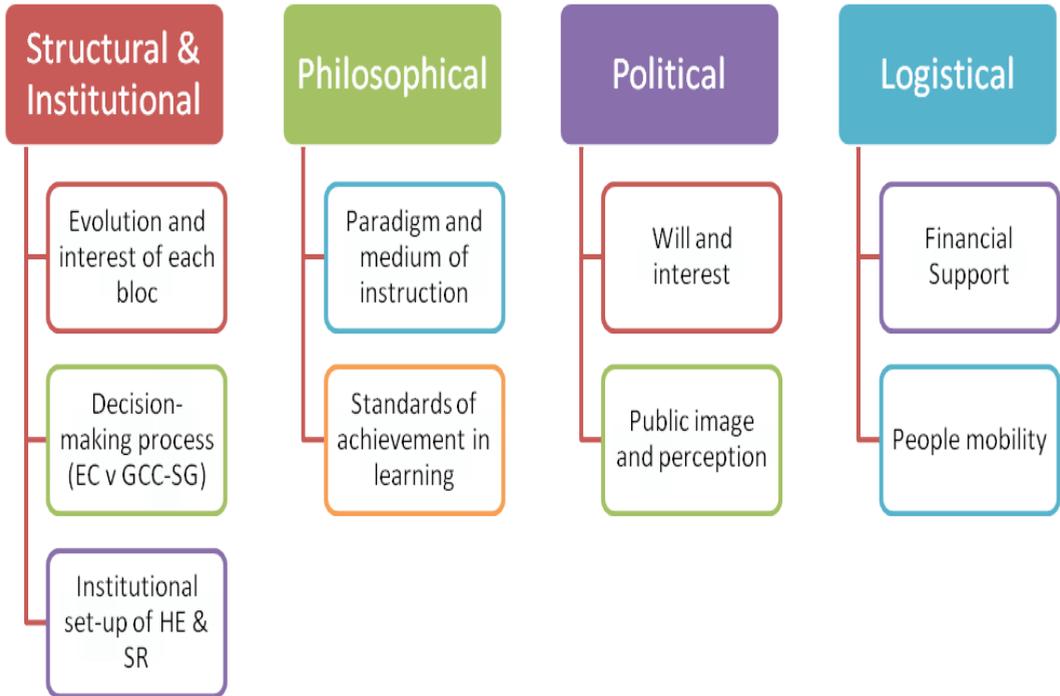
The second prominent initiative of EU-GCC cooperation deals with scientific research. INCONET-GCC is an “initiative” that aims to develop and support dialogue between the GCC and the EU by bringing together policymakers and stakeholders from the GCC and EU member states. INCONET managed to establish a dialogue and action platform to identify common interests in research areas, set up science and technology (S&T) priorities, support capacity building activities, and enhance the interaction between different cooperation instruments of the European Commission and EU member states. It has focused on the explorative aspect of cooperation with some successful isolated joint research projects, which seem to have relied on individuals and personal networking more than the GCC-EU institutional umbrella.

## **6.6. CHALLENGES TO EU-GCC COOPERATION IN HESR**

This section outlines the challenges to EU-GCC cooperation in HESR ahead of suggesting mitigation steps. These challenges have largely been categorised as follows:

- (a) structural/institutional;
- (b) philosophical/cultural;
- (c) political; and
- (d) logistical.
- (e)

**Fig. 65. Summary of identified challenges**



### 6.6.1. Structural and institutional challenges

The evolution of the EU and of the GCC was determined differently. It is important to recollect the circumstances and driving ethos behind the evolution of each organisation to realise where the priorities and the political will lie, and how this has resulted in differing structures and institutions in the EU and the GCC.

It would be deceitful to claim that the two blocs are very similar and deal with them accordingly without being cognizant of these structural and institutional differences, though the GCC's officials have repeatedly claimed that the GCC was modelled on the EU. This modelling remains superficial and incomplete at best.

One stark difference is that the EU is committed to market expansion and further integration. Security is taken as a logical consequence of economic stability and a market-led economy. Foreign policy remains a minor factor in the decision-making process within the EU which, in contrast to the GCC, is a collective, complex and institutionalised organisation of cooperation.

The GCC, on the other hand, is driven by security concerns and foreign poli-

cy factors. Though economic integration and interest in new markets have become policy issues in the last decade or so, the focus remains on strategic issues, such as domestic and regional security. Moreover, the GCC Secretariat does not possess “real” decision-making or negotiation powers, which renders the GCC less than a supra-national organisation. Decisions within the GCC remain at the individual state level. This is further compounded by the economic structures of the GCC. Different GCC countries have different national agendas and competing economic priorities, which often inhibit reaching a consensus vis-à-vis the EU. This is similar to the case of the EU, albeit to a much smaller extent and mainly within the foreign policy context.

The issue of perception is an important one in the EU-GCC relationship. Each of the two sides views the other as a funding opportunity, especially the EU<sup>332</sup>. The GCC looks at the EU mainly as an up-skilling and enabling opportunity, while the EU regards the GCC as an economic opportunity.

Moreover, the higher education and scientific research sectors have been set up differently in the EU and the GCC. HESR institutions in the EU tend to be independent in their governance and self-reliant in terms of funding. The situation in the GCC is different. Government and private higher education institutions are highly attuned to government decision-making processes and authorities. Furthermore, the HESR sectors are being led by governmental initiatives and *modus operandi*, while these sectors in the EU tend to be governed along philanthropic or non-governmental *modus operandi*. In the EU public accountability also impacts governance of HESR institutions. This is not the case within the GCC.

Over the last five years the HESR industry in the GCC has undergone some significant changes, most notably the expansion of private higher education to absorb the high growth of the population of youth seeking career betterment and more promising job opportunities (see Table 33 and Figure 66 below). The growth in tertiary education is set to continue.<sup>333</sup> EU academic and research institutions have only partially taken part in this expansion as discussed in section 3.<sup>334</sup>

The growth of GCC-based tertiary education is likely to create a structural competition-based conflict between tertiary education institutions in the EU, wanting to attract more students and generate further revenue, and the GCC

<sup>332</sup> “Europeans Seek Gulf Funding, but Free Trade Remains Far Off”, in Knowledge@Wharton, 2 November 2011, [http://knowledge.wharton.upenn.edu/arabic/article.cfm?articleid=2731&language\\_id=1](http://knowledge.wharton.upenn.edu/arabic/article.cfm?articleid=2731&language_id=1).

<sup>333</sup> Alpen Capital, GCC Education Industry, cit.

<sup>334</sup> Center for Applied Policy Research and Gulf Research Center, “Taking Stock of the EU-GCC Cooperation in Education, Science and Technology: Conference Overview Paper”, in Al-Jisr Background Papers, March 2009. [http://www.cap.lmu.de/download/2009/2009\\_EU-GCC-Cooperation.pdf](http://www.cap.lmu.de/download/2009/2009_EU-GCC-Cooperation.pdf).

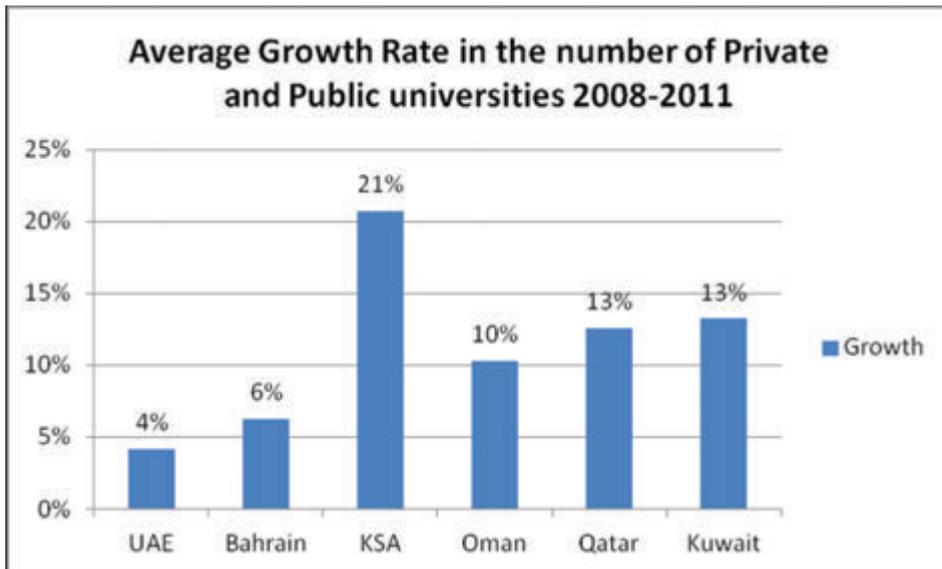
tertiary education institutions that have similar revenue aspirations and in many cases suffer economic survival challenges. It is important to consider the above factors when analysing the pace of progress in EU-GCC cooperation, especially in the HESR field, and in seeking to set more realistic goals and objectives.

**Table 33. Number of private and public universities in the GCC (2008-2011)**

Country	2008	2009	2010	2011
<b>Bahrain</b>	16	16	16	19
<b>Kuwait</b>	7	9	9	10
<b>Oman</b>	6	7	7	8
<b>Qatar</b>	10	13	13	14
<b>Saudi Arabia</b>	19	26	30	33
<b>UAE</b>	64	64	72	72
<b>Total</b>	<b>122</b>	<b>135</b>	<b>147</b>	<b>156</b>

Source: GCC Secretariat General, *GCC: A Statistical Glance, 2012*, p. 42, <http://sites.gcc-sg.org/DLibrary/index-eng.php?action=ShowOne&BID=569>.

**Fig. 66. Average growth rate of private and public universities (2008-2011)**



Source: GCC Secretariat General, *GCC: A Statistical Glance, 2012*, cit., p. 42.

### 6.6.2. *Philosophical and cultural challenges*

The philosophical challenge is a serious barrier and would require consistent efforts leading to the formulation of long-term objectives. There are three components to this challenge, as presented below.

The first of these components is the language of instruction used in the EU and the GCC. The GCC countries have adopted a policy making English the second language. Moreover, science and maths are often taught in English in private schools and colleges as well as in some government schools. Other languages, whether indigenous or foreign, though widely spoken, are not being taught systematically or formally in the region.

Focusing on the English language only limits tertiary education options for the GCC students. If some of them are to pursue their education abroad, they are limited to English speaking countries. Some of these countries have expensive tuition fees, high living expenses or complex visa procedures. As highlighted in section 2, language of instruction is a concern and a great factor in the choice of external higher education institutions for GCC students. Germany, The Netherlands, Sweden and some other EU countries have managed to attract students by offering courses and degree programmes that are taught in English, with optional, sometimes free, courses to learn the respective national languages of these countries.

While policy lines and official attitudes towards other EU languages are becoming more positive, as indicated by official statements and encouragements to introduce language training centres in the GCC, more effort and attention are required to allow these centres to play their rightful role in expanding tertiary education options for GCC students.

Another challenge with regard to the language issue relates to the fact that participation in exchange programmes, e.g. Erasmus, will be limited if GCC students are not equipped with foreign languages other than English. This leads us to suggest that perhaps what is required first is an introduction to the languages and cultures of EU nations for GCC students, academics and researchers. Solid future cooperation will certainly be dependent on good linguistic and cultural foundations.

The second component of the philosophical challenge is the paradigm of learning adopted in the GCC versus the one adopted in the EU. Despite all the educational reforms embarked upon by the GCC countries over the last decade or so, teaching methods operate to a large extent within a traditional mind-set of rote learning. EU educational systems on the other hand mostly rely on a critical thinking approach. The quality of teachers (whether national or expatriate) within the GCC has been identified as a serious challenge to the educational

reforms undertaken by the GCC countries.<sup>335</sup>

This paradigm of learning often renders it necessary for GCC students to go through a new cycle of learning when they set foot in EU higher education institutions or join research projects. Students wanting to participate in exchange programmes will have limitations and several hurdles to overcome. This picture is not intended to be pessimistic. However, if the EU and GCC are interested in achieving good progress in higher education and scientific research cooperation, then serious attention has to be paid to harmonising the two paradigms of learning through technical support and specialised up-skilling programmes for GCC students and faculty members. This would require a specific action plan whereby students and faculty members separately undertake intensive summer training. A more thorough approach would be to amend the curriculum of teachers' training and the national curriculum for students. However, effective outcomes are not certain and the whole process is time-consuming.

The third component of the philosophical challenge is the underperformance of GCC students in maths and science. Not all GCC countries take part in the TIMSS survey. Maths and science constitute the backbone of modern education systems. One possible reason is that national standards of achievement in learning these subjects are lacking, and where they are available they are often not adhered to or complied with.<sup>336</sup> Levels of learning outcomes vary greatly within each of the GCC countries and in comparisons between different GCC countries.

### 6.6.3. Political challenges

The EU is driven by economic integration and seeks wider market access within the GCC, which will provide job opportunities and economic growth. Moreover, the EU is interested in leveraging the GCC against Iran, with the objective of attaining some geopolitical stability and sustained flow of fossil fuel. The GCC, however, is driven by a strategic and political outlook. Though the GCC is quite keen on having better access to EU markets, the GCC countries' ability to capitalise on this market and compete is quite limited. The GCC would like perhaps to further bolster EU economic interests in the GCC region in order to secure some leverage over Israel and achieve geopolitical stability or perhaps a good and fair solution to the Palestinian-Israeli conflict.

Interests and the current geopolitical situation at the regional level after 9/11 and the Arab uprisings tend to determine the lack of political

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<sup>335</sup> See Alpen Capital, GCC Education Industry, cit., p. 15; Michael Barber, Mona Mourshed and Fenton Whelon, "Improving Education in the Gulf", in *The McKinsey Quarterly*, March 2007, p. 39-47, <http://abujoori.files.wordpress.com/2007/04/improve-gulf-education.pdf>.

<sup>336</sup> *Ibid.*

will to invest in education as opposed to in energy and trade. This is suggested by the growth in trade volume between the EU and the GCC and the success reported in the energy and clean environment sectors. Moreover, following the 22nd GCC-EU joint Council and Ministerial meeting in Luxembourg on 25 June 2012, the two sides “recognised there is a clear need for us to consult and to co-operate whenever possible on global challenges such as non-proliferation and disarmament, counter-terrorism and climate change.”<sup>337</sup> The two sides instructed their senior officials to prepare the new JAP for the period 2013-2016. No reference was made to education in the 2012 meeting.<sup>338</sup>

#### 6.6.4. *Logistical challenges*

Three logistical barriers are worth mentioning. They are financial resources, visa requirements and travel routes.

One of the logistical barriers inhibiting further cooperation in higher education and scientific research is financial resources. Europeans often assume that all GCC citizens are well off and that there is an abundance of public wealth available for educational and research projects. This myth has created high expectations within the EU, where large sums of GCC money were expected to pour into the EU-based higher education co-operation projects. This has led to a cutting down of the budget allocated by the EU to fund co-operation in the higher education field and inhibited solid cooperation. Moreover, such gaps are often filled by non-religious endowments or philanthropic organisations, as is the case in the United States of America. However, such endowments and philanthropic organisations are not legal within the GCC region. Instead, endowments with religious or strict charity objectives are permitted with heavy governmental oversight.

The second of these barriers is visa requirements. The existence of complex visa policies and practices between the EU and the GCC constitutes a fundamental barrier preventing the promotion of exchanges between these regions when it comes to people-to-people contacts, developing commercial relations or exchanging knowledge. Closer ties between the two regions, enhanced understanding of their respective cultures and increased educational exchange

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<sup>337</sup> Remarks by High Representative Catherine Ashton following the 22nd EU-GCC Joint Council and Ministerial Meeting, Luxembourg, 25 June, 2012, [http://www.consilium.europa.eu/ue-docs/cms\\_data/docs/pressdata/EN/foraff/131194.pdf](http://www.consilium.europa.eu/ue-docs/cms_data/docs/pressdata/EN/foraff/131194.pdf).

<sup>338</sup> L  na  c Vaudin d’Im  court, “EU, GCC pledge to deepen cooperation”, in EuroPolitics, 26 June 2012, <http://www.europolitics.info/external-policies/eu-gcc-pledge-to-deepen-cooperation-art338164-44.html>.

require increased mobility.<sup>339</sup>

Concerns over GCC students settling in the EU are not warranted. Only 12.5% of the international students, including GCC students, studying in Europe stated that they wished to stay on for more than five years. The majority of the international students seek either to return home or to go to another country. The main tendency, however, is to stay for a few years just to gain international experience<sup>340</sup>.

Last but not least, travel routes are considered to be among the inhibiting factors for a stronger GCC-EU cooperation. Except for very few EU destinations such as London and Paris, most other major European destinations are not regularly serviced or direct routes are not available. This does indeed discourage some students and researchers from pursuing this travel.

## 6.7. WHY FOCUS ON HIGHER EDUCATION AND SCIENTIFIC RESEARCH NOW? SOME TURNING POINTS

The renewed interest in EU-GCC cooperation must be provided with a new context. The 23rd GCC-EU joint Council and Ministerial meeting commended the progress achieved in relation to the Joint Action Programme.<sup>341</sup> This seems to have enhanced the GCC-EU appetite for greater cooperation. From an observer's perspective, there are other factors that can be pooled and plaited to justify a renewed interest in the EU-GCC cooperation, most notably: the Arab Spring; anticipated growth in the higher education industry; trends in energy and environmental policies; and Islamic banking and finance.

First: the Arab Spring. The impact of the Arab Spring cannot go unnoticed in the context of EU-GCC relations. The Gulf governments have shown their resilience to change and as a result the GCC has emerged once again as a regional power in the MENA area. This has become of significant importance in the southern Mediterranean countries bordering the EU and, in the case of Syria and Lebanon, bordering the Israeli-Palestinian conflict. The EU's pursuit of stability in its neighbouring region warrants a renewed examination of and momentum for a cooperative EU-GCC relationship.

Moreover, the Arab Spring has blatantly brought to surface the challenges

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<sup>339</sup> Anaïs Faure Atger and Elspeth Guild, "Reinforcing Interregional Cooperation between the EU and the GCC", cit.

<sup>340</sup> Expert Council of German Foundations on Integration and Migration (SVR), *Mobile Talent?*, cit., p. 38 and 47.

<sup>341</sup> Co-Chairs' Statement, 23rd GCC-EU Joint Council and Ministerial Meeting, Manama, 30 June 2013, [http://www.consilium.europa.eu/uedocs/cms\\_Data/docs/pressdata/EN/foraff/137671.pdf](http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/137671.pdf).

posed by the young population of the GCC. The youth challenge, if left without due consideration, could render the young GCC population prone to anarchy, extremism or exploitation. Concerted efforts would be required to ensure that the GCC youth population is provided with education, training and jobs. This is a mutual interest for the GCC and EU countries.

Second: Anticipated growth in HE industry. As mentioned earlier, the number of students in tertiary education in the GCC is expected to increase at the highest rate in the education industry. The growth rate of tertiary education is estimated to be CAGR of 5.5% until 2020.<sup>342</sup>

The GCC countries will definitely be in need of technical and policy support from EU higher education institutions. This will provide an opportunity for cementing cooperation between the EU and the GCC as well as bridging the technical gap and generating revenues for EU higher education institutions.

Third: energy & environment: the tables turned. Economic forecasts indicate that local demand for energy within the GCC is on the increase. It is expected that by 2020 the GCC countries will be consuming most of their energy produce for manufacturing purposes.<sup>343</sup> In fact some recent pessimistic scenarios suggest that some GCC countries will be importing fuel in 2050.

It is noticeable that the GCC countries have now shifted their focus to solar and nuclear energy in pursuit of clean and renewable energy sources for domestic use, deliberately allowing its hydrocarbon reserves to be used mainly for export.

The GCC's environmental concerns over clean and renewable energy sources are essentially shared by the EU, not only in terms of overall sense, but most notably from commercial, scientific and civil society perspectives. This should provide a renewed drive towards closer cooperation.

Fourth: Islamic finance. Islamic finance has grown consistently since the 1960s. The Islamic Financial Services Board (IFSB) estimated that Islamic finance assets have reached \$1.6 trillion as at end of 2012.<sup>344</sup> The GCC countries contribute around 41% of global Islamic finance turnover. Islamic finance has become a major industry comprising around 400 institutions worldwide controlling around \$500 billion.<sup>345</sup> Islamic finance instruments may provide good funding opportunities for the European economies in the form of foreign direct investments (FDIs) and sukuk purchase.

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<sup>342</sup> Alpen Capital, GCC Education Industry, cit., p. 7.

<sup>343</sup> Economist Intelligence Unit (EIU), The GCC in 2020. Outlook for the Gulf and the Global Economy, March 2009, <http://graphics.eiu.com/marketing/pdf/Gulf2020.pdf>.

<sup>344</sup> See ISFB, Islamic Financial Services Industry Stability Report 2013, May 2013, [http://www.ifsb.org/docs/IFSB%20-%20IFSI%20Stability%20Report%202013%20\(Final\).pdf](http://www.ifsb.org/docs/IFSB%20-%20IFSI%20Stability%20Report%202013%20(Final).pdf).

<sup>345</sup> Anis Ahmad, Lecture on Contemporary Islamic Finance. Presentation, October 2011.

## 6.8. POLICY RECOMMENDATIONS

### 6.8.1. Short to mid-term: small steps, large impacts

Keys to the success of EU-GCC cooperation are education and people-to-people contacts. However, two main barriers exist: insufficient financial resources; and unwelcoming visa procedures. While complex visa processes will remain an issue for both sides for some time (despite some policy guidelines to unblock this issue<sup>346</sup>), one can address for the time being the financial resource constraints. The following two recommendations aim to facilitate streamlining and quantifying of EU-GCC cooperation.

Step one: remove the logistic barriers. To address the financial resources issue, the EU and the GCC should establish a joint HESR Fund (the “Fund”). The seed money should come from both blocs. The table below shows two options for seed money contribution calculated as a percentage of the GDP for the EU and GCC.

		<b>Option One</b>	<b>Option Two</b>
	Approximate GDP for 2011 (million Euro)	Contribution at 0.001% of the GDP (Euro)	Contribution at 0.0001% of the GDP (Euro)
<b>EU</b>	13,007,720	130,077,200	13,007,720
<b>GCC</b>	827,468	8,274,680	827,468
<b>Total</b>	13,835,188	138,351,880	13,835,188

The Fund will be an independent legal entity and will be run as a civil company espousing a philanthropic spirit. Contributions to the Fund are welcome from individuals, existing endowments or commercial entities in the EU and the GCC. Universities, civil society organisations, individual students, researchers and others can apply directly to the Fund and compete openly and equitably.

The Fund will provide for the following:

- Exchange visits for students, professors, researchers, writers, poets, artists, young leaders, women, social entrepreneurs, etc.;
- Research grants and scholarships including small hardship bursaries; and
- Publications, whether electronic or in printed form.

Government officials and programmes will not benefit from the Fund.

Step two: own the momentum & personify the process. One factor contributing to the successful cooperation in the energy and other sectors is political

<sup>346</sup> Anaïs Faure Atger and Elspeth Guild, “Reinforcing Interregional Cooperation between the EU and the GCC”, cit.

ownership.

The EU and the GCC should create a political position and appoint a commissioner-level representative for cooperation in higher education and scientific research. The appointee will be responsible for providing inputs to the revision of the Joint Action Programme and supervising its implementation. The GCC and EU appointee(s) will meet regularly and be provided with access to policy makers and decision makers.

The appointee(s) will push for the identification of Key Performance Indicators that are pertinent to higher education and scientific research. This will be made possible by the results of the explorative discussions and workshops held over the period 2010-2012.

### *6.8.2. Long term: joint EU-GCC Helsinki process for GCC higher education*

Long-term steps must be also contemplated. The steps outlined below are categorised as long-term due to their invasiveness into existing structures and institutions in the EU and GCC. Hence the term “Helsinki process” for the GCC. Several iterations were made in the past. However, it is critical that the new Helsinki process possesses the following characteristics:

- focused on institutional, policy building and technical support for higher education and scientific research, acting almost as a think tank driven by the GCC agenda;
- jointly managed and guided; and
- politics-free mandate.

Step one: build EU research and studies centres in the GCC. The GCC universities should establish research and education centres dedicated to understanding the EU and monitoring the EU-GCC cooperation. These centres can also tap into knowledge resources within the EU and bring them closer to the GCC. The above-recommended Fund will help sustain some of the programmes and projects run by these centres.

Step two: make EU universities more accessible to GCC students linguistically. Successful examples in some EU countries need to be emulated. Part of the above-recommended appointee(s)' mission is to facilitate the design and delivery of degree programmes in English. This will naturally require further analysis in terms of topics, numbers and types of degrees. The above-recommended Fund can be used to provide initial financial backing for such degree programmes with the objective that they become self sustained in five years' time.

The above step will be needed also from the GCC side to diversify language curricula in their education system. Spanish, French and German must become part of the national curricula. Specialised language training centres will also need to be created by the private sector or through foreign funding to complement formal language education.

Step three: quantifying better image representation. The GCC and the EU have acknowledged the need to brush up their respective images in the media and cultural outlets of the other. However, unless both blocs specify what is meant by “image” and “cultural understanding”, this goal will remain in the distant future. Part of the scientific research agenda and funding must be directed towards media and cultural research to provide continuous monitoring and evaluation of the GCC image and presence in the EU media and public arena, and vice versa.



# 7.

## The Role of Mass Media in Building Perceptions of EU-GCC Relations and Related Impacts

*Fatma Al-Araimi and Cinzia Bianco*

### INTRODUCTION

The Gulf Cooperation Council (GCC) and the European Union (EU) have been trying since 1989 to strengthen the links between the two regions, including by moving towards a Free Trade Agreement (FTA). Unfortunately, this agreement has not seen the light to date, and the negotiations are likely to remain stalled for the time being. However, in the past few years Europe has been the recipient of substantial investments from the Gulf region. The Gulf, in turn, has been a destination for many European companies and businessmen looking for an untapped and fast-developing market. These economic and financial developments have attracted great attention from the media that contributed to the spreading of related perceptions and misperceptions. Hence the capability of the media, as relevant theories affirm, to affect the economic environment, in our case by standing in the way of sustaining and fostering this business partnership through their influence on public opinion. Indeed, as several media theories<sup>347</sup> have proved through the years, mass media play a significant role in shaping and reflecting public opinion, perceptions, and stereotypes. Recently, Edward Herrmann<sup>348</sup> exposed the link between the media's ability to shape opinion trends and perceptions with the routes of international investment, providing the theoretical ground on which our analysis is based.

In the case of EU-GCC relations, the lack of effective communication and sig-

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<sup>347</sup> Mark Balnaves, Stephanie Hemelryk Donald, Brian Shoesmith, *Media Theories and Approaches. A Global Perspective*, Basingstoke and New York, Palgrave Macmillan, 2009; James W. Carey, *Communication as Culture. Essays on Media and Society*, Revised ed., New York, Routledge, 2009; David Holmes, *Communication Theory. Media, Technology and Society*, London, Sage, 2005.

<sup>348</sup> Edward S. Herrman and Robert W. McChesney, *Global Media. The New Missionaries of Corporate Capitalism*, London and Washington, Cassell, 1997.

nificant media exposure has been acknowledged already in the relevant literature as a key factor at the root of several setbacks in the interregional dialogue. However, this chapter argues that even if this obstacle has been acknowledged, very little has been done to concretely overcome it, in particular within the media environment directly, and that under the current economic conjuncture it becomes more urgent to take action.

The chapter will start by providing an overview of the role of the media in transmitting images and perceptions. It will then describe the intensified economic and financial exchanges between the two regions and the stereotypes that have subsequently spread across the public discourse, pointing to their disruptive potential. Later on the analysis will provide the results of a survey conducted among journalists from the EU and the GCC countries and a focus group held with them at a later stage. By interviewing the sources of news and content-creators in the media environment, i.e., the journalists, it was clear how their knowledge, understanding, and familiarity with the other region were poor. This lack of familiarity inevitably makes the newsmakers more vulnerable to a misuse of the power and functions of the media and affects a high-quality coverage. Our assessment calls for concrete measures that could enhance the accuracy of the image of the other region and possibly clear the stereotypes rooted in the general public, with a view to facilitating smoother interregional relations.

## 7.1. CONTEXTUALISING EU-GCC RELATIONS AND THE ROLE OF THE MEDIA

### 7.1.1. *The importance of accurate communication*

Undoubtedly the rise of advertising and the diffusion of mass media profoundly changed communication, as well as the modes, paces, and magnitude of the diffusion of messages to society. The mediated space has become through the years a space of social practices, acquiring a reflexive and dialectical relation with society by being a socially-conditioned tool and conditioning society at the same time.<sup>349</sup>

As various theorists have proven, mass media indeed play a significant role in shaping public perceptions on a variety of important issues, mainly through two of their main functions: agenda-setting, i.e., the information that is dispensed through them, and framing, i.e., the interpretations they place upon this infor-

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<sup>349</sup> David Holmes, *Communication Theory*, cit.

mation. The agenda-setting function is the first step in public opinion-shaping. It dictates what is newsworthy, and how and when it will be reported. According to the theory, through this function mass media have the power to put issues on the public agenda and therefore to decide which issues will become a matter of public opinion and which will not.<sup>350</sup> At an international level, it has been proven that news exposure was significantly related to positive perceptions of a country and to the perception of this country as successful. In addition, due to the fact that for many people the only source of knowledge about the world is the press, if a nation mainly receives negative coverage, the negative attributes mentioned in the news reports will cause individuals to mentally link those attributes to the nation itself and vice versa.<sup>351</sup> More specifically, by portraying a certain interpretation of reality, the media can shape the public perception of that reality to be more in line with their interpretation<sup>352</sup> through framing. Framing is when a story or piece of news is portrayed in a particular way and is meant to sway the audience's attitude one way or the other. Lakoff systematised this framing through his narration theory.<sup>353</sup> According to him, narrations are made of a script and mental *frames* that include roles and settings. Some schemes of narrations are innate due to their connection with a people's cultural background and can be automatically recalled in the audience's mind simply by using the right words, that is to say, by presenting the events in a way that connects them to a particular narration. For example, everyone knows about the narration "from rags to riches": these words automatically recall the idea of a man, born poor, who managed thanks to his capabilities to gain wealth. Generally, the narration generates esteem for that man, even without knowing anything about him, as well as empathy for his previous condition and relief for the happy ending. This is precisely what happens when a narration is activated in our brain. Furthermore, Lakoff infers that most of the time the public debate is not understood by what the audience hears but by the unconscious interpretation that is given because, when a narration is accepted, the facts that contradict it are ignored or concealed. When the framing is built around a particular

<sup>350</sup> Elisabeth Noelle-Neumann, "Are We Asking the Right Questions? Developing Measurement from Theory: The Influence of the Spiral of Silence on Media Effects Research", in Cees J. Hamelink and Olga Linné (eds.), *Mass Communication Research. On Problems and Policies*, Norwood, Ablex Publishing, 1994, p. 97-120.

<sup>351</sup> John T. McNelly and Fausto Izcaray, "International News Exposure and Images of Nations", in *Journalism Quarterly*, Vol. 63, No. 3 (September 1986), p. 546-553. See also Matthew A. Baum and Philip B.K. Potter, "The Relationships Between Mass Media, Public Opinion, and Foreign Policy: Toward a Theoretical Synthesis", in *Annual Review of Political Science*, Vol. 11, 2008, p. 39-65, [http://www.hks.harvard.edu/fs/mbaum/documents/BaumPotter\\_AnnualReview2008.pdf](http://www.hks.harvard.edu/fs/mbaum/documents/BaumPotter_AnnualReview2008.pdf).

<sup>352</sup> Rowland Lorimer with Paddy Scannell, *Mass Communications. A Comparative Introduction*, Manchester and New York, Manchester University Press, 1994.

<sup>353</sup> George Lakoff, *The Political Mind. Why you can't understand 21st-century politics with an 18th-century brain*, New York, Viking, 2008.

political ideology, mass media can easily become a very powerful vehicle for instrumental stereotypes. This is mainly due to their strong ability to convey a particular set of beliefs, values, and traditions (an entire way of life) as socially desirable, i.e., in line with the general opinion of the group that the viewer identifies with.

From an economic perspective, as Herman and McChesney<sup>354</sup> explained, the characteristics and functions of the media make them an indispensable component of the global market economy. For example, mass media have the power to influence consumer trends – i.e., economic trends – both at the national and international level by shaping their social desirability. Most importantly, they have a significant ability to shape the general public's perceptions of international business, investments, and companies by acting as gatekeepers, thus controlling their exposures, as well as by framing them through a (positive or negative) political or cultural script. This function is known as cultivation of perceptions, and its effects can be very powerful in encouraging a given community to welcome or reject international business. On the other hand, the way a given country is portrayed can be instrumental in encouraging or discouraging investors to bet on it. In the Gulf context in particular, where often the biggest investments come from state-owned investment funds sustained through revenues from the country's national resources, investing abroad can easily be turned by the media into a political issue in front of the general public.

### *7.1.2. Business and perceptions*

In response to the events of 9/11, the United States' government embarked on a series of counter-terrorism policies, such as imposing substantial restrictions on the movement of capitals, freezing even slightly suspected accounts held in American banks, and introducing much stricter border controls. These kinds of measures, particularly harsh on Muslim Arabs, stirred up significantly the Gulf domestic opposition to the regimes' dependency on the US, actually damaging economic and financial interests that investors from the Gulf had in the US.<sup>355</sup> In response, the Gulf states began to move their investments to European countries, and particularly to the United Kingdom. The move came in part because Gulf investors saw Europe as having a safer and more favorable financial climate with bigger potential returns as well as being more welcoming of their investments. After 2008, European governments started working

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<sup>354</sup> Edward S. Herrman and Robert W. McChesney, *Global Media*, cit.

<sup>355</sup> Helle Malmvig, "An Unlikely Match or A Marriage in the Making? EU-GCC Relations in a Changing Security Environment", in DIIS Briefs, November 2006, [http://www.diis.dk/files/Publications/Briefs2006/hma\\_eu\\_gcc\\_relations2.pdf](http://www.diis.dk/files/Publications/Briefs2006/hma_eu_gcc_relations2.pdf).

to facilitate these investments as much as possible in order to recover from the harsh financial and economic crisis that had hit the Eurozone. Accordingly, the number and extent of Gulf investments in Europe has skyrocketed, and the idea of GCC countries' nationals as the "big spenders" has become more vivid.<sup>356</sup>

In 2008 the Abu Dhabi investment group bought Manchester City FC, and a couple of years later the Spanish football club Malaga became property of the Al-Thani family from Qatar. The UAE has also invested in the UK through a Masdar investment to construct the largest offshore wind farm in the world, and made sporting investments in the Olympic Village and London's ExCel Centre. In 2012, Gulf investment reached \$160 billion in Great Britain alone, of which more than a third came from Saudi Arabia, a significant share from Qatar, and to a lesser extent from the UAE, Bahrain, Kuwait, and Oman. The most sensational case, though, both in terms of coverage in the news and the extent of investments relative to its economic size, has been Qatar. Harrods, London's largest and most venerable department store, has been bought by Qatar's Sovereign Wealth Fund for \$2.2 billion. The Fund has also bought all or large parts of Sainsbury's supermarket, Porsche, Volkswagen, Barclay's bank, the London Stock Exchange, Canary Wharf, and Credit Suisse, to name but a few acquisitions. Qatar invested significantly in France as well, targeting major companies like Vinci and Veolia. Qatar Investment Authority has become the sole shareholder of Paris-Saint German, and Qatar Airways is now the official airline of the Tour de France. The Qatari-French deals were extensively written about in the French press, causing a stir and raising eyebrows, especially following the announcement of a €150 million allocation for investments in French suburbs inhabited by a Muslim majority, *les banlieues*. As soon as they were announced, the French media launched a fierce campaign against these investments, claiming they were instruments of religious, cultural, and political penetration.<sup>357</sup> Many journalists voiced concerns that these investments were politically motivated and indirectly aimed at supporting political Islam in Europe. Furthermore, in an article in *The Huffington Post*,<sup>358</sup> the influential French philosopher Bernard-Henri Lévy spoke of investments by these "emirate" as a source of charity and a source of

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<sup>356</sup> Information and data about Gulf states' investments in Europe are taken from Sven Behrendt, "Gulf Arab SWFs. Managing Wealth in Turbulent Times", in Carnegie Policy Outlook, 2009, <http://carnegie-mec.org/publications/?fa=22776>; Taher Al-Sharif, "Two-Way Traffic", in The Majalla, 24 July 2013, <http://www.majalla.com/eng/2013/07/article55243729>; Peter Beaumont, "How Qatar is Taking On the World", in The Guardian, 7 July 2012, <http://www.theguardian.com/world/2012/jul/07/qatar-takes-on-the-world>.

<sup>357</sup> Harvey Morris, "Qatar's Latest Investment Stirs the French", in IHT Rendezvous, 25 September 2012, <http://rendezvous.blogs.nytimes.com/?p=25526>; Ivan Rioufol, "Le Qatar n'a rien à faire dans les banlieues", in Ivan Rioufol Figaro Blog, 24 September 2012, <http://blog.lefigaro.fr/rioufol/2012/09/si-liberation-de-ce-lundi.html>.

<sup>358</sup> Bernard-Henri Lévy, "Money, Qatar and the Republic", in The Huffington Post, 2 October 2012, <http://m.huffpost.com/us/entry/1933860>.

“humiliation for the recipient country, which appears to be broke, reduced to panhandling.” In particular, he accused Qatar of using investments as instruments of propaganda to clean up its poor human rights record. It is undeniable that Qatari investments in the French suburbs came amid general concern by the French over political Islam, but it is also clear that most of these concerns are the result of a stereotyped understanding of the country, and the mass media cannot but be both a reflection and a source of this distorted view.

In the same way, some Gulf media have voiced domestic discontent at the EU-GCC economic partnership. In particular, the fact that Gulf rulers have invested vastly in Europe from their state-owned investment funds, while the Gulf region itself is in need of sustained investments, has triggered some perplexity. For example, when Qatar bought the Paris-Saint Germain football club, several columnists and bloggers criticized the decision to invest in European football teams instead of supporting local teams.<sup>359</sup> More recently the GCC itself, through its Chambers of Commerce and Industry Union, has brought up the issue of Gulf entrepreneurs investing in tourism abroad rather than regionally, particularly given the fact that the GCC is trying to strengthen its tourism sector. Ibrahim Al-Nabhani, chairman of the Tourism Committee at the GCC Chambers of Commerce and Industry Union, went so far as to declare that “despite the effort of GCC countries to boost tourism investments, Saudi investors still prefer investing in Europe and the Far East and avoid investment in GCC countries. [...] Such capitals and investments operating abroad represent a depletion of local funds and resources.”<sup>360</sup> When these capitals emigrate to the West, it is particularly easy to frame these investments negatively, in a way that stirs public opinion to disapprove the deals. This happened in particular in the wake of the wave of anti-Americanism that shook the region after the 2003 war in Iraq and which reflected badly on Europe as well, as the EU is still generally perceived as the US “bridesmaid.” This metaphor has been employed in some literature<sup>361</sup> to describe the role of the EU vis-à-vis the US in the Middle East. A free-rider on American Middle East policies, the EU has been following the US lead in the Middle East from several points of view and has struggled to differentiate its approaches or stances from Washington’s. Consequently, many in the Arab world, and in the Gulf in particular, tend to perceive the European Union as part of the “West” that also includes the United States of America and even (sometimes) Russia.<sup>362</sup> Again, this misperception partly stems from (but could also be cor-

<sup>359</sup> Dr. Saleh Bakr al Tayyar was particularly harsh on this in his column on the Saudi al Madina available at <http://www.al-madina.com>.

<sup>360</sup> Diana Al Jassem, “Saudis avoid GCC tourism investments”, in Arab News, 15 August 2013, <http://www.arabnews.com/news/461290>.

<sup>361</sup> Philip Robins, “Always the Bridesmaid: Europe and the Middle East”, in Cambridge Review of International Affairs, Vol. 10, No. 2 (Winter/Spring 1997), p. 69-83, at p. 78.

<sup>362</sup> Ana Echagüe, “The European Union and the Gulf Cooperation Council”, in FRIDE Working

rected by) the media. An extended and effective coverage of the EU could indeed shed light on all the numerous features that make the EU a quite different economic, financial, and political actor vis-à-vis the US. Given the relevance of EU-GCC relations in their respective economic and financial systems and the implications for development, it seems of utmost importance to try and make an effort to overcome the communication bug that favours the proliferation of stereotypes, which in turn can play a role in creating an unfavorable business environment and potentially even missing future opportunities.

## 7.2. THE VOICE OF THE MEDIA

### 7.2.1. Journalists surveyed

This section discusses the survey conducted among journalists across the European Union and the Gulf Cooperation Council countries to show what these media professionals' basic understanding of the other region is and how much more potential there is to engage them as carriers of a more accurate image of the two regions. During a time frame of one month, the researchers collected information from media members from both regions to assess their familiarity with the other region (the cause and effect of *agenda-setting* in the public discourse) and their perception of how their region is portrayed in the other region's media (the cause and effect of *framing*). Indeed, being journalists, the main creators and conveyers of messages, assessing them is the most effective way to understand how the two functions of *agenda-setting* and *framing* happen and why. In turn, acting on their understanding and mindset is the most effective way to alter both agenda-setting and framing. In particular, a questionnaire has been designed to cover a number of topics related to: areas of interest to journalists about the other region, general level of information about the other party, and perceptions of how their own region is covered in the other party's media. In these regards, the lack of fluency in English, encountered amongst some if not most Gulf interviewees, is a key factor to take into account. The survey has also tried to capture the level of interaction with locals of the other region and the main sources of information – whether traditional or news media – used by the journalists. As social media (SM) have become a vital source of information, the questionnaire discussed the level of dependency on social media to form an opinion about the other region and to report on it.

The researchers took a random sample approach, focusing on a small but representative sample. The only criteria considered while sending these ques-

tionnaires is that the surveyed sample consist of local, practicing journalists without focusing on a certain age group nor other socio-economic factors, as the aim was to get the views of random, local journalists from the two regions and there was no way to guarantee equal number of responses from all the categories like gender, age group, provenance, etc. Thus, the random sample approach was the most suitable method to adopt in this chapter. Two sets of questions<sup>363</sup> were sent via email to journalists and other media members holding representative positions within journalist unions, federations, and associations.<sup>364</sup> The targeted sample was made up of the nationals of these two regions, as it is believed that they are better positioned to represent their own media than their expatriate colleagues and the responses were given under condition of anonymity. From the EU region, only 12 responses were received during the period between 7 February 2013 and 18 March 2013. During the first four weeks of the same period, only five respondents from the GCC took the survey. During the last week of the same period, the questionnaire was sent again to most of the same sample from the GCC in Arabic. By 18 March 2013, the GCC surveyed sample increased to 10. As this was an early, exploratory survey intended to start exploring the problems discussed in the introduction, without the pretence to generalize from this small sample but considering the representativeness of it, the results can still be considered worth exploring. This is particularly the case after complementing the findings of the random sample of the questionnaires with a selected focus group held with journalists, scholars, diplomats, and decision-makers from both regions.

### *7.2.2. Comparative data analysis*

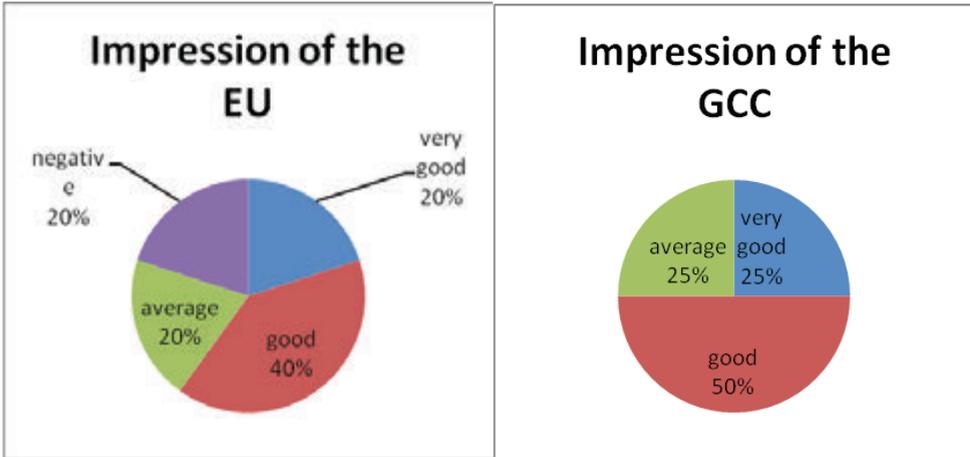
The first and broadest question received a largely positive answer: 60% of the surveyed sample from the GCC claimed they had a positive impression of the EU region (see Figure 67). On the other side, EU journalists also had a positive impression of the GCC region, with 75% saying they had either a good or very good impression of the region, while 25% had an average rating for the way they see the region (see Figure 68).

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<sup>363</sup> See Annex 28.

<sup>364</sup> For a full list, see Annex 29.

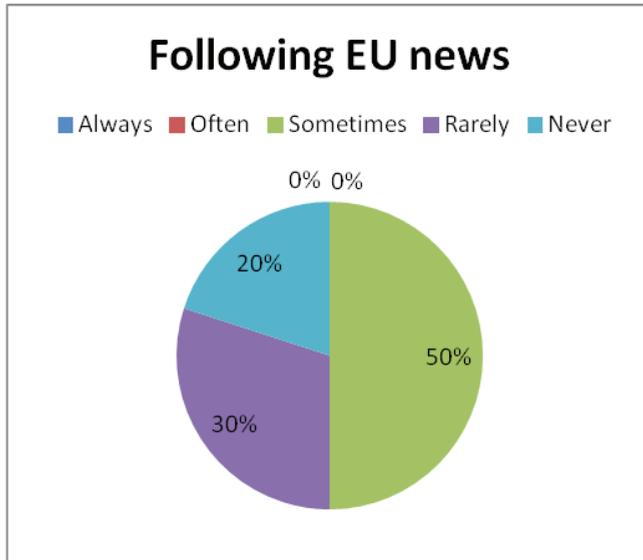
Fig. 67. Impression of the EU (left); Fig. 68. Impression of the GCC (right)



Given that reporting should hold to a central principle of first-hand witnessing, and that newsmakers' direct experiences usually find a way into how they frame the news, we questioned the interviewees about their direct experience with the other region. 67% of the surveyed sample from the EU responded that they had visited the GCC region at least once, and 75% said that they had interactions with GCC locals. 80% of the GCC sample had been to at least one European country and visited the region at least once for official or personal purposes, or even both, and all of the respondents said that they had been interacting with Europeans. On the other hand, the observed increase in the number of responses after sending the same survey in Arabic to the sample indicates a certain level of language barrier in communicating with the other region. Indeed, 60% of the respondents among the GCC journalists did not speak any European language. This limitation prevents them from following European media that could provide an insider perspective and forces them to depend more on news agencies' reports and translations or on Arabic channels broadcasting from the EU region, which inevitably look at the region from an outsider perspective. The same applies to EU journalists who weren't found, for the majority, to be fluent in Arabic.

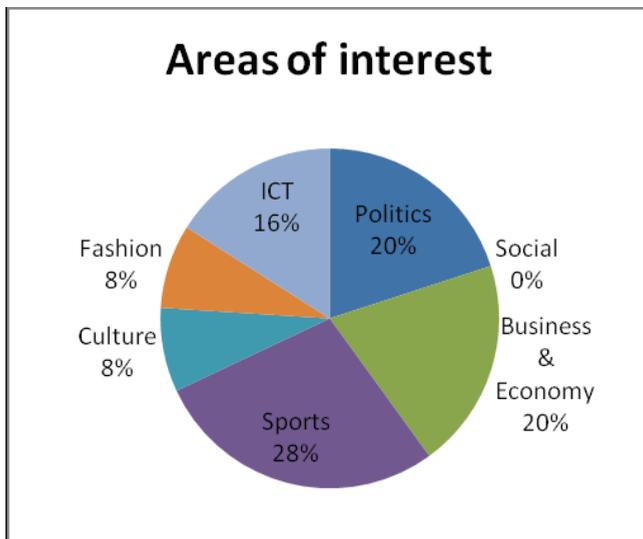
Even though 60% of the GCC journalists surveyed were interested in reporting on the EU region, none of them followed the EU region regularly. 50% of them followed the EU news channels sometimes and 20% never (see Figure 69).

Fig. 69. Following EU news



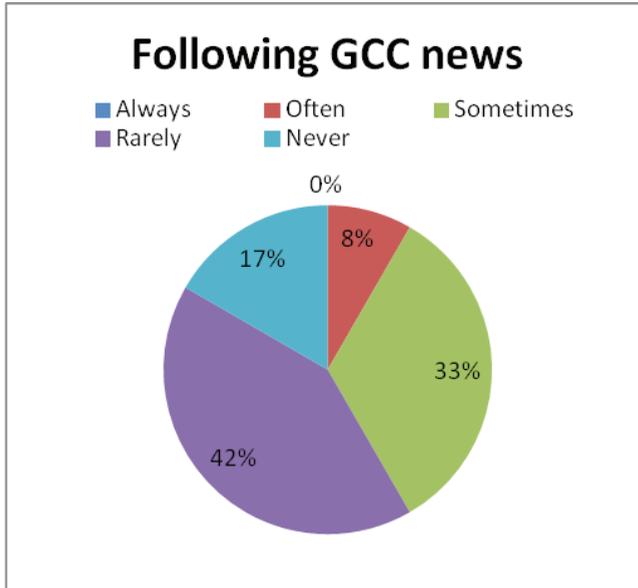
Regarding how the journalists' interests are catalyzed, we found that most of the GCC sample showed some interest in sports (28%), followed by political and economic issues (20% each), information and communication technology (16%), and fashion or cultural areas (8%). None of the journalists showed any interest in the social issues of the EU region (see Figure 70).

Fig. 70. Areas of interest



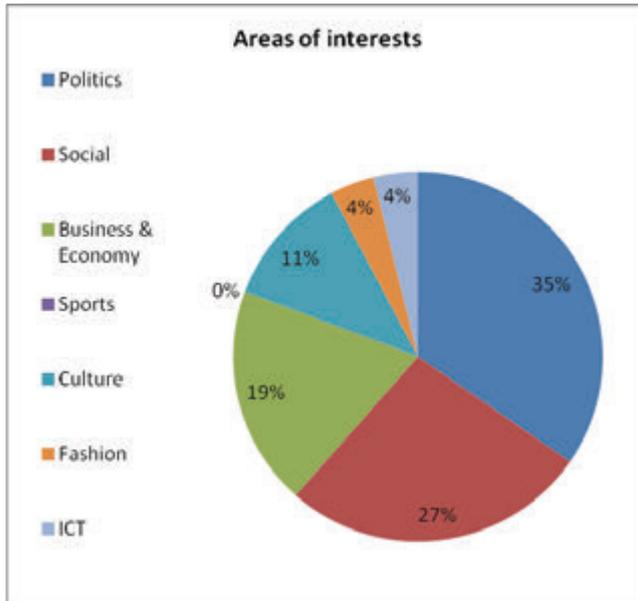
The EU journalists showed a little higher level of interest compared to their GCC counterparts in the other region's news, with 8% of them following the GCC news often, 33% following the region's news sometimes, and 17% never (see Figure 71).

Fig. 71. Following GCC news



It is noteworthy to underline how the areas of interest among European journalists were completely different from the ones indicated by Gulf respondents. While sports were the main interest with regard to the EU, Gulf sports held 0% interest for the EU journalists. And while the GCC respondents showed no interest in the EU's social issues (0%), the social issues of the GCC were one of the main areas of interest for European journalists (27%) (see Figure 72).

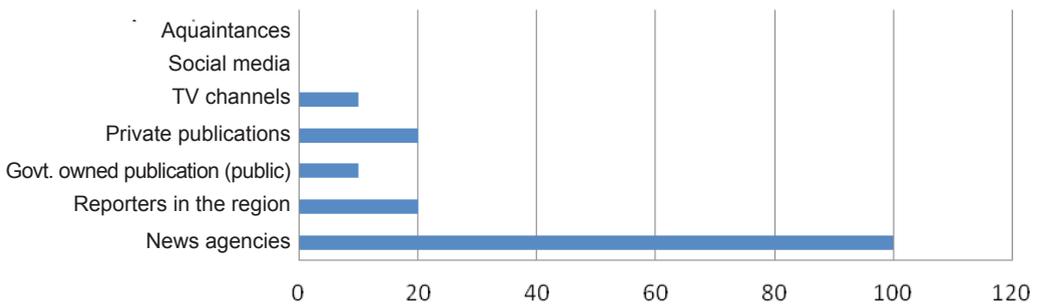
**Fig. 72. Areas of interest**



As suggested, the journalists in the GCC tend to rely heavily on news agencies. The sample interviewed was given a choice to select the three main sources of information they use when reporting about Europe. All of the respondents said that they rely on news agencies. 20% of them rely on privately owned publications or reporters from the EU region. 10% rely on TV channels or public publications (see Figure 73).

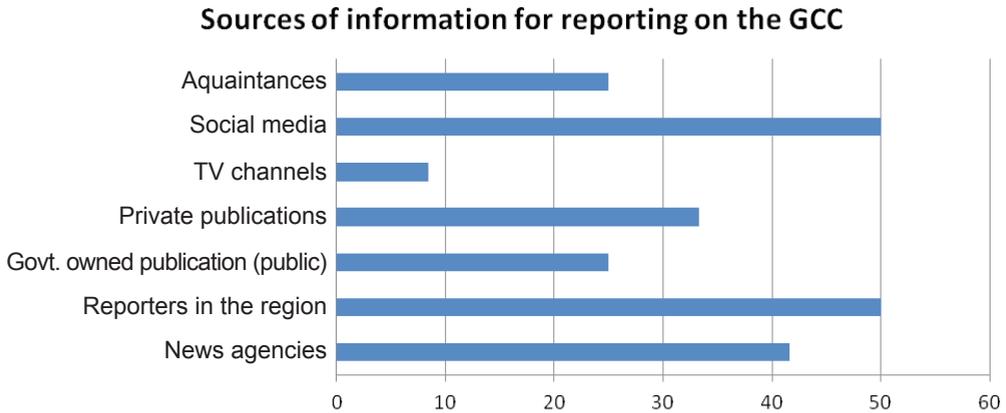
**Fig. 73. Sources of information for reporting on the EU**

**Sources of information for reporting on the EU**



The EU sample showed a higher level of diversification with regard to the sources of information when compared to the GCC sample. 50% of the respondents declared that they rely on social media or reporters on the ground, 42% on news agencies, 33% on private publications, 25% on acquaintances, 25% on public publications, and less than 10% on TV channels (see Figure 74).

Fig. 74. Sources of information for reporting on the GCC



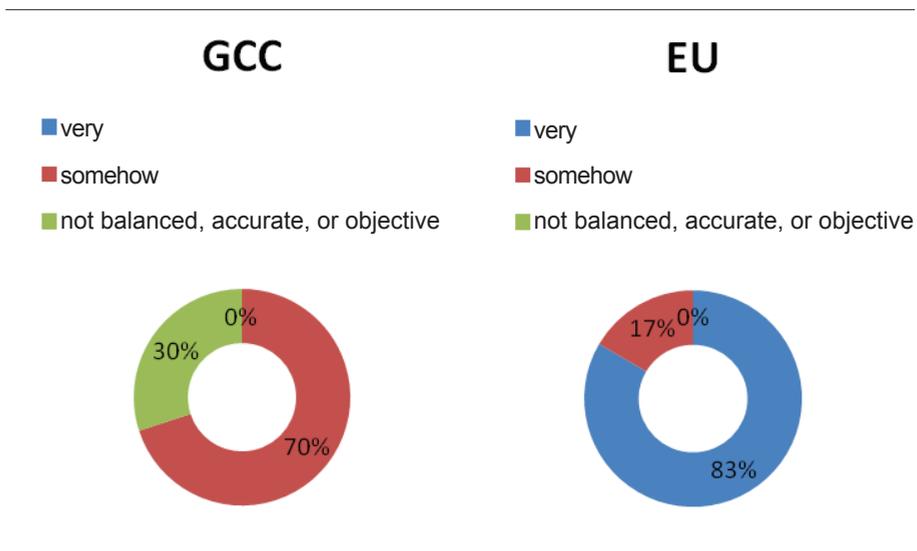
Although none of the samples from either region said that they depend on social media to collect information for reporting purposes, 50% of European journalists declared that they rely on social media content to form some kind of opinion while reporting on the Gulf region. This figure confirmed a tendency of EU journalists to work densely with the new media, in particular Facebook, Twitter, blogs, and YouTube. In contrast, journalists from the GCC region seem to have a very low degree of trust in new communication technologies as sources, in particular in relation to reporting about foreign (EU) issues. It's widely acknowledged that user-generated content (USG) has created an important extra layer of information and diverse opinion: the concept of the "*citizen journalist*" has played a role in allowing any individual to publish different sorts of data, visuals, and videos. Sometimes, the news can be published on websites and shared by normal individuals before the traditional media. This is true for Europe as well as for the Gulf. In Europe, however, mainstream news organizations, which have a long-standing tradition of reporting and fact-checking and have thus earned the audience's trust, are relied on to sort fact from fiction within USG and serve up a filtered view.<sup>365</sup> In the Gulf, where the awareness about codes of conduct in reporting, guidelines, and fact-checking is quite recent, and where

<sup>365</sup> Nic Newman, "The Rise of Social Media and its Impact on Mainstream Journalism", in RISJ Working Papers, September 2009, [https://reutersinstitute.politics.ox.ac.uk/fileadmin/documents/Publications/The\\_rise\\_of\\_social\\_media\\_and\\_its\\_impact\\_on\\_mainstream\\_journalism.pdf](https://reutersinstitute.politics.ox.ac.uk/fileadmin/documents/Publications/The_rise_of_social_media_and_its_impact_on_mainstream_journalism.pdf).

there is a lack of variety in content and views, foreign media practitioners and in particular European journalists, aware of the above-mentioned weaknesses of traditional media in the Gulf, are naturally more prone to rely on duly self-filtered USG. On the other hand, the complete dependence of GCC journalists on traditional media, in particular news agencies, could be explained by the fact that journalists in the region are not yet familiar with fact-checking techniques to filter USG, which they heavily distrust.

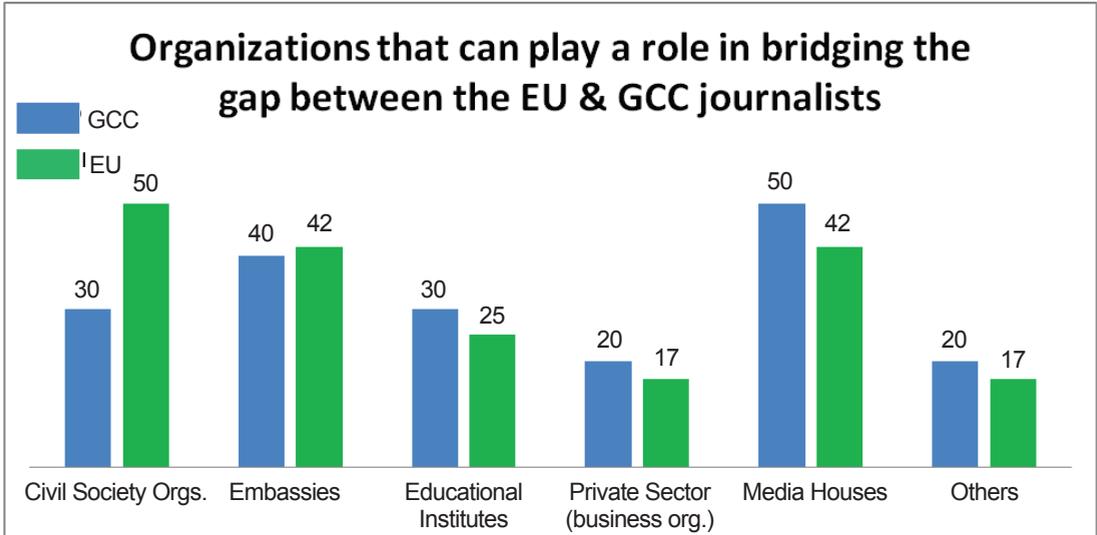
Finally, to assess the perceived level of accuracy in both the media and the way journalists feel about how their home region is featured, the questionnaires asked questions such as “How balanced, accurate, and objective are the reports about the EU in the GCC media?” and vice versa. While the EU sample felt that their region is being featured in a balanced, accurate, and objective way, 30% of the GCC participants did not feel likewise (see Figures 75-76).

Fig. 75. GCC (left); Fig. 76. EU (right)



Finally, journalists from both surveyed regions were asked about the organizations they believe can play a bigger role in developing better mutual understanding. A few options were given to the sample, while they were also asked to add any other organizations that, according to them, can participate in bridging the gap of perception (see Figure 77).

**Fig. 77. Organizations that can play a role in bridging the gap between the EU and GCC journalists**



25 of the Gulf-based and European-based journalists, scholars, diplomats and policy-makers had the chance to debate more on the topic of what direction to take during a focus group held in Muscat in March 2013, on the occasion of a workshop organized by the Sharaka project.<sup>366</sup> The group discussed some of the flaws they perceive in the Gulf media landscape, as well as what the most effective EU-GCC joint actions in these fields could be. A number of interesting ideas emerged from the focus group as well as from the survey, which have been subsequently elaborated upon by the researchers into a series of recommendations presented below.

## CONCLUSION

The lack of an effective and sustained communication flow between the Gulf region and the European region has led to the diffusion of collective stereotypes that have the potential to harm the development of interregional cooperation. This is true especially if looking at economic exchanges and strategic investments, which are also sensitive political issues, especially in the Gulf economies.

<sup>366</sup> Sharaka workshop on “Dialogue on Opportunities for Enhancing Understanding and Cooperation in EU-GCC relations in the fields of Media and Communications and Higher Education and Scientific Research”, Muscat, 26 March 2013, <http://www.sharaka.eu/?p=1147>. The workshop, organized in two panels followed by focus groups, hosted around 25 Gulf-based and European journalists, scholars, diplomats, and policymakers.

These misperceptions can partly be attributed to an underdeveloped coverage of the two regions in their respective media, which in turn could also represent effective instruments to correct them. In light of the key role that media play in shaping perceptions, the survey presented here has been addressed to media members, who are content-creators and main message-carriers. The survey showed a poor level of familiarity with the two regions, but an overall good perception and latent interest, particularly in areas such as politics and the economy. When it comes to the sources used to form an opinion about the other region, the GCC media members depended mostly on news agencies to report on the EU, while the sample from the European region showed a more diversified set of sources and a high reliance on people-to-people links in reporting on the GCC region. Language seemed to be a significant barrier when it came to consuming the other region's home-grown media channels. Finally, there was a diverging assessment in how the journalists perceived their own region to be portrayed: in particular, 30% of the journalists from the Gulf who took part in the survey perceived the way their region is portrayed as "not balanced, accurate, or objective." This might be related to the fact that the number of expatriate journalists in the Gulf is high, as journalism suffers from low prestige, suspicions, and stereotypes among Gulf nationals.<sup>367</sup> Along with the language barrier, which results in a limited exposure to the EU media, this might explain the gloomy perception by the GCC sample.

From these data and subsequent discussion in an ad-hoc focus group, some ideas emerged to foster know-how exchange and mutual understanding, thus potentially triggering positive fallout on the interregional communication system in general. Those ideas can be summed up as follows, and are further developed below as policy recommendations: intensifying interactions through exchange programmes, organizing joint seminars and workshops, and upgrading the technical skills of the media members through language courses and greater exposure to the other region. Many actors have been identified as stakeholders, including civil society organizations, media houses, embassies, and educational institutions.

The policy recommendations developed below could indeed prove effective, provided that the parties share the long-term goal of nurturing the public perception of their relations. Media is indeed one of the main ways to form a public and political opinion: by helping press members of one region to understand the other, EU-GCC cooperation on media could bring the two regions closer and provide a more accurate image for the general public. Only in this way would it

<sup>367</sup> Jim Naureckas, "Media on the March: Journalism in the Gulf", in Jim Naureckas and Janine Jackson (eds.), *The FAIR Reader. An Extra! Review of Press and Politics in the '90s*, Boulder, Westview Press, 1996, p. 20-27; Carolyn Wakeman (ed.), *The Media and the Gulf: A Closer Look*, Berkeley, University of California Berkeley Graduate School of Journalism, 1991.

be possible to properly uncover and assess some of the existing weaknesses in this relation as well as display a whole set of disregarded possibilities that could do nothing but boost the existing ties, eventually bringing tangible benefits to the people of both regions.

## POLICY RECOMMENDATIONS

- 1 Create, as a preparatory step, a Media Task Force composed of members of the journalists' associations in the Gulf countries to start a debate about how to overcome the problems besetting the media landscape in the Gulf region.
- 2 Enhance the quantity of research and papers on EU-GCC relations in different areas of interest – in Arabic as well as English – and the extent of research dissemination.
- 3 Encourage media houses and journalists' associations from both regions to communicate and interact more, including through joint seminars and workshops as well as exchange programmes for journalists, with the cooperation of media associations and federations.
- 4 Enhance the ability of GCC journalists to produce their own reports – particularly on foreign policy topics, given the lack of home-grown foreign policy reporting – instead of relying on the products of news agencies. In this regard, it would be helpful to have more interaction between journalists and representatives from the embassies. Embassies could be encouraged to have official spokespersons, official social media pages, and regular meetings with the press.
- 5 Arrange a framework for joint events by civil society organizations from both regions in the field of media and communications, in cooperation with higher educational institutes and media houses. This might include journalists' associations or think tanks.
- 6 Enhance the English language skills of journalists from the Gulf as well as the Arabic language skills of European journalists to reinstate the primacy of primary sources.
- 7 Form a committee with members of civil society, media, educational institutes, and other concerned stakeholders to carry these recommendations forward, with the support of the GCC Secretariat as well as the EU Delegation in the GCC.



# Annexes

## ANNEX 1. CONCENTRATION AND DIVERSIFICATION INDICES

The concentration index is a measure of the degree of market concentration. It has been normalised to obtain values from 0 to 1 (maximum concentration), according to the following formula:

$$H_j = \frac{\sqrt{\sum_{i=1}^n \left(\frac{x_i}{X}\right)^2} - \sqrt{1/n}}{1 - \sqrt{1/n}}$$

Where:  $H_j$  = country group ;  $x_i$  = value of exports of product  $i$ ;  $n$  = number of products (SITC Revision 3 at 3-digit group level )and:

$$X = \sum_{i=1}^n x_i$$

Source: Quoted from UNCTADstat Definitions and Metadata.

## ANNEX 2. BRIEF TECHNICAL SUMMARY FOR CALCULATING THE OTRI

The OTRI provides a uniform metric of a country's trade protection structure at the tariff line level that leaves its welfare constant for any given level of imports of a good. It solves two important aggregation problems in trade policy analysis. First, as countries resort to different policy instruments such as tariffs and non-tariff barriers (NTBs), a direct comparison between trade policies is not possible. Second, as trade policy measures are applied at the tariff line level, any comparison between different countries' trade policies needs to take into

account the level of each country's imports of a good. For example, a particular good  $n$  might be subject to high tariff and a number of NTBs in the form of technical requirements, sanitary and phyto-sanitary measures etc., but its imports in a country  $c$  might be low. Hence, any measure failing to take into account the quantity effect of imports of the good would give a biased measure of trade protection.

The construction of the OTRI follows a three step procedure. First, Kee et al.<sup>368</sup> estimate average tariff equivalents (AVEs) of NTBs. NTBs are a set of regulations any exporter located in country  $c$  needs to fulfil to export a good  $n$  in country  $b$ . NTBs consist of "core" and "non-core" measures protecting local producers and consumers respectively. They (core and non-core NTBs) are classified in 16 categories: sanitary and phyto-sanitary measures (SPS), technical barriers to trade (TBT), other technical measures, price control measures, quantity control measures, para-tariffs, finance measures, anti-competitive measures, export related measures, trade and investment measures, distribution restrictions, restrictions on post-sale services, subsidies, government procurement measures, intellectual property rights and rules of origin. Data on NTBs is available in UNCTAD's TRAINS database. The basic formula for estimating AVEs consists in differentiating the following equation with respect to  $\text{Core}_{n,c}$  and  $\ln \text{DS}_{n,c}$  after estimating  $\beta^{\text{Core}}_{n,c}$  and  $\beta^{\text{DS}}_{n,c}$ :

$$\ln m_{n,c} = \alpha_n + \sum_k \alpha_{n,k} C_c^k + \beta_{n,c}^{\text{Core}} \text{Core}_{n,c} + \beta_{n,c}^{\text{DS}} \ln \text{DS}_{n,c} + \varepsilon_{n,c} \ln(1 + t_{n,c}) + \mu_{n,c}$$

Where:

- $m_{n,c}$  is the import value of a good  $m$  in country  $c$ , evaluated at world prices
- $\alpha_n$  are tariff line dummies for good specific effects
- $C_c^k$  is a vector of variables controlling for country specific characteristics (GDP, population, etc.)
- $\alpha_{n,k}$  are parameters capturing country characteristics
- $\text{Core}_{n,c}$  is a dummy capturing the presence of NTBs on a good  $n$  in a country  $c$
- $\ln \text{DS}_{n,c}$  is the logarithm of domestic support to the agricultural sector
- $\beta^{\text{Core}}_{n,c}$  is the parameter capturing the impact of a core NTB on imports of the good  $n$  in country  $c$
- $\beta^{\text{DS}}_{n,c}$  is the parameter capturing the impact of domestic agricultural support on the good  $n$  in country  $c$
- $t_{n,c}$  is the ad-valorem tariff of good  $n$  in country  $c$
- $\varepsilon_{n,c}$  is the import demand elasticity of good  $n$  in country  $c$
- $\mu_{n,c}$  is the independently and identically distributed error term.

<sup>368</sup> Hiau Looi Kee, Alessandro Nicita and Marcelo Olarreaga, "Estimating Trade Restrictiveness Indices", cit.

In a second step, once AVEs have been obtained, before calculating the OTRI, Kee, Nicita and Olarreaga calculate the Trade Restrictiveness Index, which measures the impact of trade protection (comprising tariffs and NTBs) on a country's own welfare. The TRI can be found by differentiating the following equation and using second order linear approximation to calculate welfare costs in equilibrium:

$$TRI_c : \sum_n W_{n,c}(TRI_c) = \sum_n W_{n,c}(T_{n,c}) = W_c^0$$

Where:

- $W_{n,c}$  is the country's welfare associated with its imports of the good  $n$
- $T_{n,c}$  is the country's uniform tariff equivalent of tariffs and NTBs for good  $n$
- $W_c^0$  is the current level of a country's aggregate welfare

Finally, the OTRI can be found solving for this equation in a partial equilibrium set-up:

$$OTRI_c : \sum_n m_{n,c}(OTRI_c) = \sum_n m_{n,c}(T_{n,c}) = m_c^0$$

Where:

- $m_c^0$  is the current level of a country's total imports of all goods.

*Source:* Hiau Looi Kee, Alessandro Nicita and Marcelo Olarreaga, "Estimating Trade Restrictiveness Indices", cit.

### ANNEX 3. BRIEF TECHNICAL SUMMARY FOR CALCULATING THE STRI

The STRI ranks countries' different services sector policies according to the restrictions applied by governments on foreign suppliers. It is constructed from the perspective of a foreign supplier willing to supply services in a country through cross-border supply (mode 1), commercial presence (mode 3), and temporary movement of natural persons (mode 4). Consumption abroad (mode 2) is not considered. Information comes from two sources: for OECD countries, the index builds on publicly available sources; for developing countries, a ques-

tionnaire was addressed to national authorities. In both cases, after gathering the relevant policy information, local authorities were consulted in a second stage to evaluate how the different policies were implemented in practice. Data was collected for each combination of service sector, subsector and mode of supply. For example, in the case of banking, the data considers restrictions on foreign suppliers for lending and deposit acceptance through cross-border supply and commercial presence. While the index is subjective to the choice of sectors and subsectors, Borchert et al.<sup>369</sup> conduct robustness checks to assess the validity of their results. Broadly, the authors find that consistent with trade theories, a greater level of openness in the services sector is simultaneous with higher total factor productivity and GDP per capita.

The index is constructed using a three-step methodology to derive a sector/country-level as well as a total country measure of restrictiveness. After identifying the different policies regulating the presence of foreign suppliers across each sub category of services and mode of supply, the authors rank the different policy regimes assigning a score from 0 to 100, denoted  $S_{jmc}$ . Five levels of restrictiveness are used in the database:

- Completely open (score=0)
- Virtually open with some restrictions (score=25)
- Virtually closed but with some possibilities to operate (score=75)
- Completely closed (score=100)
- Non stringent regulations (score=50). Most countries/sub-sectors fall under this category as regulation of some services is of prudential nature.

Once a score has been attributed to each subsector, there is an aggregation across services sub-sectors to derive a sector index of restrictiveness, and another one to derive country/sector indices. The aggregations are based on two criteria:

- The relative importance of supply modes for each subsector. For example, in the case of professional services, regulations affecting the movement of natural persons are more relevant than regulations affecting the cross-border supply of services. To take this into account, authors assign a weight to each mode of supply. The more stringent the regulations, the higher the weight denoted by  $w_j^m$ .
- The relative importance of a service sector in a country's economy. For example, in some countries, professional services might be more important than retail, and aggregating restrictiveness scores across these two categories would give a biased measure of policy barriers affecting international trade in services. To take this into account, authors consider

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<sup>369</sup> Ingo Borchert, Batshur Gootiiz and Aaditya Mattoo, "Policy Barriers to International Trade in Services. Evidence from a New Database", cit.

the share in value added of each sub sector in a country's value added, denoted  $w_j$ .

Two services sector restrictiveness indexes follow:

- The country sector index:

$$STRI_{cj} = \sum_m w_m^{(j)} s_{jmc}$$

- The overall country STRI:

$$STRI_c = \sum_j w_j STRI_{cj}$$

*Source:* Ingo Borchert, Batshur Gootiiz and Aaditya Mattoo, "Policy Barriers to International Trade in Services. Evidence from a New Database", cit.

## ANNEX 4. EU AND GCC ECONOMIC AND SOCIAL INDICATORS, 2010

Country	Currency	GDP (Eur. bn)	GDP per capita (Eur.)	GDP growth (annual %)	Inflation	Trade (% GDP)	Stocks traded, total value (% GDP)	Population (millions)	Life expectancy at birth, total	Adult literacy rate (%)
<b>Bahrain</b>	Bahraini Dinar BHD	17.31	13,716.68	6.3	1.96	140 (2009)	4.16 (2009)	1.26	75.02	91.35 (2009)
<b>Kuwait</b>	Kuwaiti Dinar KWD	93.80	34,273.81	4.3 (2007)	4.02	89 (2009)	63.88 (2009)	2.74	74.60	93.91 (2008)
<b>Oman</b>	Omani Rial OMN	43.64	15,682.91	1 (2009)	3.20	94 (2009)	12.44 (2009)	2.78	73.12	86.62 (2008)
<b>Qatar</b>	Qatari Rial QAR	96.05	54,610.86	8.6 (2009)	-2.43	48 (2009)	25.94 (2009)	1.76	78.10	94.72 (2009)
<b>Saudi Arabia</b>	Saudi Rial SAR	340.04	12,388.50	3.7	5.34	78 (2009)	46.75	27.45	73.85	86.13 (2009)
<b>United Arab Emirates</b>	United Arab Emirates Dirham AED	224.52	29,889.64	1.4	..	144 (2009)	9.22	7.51	76.57	..
<b>GCC*</b>	..	815.35	18,743.79	4.2	2.42	99	27.06	43.50	75.21	90.5
<b>EU</b>	Euro	12,181.77	24,251.85	2	1.9	71	58	502.3	80	99

\*Regional averages, except for population and GDP; Data are for 2010 unless otherwise stated  
 Source: World Bank, *World Development Indicators 2010*, Washington, World Bank, 2010, <http://data.worldbank.org/data-catalog/world-development-indicators/wdi-2010>.

## ANNEX 5. EVOLUTION OF GCC COUNTRIES' HYDROCARBONS ENDOWMENTS

Oil: Proved reserves										
	1980	1990	2000	2010	2012	1980	1990	2000	2010	2012
	Billion barrels					% of world total				
GCC	272.4	462.8	479.8	494.0	494.6	39.9	45.0	38.1	30.5	29.6
Bahrain										
Kuwait	67.9	97.0	96.5	101.5	101.5	9.9	9.4	7.7	6.3	6.1
Oman	2.5	4.4	5.8	5.5	5.5	0.4	0.4	0.5	0.3	0.3
Qatar	3.6	3.0	16.9	24.7	23.9	0.5	0.3	1.3	1.5	1.4
Saudi Arabia	168.0	260.3	262.8	264.5	265.9	24.6	25.3	20.9	16.3	15.9
United Arab Emirates	30.4	98.1	97.8	97.8	97.8	4.4	9.5	7.8	6.0	5.9
European Union (excl. former USSR)	11.8	8.1	8.8	6.8	6.8	1.7	0.8	0.7	0.4	0.4
US	36.5	33.8	30.4	35.0	35.0	5.3	3.3	2.4	2.1	2.1

Source: BP, *Statistical Review of World Energy 2013*, 2013, <http://www.bp.com/en/global/corporate/about-bp/statistical-review-of-world-energy-2013.html>.

Natural gas: Proved reserves										
	1980	1990	2000	2010	2012	1980	1990	2000	2010	2012
	Trillion cubic metres					% of world total				
GCC	9.7	11.8	23.3	36.0	36.3	12.0	9.4	15.1	23.6	22.7
Bahrain	0.2	0.2	0.1	0.2	0.2	0.3	0.1	0.1	0.1	0.1
Kuwait	1.1	1.5	1.6	1.8	1.8	1.3	1.2	1.0	1.0	1.0
Oman	0.1	0.3	0.9	0.9	0.9	0.1	0.2	0.6	0.5	0.5
Qatar	2.8	4.6	14.4	25.0	25.1	3.5	3.7	9.4	14.1	13.4
Saudi Arabia	3.2	5.2	6.3	8.0	8.2	3.9	4.2	4.1	4.5	4.4
United Arab Emirates	2.4	5.6	6.0	6.1	6.1	2.9	4.5	3.9	3.4	3.3
European Union (excl. former USSR)	3.7	3.4	3.8	2.3	1.7	4.6	2.7	2.5	1.3	0.9
US	5.6	4.8	5.0	8.6	8.5	7.0	3.8	3.3	4.8	4.5

Source: BP, *Statistical Review of World Energy 2013*, cit.

## ANNEX 6. COUNTRY GROUPINGS

Africa		EU 20	Major hydrocarbons exporters	MED 11 - MED 7	ASEAN	MERCOSUR	NAFTA
Algeria	Madagascar	Austria	Algeria	Algeria (MED 7)	Brunei	Argentina	Canada
Angola	Malawi	Belgium	Angola	Egypt (MED 7)	Cambodia	Bolivia	Mexico
Benin	Mali	Bulgaria	Iran	Israel	Indonesia	Brazil	United States
Botswana	Mauritania	Czech Republic	Iraq	Jordan (MED 7)	Laos	Paraguay	
Burkina Faso	Mauritius	Denmark	Kazakhstan	Lebanon (MED 7)	Malaysia	Uruguay	
Burundi	Mayotte	Finland	Kuwait	Libya	Myanmar	Venezuela	
Cameroon	Morocco	France	Libya	Morocco (MED 7)	Philippines		
Cape Verde	Mozambique	Germany	Nigeria	Palestine	Singapore		
Central African Republic	Namibia	Greece	Norway	Syria	Thailand		
Chad	Niger	Hungary	Oman	Tunisia (MED 7)	Vietnam		
Comoros	Nigeria	Ireland	Qatar	Turkey (MED 7)			
Congo	Rwanda	Italy	Russian Federation				
Côte d'Ivoire	Saint Helena	Lithuania	Saudi Arabia				
Dem. Rep. of the Congo	Sao Tome and Principe	Netherlands	United Arab Emirates				
Djibouti	Senegal	Poland	Venezuela				
Egypt	Seychelles	Portugal					
Equatorial Guinea	Sierra Leone	Romania					
Eritrea	Somalia	Spain					
Ethiopia	South Africa	Sweden					
Ethiopia (...1991)	Sudan	United Kingdom					
Gabon	Sudan (...2011)						
Gambia	Swaziland						
Ghana	Togo						
Guinea	Tunisia						
Guinea-Bissau	Uganda						
Kenya	United Republic of Tanzania						
Lesotho	Western Sahara						
Liberia	Zambia						
Libya	Zimbabwe						

Sources: UNCTADstat methodologies and country/product groupings; World Bank, *Services Trade Restrictions Database*, cit.

## ANNEX 7. KNOWLEDGE-INTENSIVE PRODUCTS

**Product name (SITC Rev 3)**

Hydrocarbons, n.e.s., & halogenated, nitr. derivative  
 Alcohols, phenols, halogenat., sulfonat., nitrat. der.  
 Carboxylic acids, anhydrides, halides, per.; derivati.  
 Nitrogen-function compounds  
 Organo-inorganic, heterocycl. compounds, nucl. acids  
 Other organic chemicals  
 Inorganic chemical elements, oxides & halogen salts  
 Metallic salts & peroxysalts, of inorganic acids  
 Other inorganic chemicals  
 Synth. organic colouring matter & colouring lakes  
 Dyeing & tanning extracts, synth. tanning materials  
 Pigments, paints, varnishes and related materials  
 Medicinal and pharmaceutical products, excluding 542  
 Medicaments (incl. veterinary medicaments)  
 Essential oils, perfume & flavour materials  
 Perfumery, cosmetics or toilet prepar. (excluding soaps)  
 Soaps, cleansing and polishing preparations  
 Fertilizers (other than those of group 272)  
 Polymers of ethylene, in primary forms  
 Polymers of styrene, in primary forms  
 Polymers of vinyl chloride or halogenated olefins  
 Polyethers, epoxide resins; polycarbonat., polyesters  
 Other plastics, in primary forms  
 Waste, parings and scrap, of plastics  
 Tubes, pipes and hoses of plastics  
 Plates, sheets, films, foil & strip, of plastics  
 Monofilaments, of plastics, cross-section > 1mm  
 Insectides & similar products, for retail sale  
 Starche, wheat gluten; albuminoidal substances; glues

Explosives and pyrotechnic products  
Prepared addit. for miner. oils; lubricat., de-icing  
Miscellaneous chemical products, n.e.s.  
Aircraft & associated equipment; spacecraft, etc.  
Optical instruments & apparatus, n.e.s.  
Instruments & appliances, n.e.s., for medical, etc.  
Meters & counters, n.e.s.  
Measuring, analysing & controlling apparatus, n.e.s.  
Photographic apparatus & equipment, n.e.s.  
Cinematographic & photographic supplies  
Cinematograph films, exposed & developed  
Optical goods, n.e.s.  
Watches & clocks  
Arms & ammunition  
Office machines  
Automatic data processing machines, n.e.s.  
Television receivers, whether or not combined  
Radio-broadcast receivers, whether or not combined  
Sound recorders or reproducers  
Household type equipment, electrical or not, n.e.s.  
Parts and components for electrical and electronic goods  
Parts, accessories for machines of groups 751, 752  
Telecommunication equipment, n.e.s.; & parts, n.e.s.  
Apparatus for electrical circuits; board, panels  
Cathode valves & tubes

Source: UNCTADstat, *SITC rev.3 products, Manufactured goods by degree of manufacturing groupings*,  
[http://unctadstat.unctad.org/UnctadStatMetadata/Classifications/UnctadStat.SitcRev3Products.Degree-OfManufacturing.Classification\\_En.xls](http://unctadstat.unctad.org/UnctadStatMetadata/Classifications/UnctadStat.SitcRev3Products.Degree-OfManufacturing.Classification_En.xls).

## ANNEX 8. BANK ACTIVITY RESTRICTIVENESS (% OF MAXIMUM SCORE)

	2000	2003	2007	2011
Bahrain	67	67	67	50
Kuwait	58	42	67	33
Oman	83	75	67	67
Qatar	67	25	..	67
Saudi Arabia	67	67	75	..
UAE	..	42	..	75
<b>GCC*</b>	<b>66</b>	<b>53</b>	<b>72</b>	<b>64</b>
Austria	33	42	42	33
Belgium	58	58	42	42
Denmark	42	58	58	58
Finland	42	50	58	42
France	33	33	58	67
Germany	25	42	42	42
Greece	58	67	50	50
Ireland	50	42	42	33
Italy	58	67	75	58
Luxembourg	33	25	58	58
Netherlands	33	42	42	42
Portugal	50	58	75	42
Spain	50	42	42	42
Sweden	50	58	67	..
UK	33	33	25	33
<b>EU15*</b>	<b>36</b>	<b>42</b>	<b>45</b>	<b>47</b>
Bulgaria	67	58	58	42
Cyprus	42	67	67	58
Czech Republic	42	75	75	..
Estonia	50	25	50	50
Hungary	50	67	75	42
Latvia	50	42	50	42
Lithuania	58	50	75	50
Malta	58	67	67	67
Poland	67	50	58	92
Romania	83	75	67	33
Slovakia	58	67	58	75
Slovenia	50	67	67	50
<b>NMS12*</b>	<b>55</b>	<b>62</b>	<b>65</b>	<b>64</b>
<b>EU27*</b>	<b>36</b>	<b>42</b>	<b>46</b>	<b>47</b>
<b>AVG</b>	<b>36</b>	<b>42</b>	<b>46</b>	<b>47</b>
<b>STDEV</b>	<b>13</b>	<b>12</b>	<b>17</b>	<b>15</b>

\* Regional averages are weighted by total banking assets.  
Source: BRSS.

## ANNEX 9. ENTRY INTO BANKING REQUIREMENTS (% OF MAXIMUM SCORE)

	2000	2003	2007	2011
Bahrain	100	100	100	100
Kuwait	63	75	100	100
Oman	100	100	100	100
Qatar	100	50	..	75
Saudi Arabia	100	100	100	..
UAE	..	100	..	100
<b>GCC*</b>	<b>92</b>	<b>93</b>	<b>100</b>	<b>95</b>
Austria	100	100	100	88
Belgium	100	100	100	88
Denmark	100	100	100	100
Finland	25	75	88	100
France	75	75	88	100
Germany	50	63	75	100
Greece	100	88	88	88
Ireland	88	0	100	100
Italy	100	100	100	100
Luxembourg	100	100	100	100
Netherlands	100	100	88	100
Portugal	88	88	88	88
Spain	100	100	88	100
Sweden	100	100	75	..
UK	100	100	100	100
<b>EU15*</b>	<b>83</b>	<b>84</b>	<b>91</b>	<b>99</b>
Bulgaria	100	100	100	100
Cyprus	100	75	38	100
Czech Republic	100	100	100	..
Estonia	100	100	100	100
Hungary	88	100	100	100
Latvia	75	100	100	100
Lithuania	100	100	100	100
Malta	100	100	100	100
Poland	88	88	100	88
Romania	100	100	88	100
Slovakia	100	100	100	100
Slovenia	100	88	100	100
<b>NMS12*</b>	<b>95</b>	<b>93</b>	<b>93</b>	<b>96</b>
<b>EU27*</b>	<b>83</b>	<b>84</b>	<b>91</b>	<b>99</b>
<b>AVG</b>	<b>83</b>	<b>84</b>	<b>91</b>	<b>99</b>
<b>STDEV</b>	<b>24</b>	<b>23</b>	<b>11</b>	<b>4</b>

\* Regional averages are weighted by total banking assets.

Source: BRSS.

## ANNEX 10. SHARE OF FOREIGN APPLICATIONS DENIED

	2000	2003	2007	2011
Bahrain	0	10	24	22
Kuwait	100**	100**	71	44
Oman	100**	100**	75	0
Qatar	100**	..	..	100**
Saudi Arabia	0	0	..	..
UAE	..	100**	..	0
<b>GCC*</b>	<b>35</b>	<b>53</b>	<b>60</b>	<b>30</b>
Austria	20	..	..	100**
Belgium	0	0	0	100**
Denmark	0	..	0	100**
Finland	100**	100	0	0
France	..	..	0	0
Germany	0	..	0	100**
Greece	0	14	0	0
Ireland	0	0	0	0
Italy	0	13	3	9
Luxembourg	0	0	0	0
Netherlands	0	0	0	100**
Portugal	0	0	0	0
Spain	0	7	0	0
Sweden	0	0	100**	..
UK	..	..	..	0
<b>EU15*</b>	<b>2</b>	<b>7</b>	<b>3</b>	<b>33</b>
Bulgaria	0	0	0	0
Cyprus	0	0	0	20
Czech Republic	..	0	25	..
Estonia	100**	100**	..	100**
Hungary	0	0	4	0
Latvia	0	25	100**	6
Lithuania	0	20	0	100**
Malta	0	0	0	0
Poland	0	0	0	0
Romania	25	..	0	6
Slovakia	50	100**	100**	0
Slovenia	0	0	0	0
<b>NMS12*</b>	<b>13</b>	<b>16</b>	<b>15</b>	<b>8</b>
<b>EU27*</b>	<b>2</b>	<b>8</b>	<b>3</b>	<b>32</b>
<b>AVG</b>	<b>2</b>	<b>9</b>	<b>4</b>	<b>32</b>
<b>STDEV</b>	<b>19</b>	<b>37</b>	<b>22</b>	<b>51</b>

\* Regional averages are weighted by total banking assets.

\*\* 100% if no foreign applications were registered.

Source: BRSS.

## ANNEX 11. MARKET SHARE OF GOVERNMENT-CONTROLLED BANKS (% OF TOTAL ASSETS)

	2003	2007	2011
Bahrain	0	1	0
Kuwait	0	..	0
Oman	0	0	0
Qatar	46	..	43
Saudi Arabia	21	20	20
UAE	35	..	49
<b>GCC*</b>	<b>21</b>	<b>16</b>	<b>29</b>
Austria	0	0	12
Belgium	0	0	0
Denmark	0	0	1
Finland	0	0	0
France	0	0	2
Germany	42	40	32
Greece	23	..	11
Ireland	..	..	21
Italy	10	9	0
Luxembourg	5	5	5
Netherlands	4	5	14
Portugal	23	25	23
Spain	0	0	0
Sweden	0	0	..
UK	0	..	26
<b>EU15*</b>	<b>12</b>	<b>12</b>	<b>14</b>
Bulgaria	18	0	3
Cyprus	4	3	1
Czech Republic	4	2	..
Estonia	0	0	0
Hungary	9	0	4
Latvia	3	4	16
Lithuania	12	0	0
Malta	0	0	0
Poland	24	20	22
Romania	42	..	8
Slovakia	4	1	1
Slovenia	12	18	51
<b>NMS12*</b>	<b>12</b>	<b>8</b>	<b>12</b>
<b>EU27*</b>	<b>12</b>	<b>12</b>	<b>14</b>
<b>AVG</b>	<b>12</b>	<b>12</b>	<b>15</b>
<b>STDEV</b>	<b>20</b>	<b>21</b>	<b>15</b>

\* Regional averages are weighted by total banking assets.

Source: BRSS.

## ANNEX 12. REGULATORY CAPITAL RATIO (% OF RISK-WEIGHTED ASSETS)

	2000	2003	2007	2011
Bahrain	21	21	23	..
Kuwait	22	23	17	19
Oman	19	16	18	..
Qatar	..	..	..	16
Saudi Arabia	21	20	18	..
UAE	20	20	14	..
GCC*	21	20	16	17
Austria	13	15	15	13
Belgium	11	13	12	18
Denmark	12	10	14	18
Finland	12	11	17	14
France	12	12	12	12
Germany	11	11	12	16
Greece	11	14	13	12
Ireland	13	14	11	14
Italy	13	11	11	12
Luxembourg	13	13	15	18
Netherlands	11	12	12	14
Portugal	12	10	11	10
Spain	13	13	12	12
Sweden	15	20	10	..
UK	13	13	13	16
EU15*	12	12	12	14
Bulgaria	36	31	15	17
Cyprus	10	14	..	12
Czech Republic	11	15	12	..
Estonia	16	15	12	22
Hungary	17	16	11	17
Latvia	16	14	10	15
Lithuania	22	16	10	16
Malta	15	18	21	..
Poland	14	15	15	14
Romania	14	29	21	15
Slovakia	13	13	15	13
Slovenia	15	12	11	11
NMS12*	14	16	14	14
EU27*	12	12	12	14
AVG	12	12	12	14
STDEV	2	2	1	2

\* Regional averages are weighted by total banking assets.  
Sources: BRSS and IMF Global Financial Stability Reports.

## ANNEX 13. MINIMUM REGULATORY CAPITAL RATIO (% OF RISK-WEIGHTED ASSETS)

	2000	2003	2007	2011
Bahrain	12	12	12	12
Kuwait	12	12	12	12
Oman	12	12	12	12
Qatar	8	10	10	10
Saudi Arabia	8	8	8	8
UAE	..	10	10	12
<b>GCC*</b>	<b>9</b>	<b>10</b>	<b>10</b>	<b>10</b>
Austria	8	8	8	8
Belgium	8	8	8	8
Denmark	8	8	8	8
Finland	8	8	8	8
France	8	8	8	8
Germany	8	8	8	8
Greece	8	8	8	8
Ireland	8	8	8	8
Italy	8	8	8	8
Luxembourg	8	8	8	8
Netherlands	8	8	8	8
Portugal	8	8	8	8
Spain	8	8	8	8
Sweden	8	8	8	8
UK	8	8	8	8
<b>EU15*</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>
Bulgaria	12	12	12	12
Cyprus	8	10	10	8
Czech Republic	8	8	8	8
Estonia	10	10	10	10
Hungary	8	8	8	8
Latvia	10	10	8	8
Lithuania	10	10	8	8
Malta	8	8	8	8
Poland	8	8	8	8
Romania	8	8	12	8
Slovakia	8	8	8	8
Slovenia	8	8	8	8
<b>NMS12*</b>	<b>8</b>	<b>8</b>	<b>9</b>	<b>8</b>
<b>EU27*</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>
<b>AVG</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>
<b>STDEV</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>

\* Regional averages are weighted by total banking assets.  
Sources: BRSS and IMF Global Financial Stability Reports.

## ANNEX 14. CAPITAL STRINGENCY (% OF MAXIMUM SCORE)

	2000	2003	2007	2011
Bahrain	22	56	67	57
Kuwait	78	67	78	86
Oman	56	56	56	71
Qatar	78	33	..	86
Saudi Arabia	33	33	67	..
UAE	..	67	..	71
GCC*	47	50	69	76
Austria	89	89	67	57
Belgium	78	44	22	86
Denmark	89	89	33	43
Finland	44	44	56	57
France	56	22	89	71
Germany	67	67	56	71
Greece	33	56	33	57
Ireland	67	56	44	86
Italy	44	33	33	57
Luxembourg	56	56	56	71
Netherlands	44	56	44	71
Portugal	44	67	78	57
Spain	78	89	89	71
Sweden	11	11	44	..
UK	67	56	67	43
EU15*	62	53	62	63
Bulgaria	33	67	67	71
Cyprus	11	44	67	86
Czech Republic	33	56	33	..
Estonia	78	22	44	86
Hungary	67	33	89	57
Latvia	11	56	44	86
Lithuania	33	33	22	71
Malta	67	56	56	57
Poland	44	33	22	71
Romania	33	33	56	71
Slovakia	44	67	22	57
Slovenia	78	89	56	71
NMS12*	43	46	45	71
EU27*	61	53	62	63
AVG	61	53	62	63
STDEV	15	22	21	15

\* Regional averages are weighted by total banking assets.  
Sources: BRSS and IMF Global Financial Stability Reports.

## ANNEX 15. OFFICIAL SUPERVISORY POWER (% OF MAXIMUM SCORE)

	2000	2003	2007	2011
Bahrain	100	74	66	64
Kuwait	89	53	47	64
Oman	89	71	63	71
Qatar	89	53	..	57
Saudi Arabia	100	74	68	..
UAE	..	74	..	57
<b>GCC*</b>	<b>96</b>	<b>69</b>	<b>62</b>	<b>60</b>
Austria	100	68	53	64
Belgium	89	53	58	64
Denmark	56	47	53	64
Finland	67	32	47	43
France	67	37	45	57
Germany	67	42	42	57
Greece	56	63	53	39
Ireland	56	58	63	50
Italy	33	26	37	71
Luxembourg	100	68	53	71
Netherlands	44	21	37	64
Portugal	67	74	74	71
Spain	44	47	61	57
Sweden	44	42	26	..
UK	78	58	42	29
<b>EU15*</b>	<b>66</b>	<b>45</b>	<b>45</b>	<b>53</b>
Bulgaria	78	58	58	57
Cyprus	100	42	63	64
Czech Republic	89	37	53	..
Estonia	89	74	68	71
Hungary	100	74	76	71
Latvia	56	68	53	64
Lithuania	44	58	76	64
Malta	67	74	74	71
Poland	67	37	47	64
Romania	44	47	47	71
Slovakia	100	74	68	64
Slovenia	100	63	68	79
<b>NMS12*</b>	<b>83</b>	<b>52</b>	<b>59</b>	<b>67</b>
<b>EU27*</b>	<b>67</b>	<b>46</b>	<b>46</b>	<b>53</b>
<b>AVG</b>	<b>67</b>	<b>46</b>	<b>46</b>	<b>53</b>
<b>STDEV</b>	<b>18</b>	<b>14</b>	<b>9</b>	<b>16</b>

\* Regional averages are weighted by total banking assets.

Source: BRSS.

## ANNEX 16. INDEPENDENCE FROM POLITICAL INTERFERENCE (% OF MAXIMUM SCORE)

	2003	2007	2011
Bahrain	33	33	67
Kuwait	67	67	67
Oman	33	0	33
Qatar	33	..	67
Saudi Arabia	33	67	..
UAE	33	..	67
<b>GCC*</b>	<b>39</b>	<b>60</b>	<b>65</b>
Austria	67	33	67
Belgium	33	67	67
Denmark	0	67	67
Finland	67	67	100
France	33	33	100
Germany	33	33	33
Greece	67	33	67
Ireland	67	67	100
Italy	0	33	33
Luxembourg	67	67	67
Netherlands	33	67	67
Portugal	67	67	100
Spain	33	67	100
Sweden	67	67	..
UK	33	100	33
<b>EU15*</b>	<b>34</b>	<b>59</b>	<b>61</b>
Bulgaria	100	100	100
Cyprus	67	100	100
Czech Republic	67	67	..
Estonia	100	67	67
Hungary	67	67	100
Latvia	100	100	33
Lithuania	33	67	33
Malta	100	67	67
Poland	0	67	67
Romania	67	100	100
Slovakia	33	33	100
Slovenia	33	100	67
<b>NMS12*</b>	<b>50</b>	<b>75</b>	<b>81</b>
<b>EU27*</b>	<b>34</b>	<b>59</b>	<b>61</b>
<b>AVG</b>	<b>34</b>	<b>59</b>	<b>61</b>
<b>STDEV</b>	<b>18</b>	<b>29</b>	<b>33</b>

\* Regional averages are weighted by total banking assets.  
Source: BRSS.

## ANNEX 17. DEPOSIT INSURANCE INDEX (% OF MAXIMUM SCORE)

	2003	2007	2011
Bahrain	67	67	67
Kuwait	0	0	0
Oman	0	0	0
Qatar	0	0	0
Saudi Arabia	0	0	0
UAE	0	0	0
<b>GCC*</b>	<b>2</b>	<b>4</b>	<b>3</b>
Austria	67	33	0
Belgium	100	67	33
Denmark	33	33	33
Finland	67	67	67
France	100	67	67
Germany	100	67	67
Greece	33	33	67
Ireland	67	67	33
Italy	67	67	67
Luxembourg	33	33	33
Netherlands	33	33	0
Portugal	100	100	67
Spain	33	33	33
Sweden	33	0	..
UK	67	67	33
<b>EU15*</b>	<b>75</b>	<b>59</b>	<b>48</b>
Bulgaria	33	33	33
Cyprus	67	33	33
Czech Republic	67	67	..
Estonia	33	67	33
Hungary	100	100	67
Latvia	33	0	67
Lithuania	33	67	33
Malta	67	33	33
Poland	67	67	33
Romania	33	33	33
Slovakia	67	67	33
Slovenia	67	33	0
<b>NMS12*</b>	<b>66</b>	<b>58</b>	<b>37</b>
<b>EU27*</b>	<b>75</b>	<b>59</b>	<b>48</b>
<b>AVG</b>	<b>74</b>	<b>58</b>	<b>47</b>
<b>STDEV</b>	<b>29</b>	<b>19</b>	<b>24</b>

\* Regional averages are weighted by total banking assets.

Sources: BRSS, European Commission (2010), World Bank, Central Bank of Bahrain and Central Bank of Oman.

## ANNEX 18. PRIVATE MONITORING (% OF MAXIMUM SCORE)

	2000	2003	2007	2011
Bahrain	89	64	82	91
Kuwait	100	91	82	82
Oman	89	82	55	64
Qatar	78	73	..	73
Saudi Arabia	100	82	82	..
UAE	..	91	..	73
<b>GCC*</b>	<b>97</b>	<b>85</b>	<b>80</b>	<b>75</b>
Austria	56	55	55	73
Belgium	67	64	64	73
Denmark	78	73	82	73
Finland	100	82	73	64
France	67	55	73	91
Germany	67	73	82	64
Greece	67	64	82	73
Ireland	78	82	82	91
Italy	67	73	73	73
Luxembourg	78	73	64	73
Netherlands	78	73	91	73
Portugal	89	55	64	55
Spain	89	73	82	82
Sweden	67	64	64	..
UK	89	91	91	82
<b>EU15*</b>	<b>75</b>	<b>73</b>	<b>80</b>	<b>77</b>
Bulgaria	78	64	64	73
Cyprus	67	73	73	82
Czech Republic	56	73	64	..
Estonia	78	73	64	64
Hungary	56	82	82	73
Latvia	56	73	73	64
Lithuania	78	64	82	64
Malta	89	73	73	73
Poland	78	64	73	82
Romania	67	55	55	64
Slovakia	56	64	45	73
Slovenia	67	73	73	64
<b>NMS12*</b>	<b>67</b>	<b>69</b>	<b>69</b>	<b>75</b>
<b>EU27*</b>	<b>75</b>	<b>73</b>	<b>80</b>	<b>77</b>
<b>AVG</b>	<b>75</b>	<b>73</b>	<b>80</b>	<b>77</b>
<b>STDEV</b>	<b>12</b>	<b>13</b>	<b>10</b>	<b>11</b>

\* Regional averages are weighted by total banking assets.

Source: BRSS.

## ANNEX 19. STRENGTH OF LEGAL RIGHTS (% OF MAXIMUM SCORE)

	2003	2007	2011
Bahrain	..	40	40
Kuwait	40	40	40
Oman	40	40	40
Qatar	40	40	40
Saudi Arabia	30	30	50
UAE	40	40	40
GCC*	36	37	43
Austria	70	70	70
Belgium	60	60	60
Denmark	80	90	90
Finland	80	80	80
France	40	70	70
Germany	80	70	70
Greece	40	40	40
Ireland	90	90	90
Italy	30	30	30
Luxembourg	..	50	50
Netherlands	60	60	60
Portugal	30	30	30
Spain	60	60	60
Sweden	60	70	80
UK	100	100	100
EU15*	70	72	71
Bulgaria	80	80	80
Cyprus	..	90	90
Czech Republic	70	60	60
Estonia	60	60	70
Hungary	70	70	70
Latvia	100	100	100
Lithuania	50	50	50
Malta	..	..	30
Poland	80	80	90
Romania	80	90	90
Slovakia	90	90	90
Slovenia	50	40	40
NMS12*	75	75	77
EU27*	70	73	72
AVG	69	72	71
STDEV	27	22	23

\* Regional averages are weighted by total banking assets.  
Source: World Bank Doing Business surveys.

## ANNEX 20. DEPTH OF CREDIT INFORMATION (% OF MAXIMUM SCORE)

	2003	2007	2011
Bahrain	..	50	50
Kuwait	50	67	67
Oman	..	33	83
Qatar	0	33	67
Saudi Arabia	0	100	100
UAE	33	83	83
<b>GCC*</b>	<b>20</b>	<b>78</b>	<b>82</b>
Austria	100	100	100
Belgium	67	67	67
Denmark	67	67	67
Finland	67	67	67
France	67	67	67
Germany	100	100	100
Greece	67	67	83
Ireland	83	83	83
Italy	100	83	83
Luxembourg	..	0	0
Netherlands	83	83	83
Portugal	83	83	83
Spain	83	83	83
Sweden	67	67	67
UK	100	100	100
<b>EU15*</b>	<b>89</b>	<b>84</b>	<b>84</b>
Bulgaria	50	100	67
Cyprus	..	0	33
Czech Republic	67	83	83
Estonia	83	83	83
Hungary	83	83	67
Latvia	33	67	83
Lithuania	50	100	100
Malta	..	..	0
Poland	67	83	100
Romania	67	83	83
Slovakia	50	67	67
Slovenia	50	67	67
<b>NMS12*</b>	<b>66</b>	<b>73</b>	<b>75</b>
<b>EU27*</b>	<b>89</b>	<b>84</b>	<b>84</b>
<b>AVG</b>	<b>88</b>	<b>84</b>	<b>83</b>
<b>STDEV</b>	<b>18</b>	<b>22</b>	<b>21</b>

\* Regional averages are weighted by total banking assets.

Source: World Bank Doing Business surveys.

## ANNEX 21. KEY INDICATORS AND COMPOUND INDICATORS FOR GCC COUNTRIES, EU-27 AND THE WORLD, 2009

Key Indicators	Units	EU-27	GCC	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE	World
Population	Million	500,37	37,84	0,79	2,80	2,85	1,41	25,39	4,60	6 760,75
GDP	Billion 2000 USD	9 841,59	517,24	13,67	63,63	31,63	40,71	249,54	118,06	39 674,41
GDP (PPP)	Billion 2000 USD	12 007,61	664,36	17,91	72,41	49,02	36,47	371,91	116,64	64 244,43
Energy Production	Mtoe	817,29	1 052,12	17,55	130,24	67,20	139,95	528,38	168,80	12 291,68
Net imports	Mtoe	941,46	-735,27	-5,58	-98,58	-51,03	-115,07	-371,80	-93,21	0,00
TPES	Mtoe	1 655,79	295,96	9,47	30,17	15,06	23,82	157,85	59,59	12 149,85
Electricity Consumption*	TWh	3 037,15	374,60	10,78	46,60	15,52	23,04	199,12	79,54	18 451,50
CO <sub>2</sub> Emissions**	Mt of CO <sub>2</sub>	3 577	757	23	81	39	57	410	147	28 999
Compound Indicators	Units	EU-27	GCC	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE	World
TPES/ Population	toe/capita	3,31	7,82	11,97	10,8	5,29	16,91	6,22	12,96	1,8
TPES/ GDP	toe/ thousand 2000 USD	0,17	0,57	0,69	0,47	0,48	0,59	0,63	0,5	0,31
TPES/ GDP (PPP)	toe/ thousand 2000 USD	0,14	0,45	0,53	0,42	0,31	0,65	0,42	0,51	0,19
Electricity consumption/ Population	kWh/capita	6 070	9 900	13 625	16 673	5 457	16 353	7 842	17 296	2 729
CO <sub>2</sub> / TPES	t CO <sub>2</sub> /toe	2,16	2,56	2,41	2,68	2,59	2,37	2,6	2,47	2,39
CO <sub>2</sub> / Population	t CO <sub>2</sub> / capita	7,15	19,99	28,86	28,88	13,69	40,12	16,17	31,97	4,29
CO <sub>2</sub> / GDP	kg CO <sub>2</sub> / 2000 USD	0,38	1,46	1,67	1,27	1,23	1,39	1,64	1,25	0,73
CO <sub>2</sub> / GDP (PPP)	kg CO <sub>2</sub> / 2000 USD	0,30	1,14	1,27	1,11	0,79	1,55	1,1	1,26	0,45

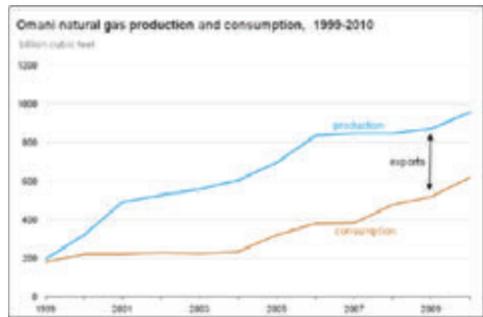
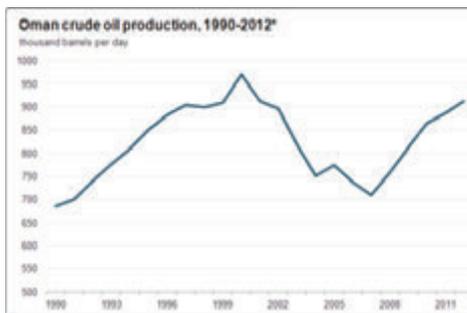
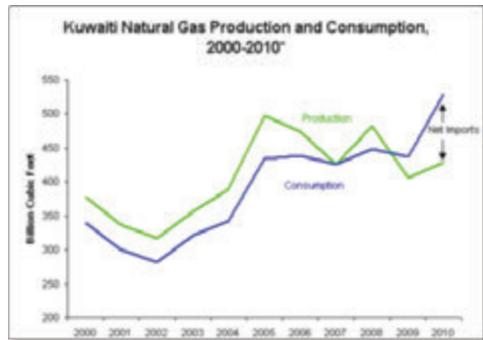
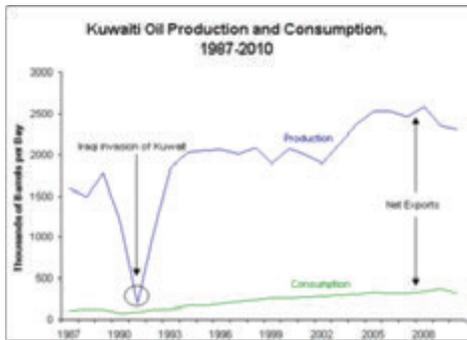
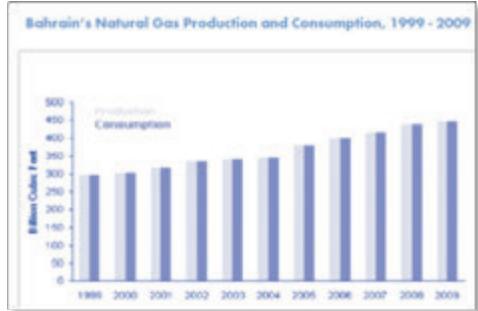
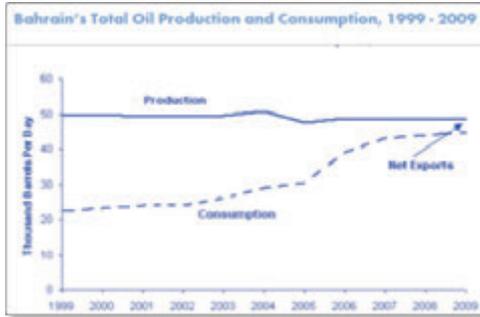
Source: International Energy Agency, 2009

\*Gross production + imports - exports - losses

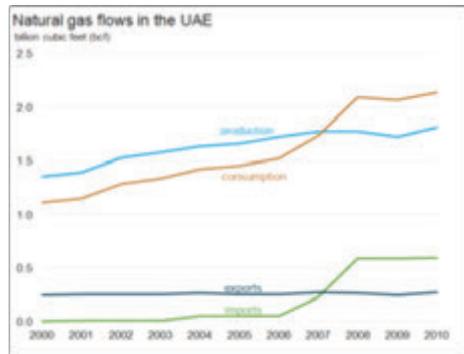
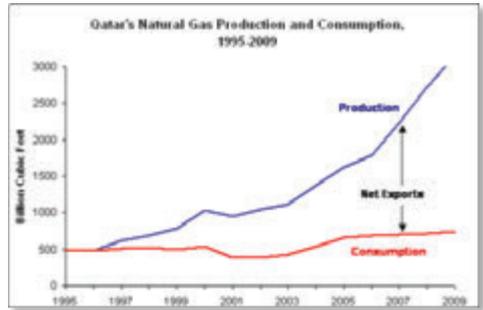
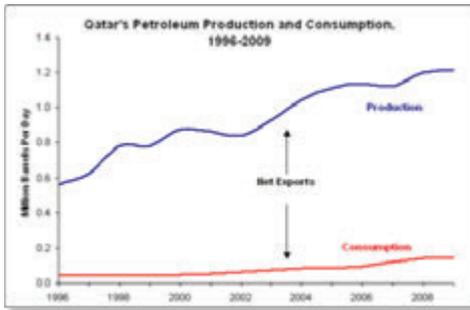
\*\*CO<sub>2</sub> - Emissions from fuel combustion only. Emissions are calculated using IEA's enerav balances and the Revised 1996 IPCC Guidelines.

Source: IEA, Key World Energy Statistics 2011, cit.

## ANNEX 22. CRUDE OIL AND NATURAL GAS PRODUCTION AND CONSUMPTION IN SOME GCC COUNTRIES

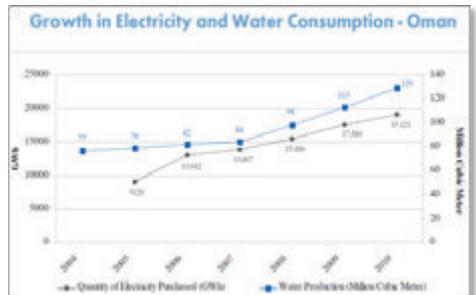
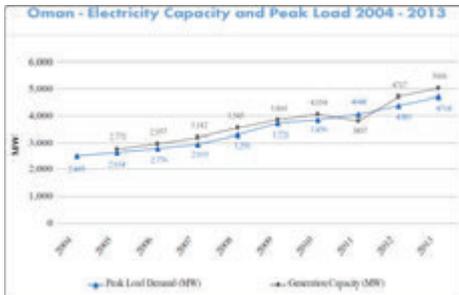
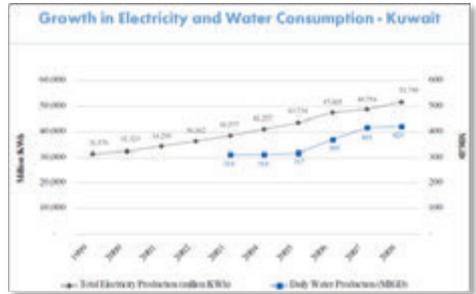
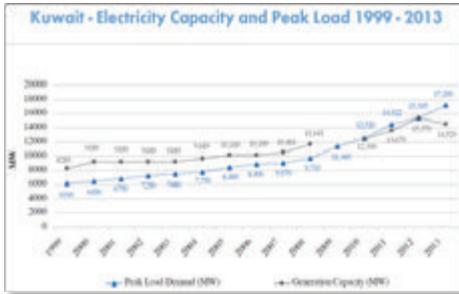
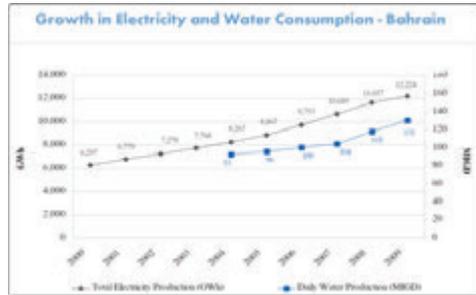
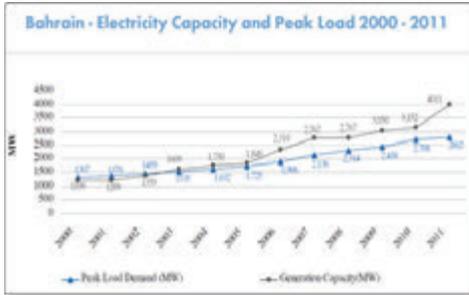


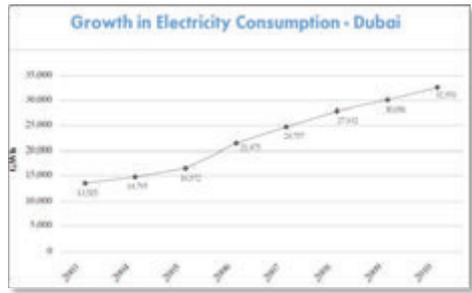
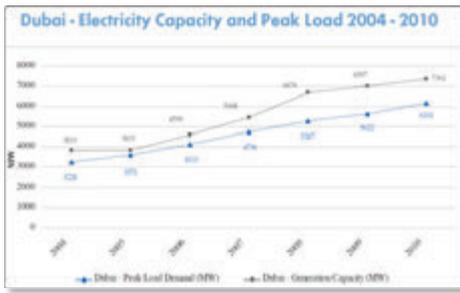
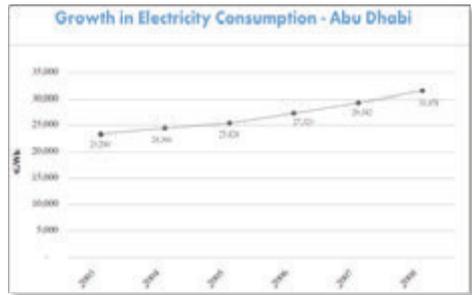
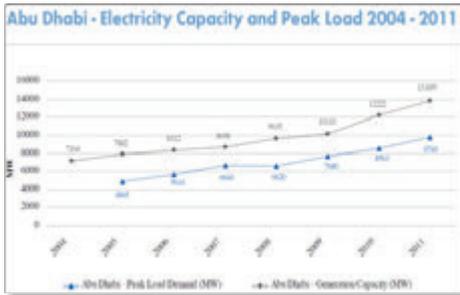
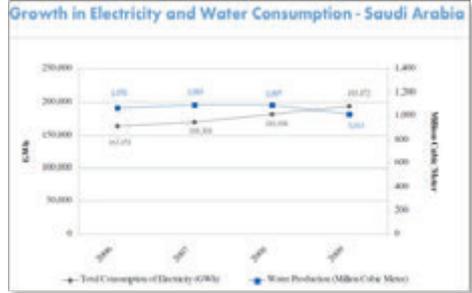
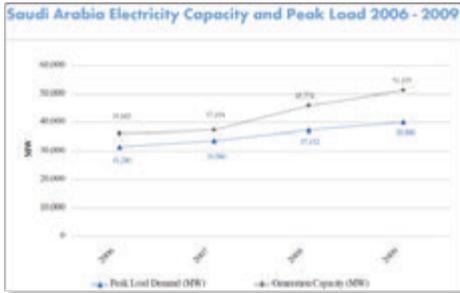
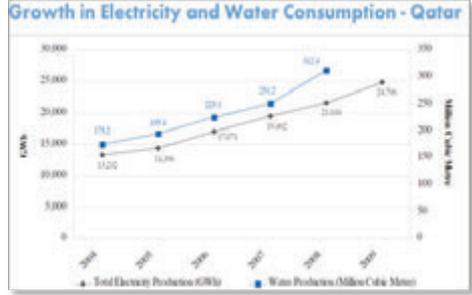
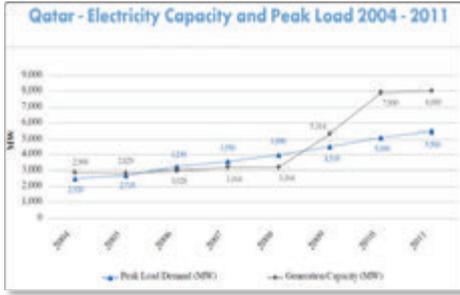
Papers, No. 39 (May 2007), <http://www.frider.org/publication/43/>.



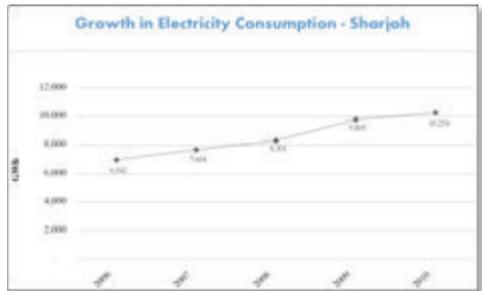
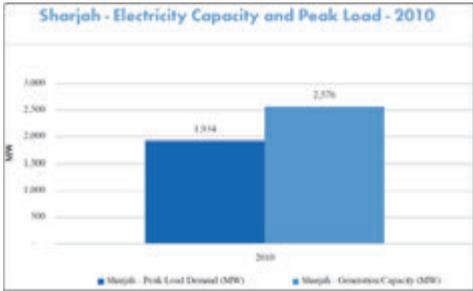
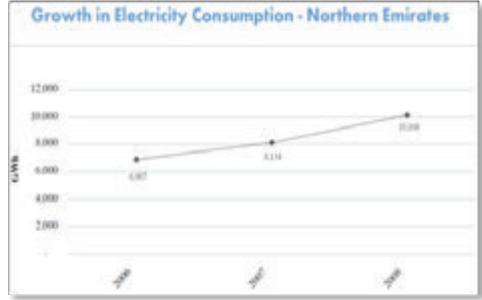
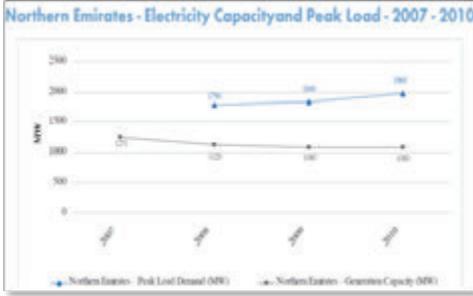
Sources: US Energy Information Administration, "United Arab Emirates", cit.; Imen Jeridi Bachellerie, *Renewable Energy in the GCC Countries*, cit.

# ANNEX 23. ELECTRICITY AND WATER CONSUMPTION GROWTH IN GCC COUNTRIES





ANNEXES



Source: Imen Jeridi Bachelier, *Renewable Energy in the GCC Countries*, cit.

## ANNEX 24. ELECTRICITY TARIFFS IN GCC COUNTRIES IN THE RESIDENTIAL SECTOR

<b>Abu Dhabi</b>			<b>Bahrain</b>		
Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
1 (Remote areas - UAE national)	3	0.82	1 - 3,000	3	0.80
			3,001 - 5,000	9	2.39
			>5,001	16	4.24
1 (other areas - UAE national)	5	1.36			
1 (Non-UAE national)	15	4.08			

<b>Dubai</b>			<b>Kuwait</b>		
Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
0 - 2,000	23	6.26	1	2	0.70
2,001 - 4,000	28	7.62			
4,001 - 6,000	32	8.71			
>6,001	38	10.35			

<b>Oman</b>			<b>Qatar</b>		
Consumption Slab [kWh]	LC Bz/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC Dh/kWh	USD \$ cent/kWh
1 - 3,000	10	2.60	1 - 4,000	8	2.20
3,001 - 5,000	15	3.90	>4,001	10	2.75
5,001 - 7,000	20	5.19			
7,001 - 10,000	25	6.49			
>10,000	30	7.79			

<b>Saudi Arabia</b>			<b>Northern Emirates (UAE)</b>		
Consumption Slab [kWh]	LC Bz/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
1 - 2,000	5	1.33	0 - 2,000	20	5.45
2,001 - 4,000	10	2.67	2,001 - 4,000	24	6.54
4,001 - 6,000	12	3.20	4,001 - 6,000	28	7.62
6,001 - 7,000	15	4.00	>6,001	33	8.99
7,001 - 8,000	20	5.33			
8,001 - 9,000	22	5.87			
9,001 - 10,000	24	6.40			
>10,000	26	6.93			

Source: OME based on national sources 2013.

## ANNEX 25. ELECTRICITY TARIFFS IN GCC COUNTRIES IN THE COMMERCIAL SECTOR

<b>Abu Dhabi</b>			<b>Bahrain</b>		
Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
1	15	4.08	any	16	4.24

<b>Dubai</b>			<b>Kuwait</b>		
Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
0 - 2,000	23	6.26	1	2	0.70
2,001 - 4,000	28	7.62			
4,001 - 6,000	32	8.71			
>6,001	38	10.35			

<b>Oman</b>			<b>Qatar</b>		
Consumption Slab [kWh]	LC Bz/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC Dh/kWh	USD \$ cent/kWh
			1 - 4,000	9	2.47
			4,001 - 15,000	12	3.30
NA			>15,001	14	3.84

<b>Saudi Arabia</b>			<b>Northern Emirates (UAE)</b>		
Consumption Slab [kWh]	LC Bz/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
1 - 2,000	5	1.33	0 - 2,000	20	5.45
2,001 - 4,000	10	2.67	2,001 - 4,000	24	6.54
4,001 - 6,000	12	3.20	4,001 - 6,000	28	7.62
6,001 - 7,000	15	4.00	>6,001	33	8.99
7,001 - 8,000	20	5.33			
8,001 - 9,000	22	5.87			
9,001 - 10,000	24	6.40			
>10,000	26	6.93			

Source: OME based on national sources 2013.

## ANNEX 26. ELECTRICITY TARIFFS IN GCC COUNTRIES IN THE INDUSTRIAL SECTOR

<b>Abu Dhabi</b>			<b>Bahrain</b>		
Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
1	15	4.08	any	16	4.24

<b>Dubai</b>			<b>Kuwait</b>		
Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
0 - 10,000	23	6.26	1	1	0.35
>10,001	38	10.35			

<b>Oman</b>			<b>Qatar</b>		
Consumption Slab [kWh]	LC Bz/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC Dh/kWh	USD \$ cent/kWh
From Sept to April	12	3.12	1	7	1.92
From May to August	24	6.23			

<b>Saudi Arabia</b>			<b>Northern Emirates (UAE)</b>		
Consumption Slab [kWh]	LC Bz/kWh	USD \$ cent/kWh	Consumption Slab [kWh]	LC fils/kWh	USD \$ cent/kWh
1	12	3.20	1	40	10.89

Source: OME based on national sources 2013.

## ANNEX 27. COMMENTARY ON THE HIGHER EDUCATION AND SCIENTIFIC RESEARCH COMPONENT OF THE JOINT ACTION PROGRAMME

<b>Areas of Cooperation in Higher Education</b>	<b>Proposed Mechanisms</b>	<b>Comments</b>
<p>1. Continue cooperation between EU and GCC at senior expert level.</p>	<ul style="list-style-type: none"> <li>• Establishment of a joint GCC-EU expert group to follow up and coordinate on a regular basis.</li>   <li>• Explore the possibility of cooperation between the European University Association and the GCC Committee of Heads of Universities.</li> </ul>	<ul style="list-style-type: none"> <li>• The official literature and media outlets consulted suggest that this expert group has not been established yet.</li>   <li>• Several high-level meetings have taken place over the last 5 years. However, these two incomparable bodies were not reported to have synthesised concrete collective cooperation measures. Perhaps they should start with designing the vision and desired outcomes for the EU-GCC cooperation in this field.</li> </ul>
<p>2. Enhance GCC participation in ERASMUS MUNDUS and Marie Curie Scientific Mobility Programmes. Universities shall select the fields deemed most appropriate and compatible with their bylaws and rules of procedure of the relevant Ministry of Higher Education.</p>	<ul style="list-style-type: none"> <li>• Promotion and awareness campaigns in the region.</li>   <li>• Explore possibilities for partnership between GCC and EU universities.</li> </ul>	<ul style="list-style-type: none"> <li>• Some progress has been made along this line.</li>   <li>• This aspect of the EU-GCC cooperation remains explorative with some isolated successes at the bilateral level.</li> </ul>

<p>3. Establish a sustained partnership between EU and GCC universities for co-operation in teaching Arabic language and Middle Eastern studies as well as European languages and studies under which universities will be open to receive specific modules and training.</p>	<ul style="list-style-type: none"> <li>• Study the possibility of increasing exchanges of students and faculty staff in Arabic language and Middle Eastern studies, as well as in European languages and studies.</li> </ul>	<ul style="list-style-type: none"> <li>• This aspect of the EU-GCC cooperation remains explorative and non-committal.</li> </ul>
<p>4. Establish and develop joint supervision programmes between GCC and EU universities through which scholarships would be granted to students of GCC universities to study in the EU in major fields that are important to the GCC States.</p>	<ul style="list-style-type: none"> <li>• Enhance and facilitate existing cooperation between GCC universities and distinguished EU universities with regard to joint supervision in higher education programmes.</li> <li>• GCC Secretariat will provide the list of recognized public and private universities in the GCC countries. The EU will provide a similar list.</li> </ul>	<ul style="list-style-type: none"> <li>• Very limited or no specific information is available on the progress made along this line.</li> <li>• A mere procedural step.</li> </ul>

<p>5. Cooperation with EU universities in developing academic programmes at GCC universities, focusing on new scientific specializations such as the peaceful use of nuclear energy, genetics, etc.</p>	<ul style="list-style-type: none"> <li>• Organise a workshop at one of the GCC universities (coordination could be made with Bahrain University to organise this type of workshop as the electronic learning centre is based there) wherein concerned universities from both sides can participate.</li> <li>• Organise workshops on best practices on these subjects.</li> <li>• Explore the EU's opinion on the assistance that EU universities can provide to GCC universities in the cooperative education provided by the EU universities.</li> <li>• Organise a workshop at one of the GCC universities (coordination can be made with King Abdulaziz University, King Saud University or the Arab Gulf University) in which representatives from universities on both sides can participate to identify cooperation opportunities.</li> </ul>	<ul style="list-style-type: none"> <li>• A passing reference to this step was found announcing the award of the grant to implement this step. No further details were found.</li> <li>• An explorative and non-committal step.</li> <li>• An explorative step. Several similar meetings were held, interesting findings were shared and a group of policy recommendations were deduced.</li> </ul>
<p>5.1. Call on the EU countries to develop a mechanism for exchanging e-learning expertise with the GCC universities.</p>	<ul style="list-style-type: none"> <li>• Organise workshops on best practices on this subject.</li> </ul>	<ul style="list-style-type: none"> <li>• Policy recommendations were developed.</li> </ul>

<p><b>5.2.</b> Call on the EU universities to establish partnerships with the GCC States in the field of cooperative education to enable exchange of expertise and give opportunities to the students from both sides to be exposed in the industrial and commercial training programmes.</p>	<ul style="list-style-type: none"> <li>• Explore the EU's opinion on the assistance that EU universities can provide to the GCC universities in the cooperative education provided by the EU universities.</li> </ul>	<ul style="list-style-type: none"> <li>• An explorative step. No further details were available.</li> </ul>
<p><b>5.3.</b> Call for cooperation with the EU universities to upgrade academic performance (university leadership level, teaching staff level or administrative level) through participation of the GCC universities in sharing best practices.</p>	<ul style="list-style-type: none"> <li>• Organise a workshop at one of the GCC universities in which representatives from universities on both sides can participate to identify cooperation opportunities.</li> </ul>	<ul style="list-style-type: none"> <li>• Intersects with earlier mechanisms identified above. Several such meetings were held.</li> </ul>

Areas of Cooperation in Scientific Research	Proposed Mechanisms	Comments
<p><b>1.</b> Achieve highest degree of cooperation between the GCC and EU universities and research centres in the joint research projects of applied nature through which knowledge and modern technology can be transferred from the EU countries to the GCC States in areas of importance to GCC countries such as: water related technologies (i.e., solar techniques applied to desalination), renewable energies (solar and wind), environment, bio-technology, nano-technologies and petrochemicals.</p>	<ul style="list-style-type: none"> <li>• Establish a GCC-EU science and technology policy dialogue to deal with the main issues of research, development and innovation.</li> <li>• Develop ways and means to ensure the participation of GCC researchers in the 7th EU Research Framework Programme through scholarships.</li> <li>• Provide opportunities to GCC researchers (via research cluster meetings) to participate in joint research projects undertaken by European research institutes with a view to upgrading their capacities and expertise.</li> <li>• Invite EU researchers to participate in certain research projects existing in the GCC States.</li> </ul>	<ul style="list-style-type: none"> <li>• Intersects with earlier mechanisms identified above.</li> <li>• Non committal. Cases of successful incorporation reported.</li> <li>• Non committal. Cases of successful incorporation reported.</li> </ul>
<p><b>2.</b> Open up the field for GCC universities and Research Centres to make use of the INCONET initiative for scientific research.</p>	<ul style="list-style-type: none"> <li>• Expand the participation of GCC universities and research centres to make use of this initiative.</li> </ul>	<ul style="list-style-type: none"> <li>• Non committal.</li> </ul>
<p><b>3.</b> Transfer of EU expertise in the field of establishing financing and managing research programmes to the GCC universities and national research centres, and establish a long-term relationship to foster those practices in research area.</p>	<ul style="list-style-type: none"> <li>• EU will provide background documents about its experience in this area at the earliest joint meeting between the two sides and will also organise a thematic seminar on this subject.</li> </ul>	

## ANNEX 28. QUESTIONNAIRES

### A. To the GCC

1. You are currently working...

In the GCC                      Outside the GCC

2. How is the EU region featured in the GCC media?

Positively                      Balanced                      Negatively

3. What are the main sources of information that you rely on to gather news about the EU region?

News agencies	Reporters in the region	Public publications
Private publications	TV channels	Social media
Acquaintances	Other	

4. What are the main areas of interest about the EU region shown in the GCC region's media?

Politics	Social	Business
Sports	Culture	Fashion
ICT	Other	

5. How do you describe the way your region is being featured in the EU region's media?

Positively                      Balanced                      Negatively

6. How interested are the journalists from the GCC in reporting on the EU region?

Very interested                      Somewhat interested                      Not interested

7. How balanced, accurate, and objective are the reports about your region in the EU media?

Very	Somewhat	Not balanced, accurate, or objective
------	----------	--------------------------------------------

8. How balanced, accurate, and objective are the reports about the EU in the GCC media?

Very	Somewhat	Not balanced, accurate, or objective
------	----------	-----------------------------------------

9. What are the different organizations that can play a role in bridging the gap between the EU & GCC journalists to help them report more comprehensively and accurately on the other region?

Civil society organizations      Embassies      Educational institutes  
Private Sector (business)      Media houses      Other  
(please specify)

10. What is your impression of the EU region?

Very good      Good      Average  
Negative      No impression

11. Have you ever been to the EU region?

Yes      No

12. How many times have you been to the EU?

1-2      3-5      6-10  
More than 10 visits      Not Applicable

13. What was the nature of your visit?

Official      Personal      Both      Not applicable

14. Have you ever been in touch with EU citizens?

Yes      No

15. How often do you read or follow EU channels?

Always      Often      Sometimes  
Rarely      Never

16. How often do you rely on social media (Facebook, Twitter, blogs, YouTube, etc.) to form an opinion about certain issues taking place in the EU?

Always      Often      Sometimes  
Rarely      Never

17. Do you speak any of the EU languages?

Yes      No

## B. TO THE EU

1. You are currently working...

In Europe                      Outside Europe

2. How is the GCC region featured in the EU media?

Positively                      Balanced                      Negatively

3. What are the main sources of information that you rely on to gather news about the GCC region?

News agencies                      Reporters in the region                      Public publications  
Private publications                      TV channels                      Social media  
Acquaintances                      Other

4. What are the main areas of interest about the GCC region shown in the EU region's media?

Politics                      Social                      Business  
Sports                      Culture                      Fashion  
ICT                      Other

5. How do you describe the way your region is being featured in the GCC region's media?

Positively                      Balanced                      Negatively

6. How interested are the journalists from the EU in reporting on the GCC region?

Very interested                      Somewhat interested                      Not interested

7. How balanced, accurate, and objective are the reports about your region in the GCC media?

Very                      Somewhat                      Not balanced, accurate,  
or objective

8. How balanced, accurate, and objective are the reports about the GCC in the EU media?

Very                      Somewhat                      Not balanced, accurate,  
or objective

9. What are the different organizations that can play a role in bridging the gap between the EU & GCC journalists to help them report more comprehensively and accurately on the other region?

Civil society organizations	Embassies	Educational institutes
Private Sector (business)	Media houses	Other (please specify)

10. What is your impression of the GCC region?

Very good	Good	Average
Negative	No impression	

11. Have you ever been to the GCC region?

Yes	No
-----	----

12. How many times have you been to the GCC?

1-2	3-5	6-10
More than 10 visits		Not Applicable

13. What was the nature of your visit?

Official	Personal	Both
Not applicable		

14. Have you ever been in touch with GCC citizens?

Yes	No
-----	----

15. How often do you read or follow GCC channels?

Always	Often	Sometimes
Rarely	Never	

16. How often do you rely on social media (Facebook, Twitter, blogs, YouTube, etc.) to form an opinion about certain issues taking place in the GCC?

Always	Often	Sometimes
Rarely	Never	

17. How do you describe the way your region is being featured in the GCC region's media?

Positively	Balanced	Negatively
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## **ANNEX 29. LIST OF FEDERATIONS AND ASSOCIATIONS CONTACTED FOR PARTICIPATION IN THE SURVEY**

Gulf Press Association  
Dubai Press Club  
Bahrain Journalists Association  
Saudi Association for Media & Communication  
Kuwaiti Journalists Association  
Doha Centre for Media Freedom  
European Journalists Association  
German Journalists Federation  
The British Association of Journalists

Apart from the above-mentioned organizations, individual reporters and editors in both regions were contacted via email, Facebook, LinkedIn, or their personal website.

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