Asia’s Booming Ties with the Gulf

By Samir Pradhan
A FUNDAMENTAL QUESTION posed by the on-going global financial crisis is whether it heralds the beginning of yet another so-called New World Order, a fundamental structural reshaping of the international environment. This possibility was vividly manifest in the Group of 20 (G-20) nations summit held on April 2, where emerging powers such as China, India and Saudi Arabia, sat together with the leaders of the developed world to consider strategies to cope with the financial meltdown. The summit illustrated how the international power constellation is being transformed from the post-Cold War Pax Americana into something more inclusive.

A new geo-economic space is taking shape that includes major emerging powers, production and consumption centers and financial capitals. The network of relationships between Asia and the countries of the Persian Gulf are indicative of the changes underway. The Gulf Cooperation Council (GCC), which includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE), is a key player, given its oil-rich status and importance to energy-thirsty new powers like India and China.

While critics may argue that the global economic slowdown is evidence that the world has not yet decoupled from American capitalism, the situation would have been much worse if emerging markets were not robust centers of growth. Importantly, this new geo-economic space is laying the foundation for a new geopolitics based on the converging interests of Asia and the GCC. It is also simultaneously generating a rethinking

In one respect above all, Asia and the countries of the Gulf are a match made in heaven: the former accounts for the bulk of the world’s growth in oil demand, while the latter dominates world oil exports.

But as Samir Pradhan, an expert in Gulf-Asia relations, argues, the links between the two regions go much deeper than oil.

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of the regional security architecture from the point of view of the respective roles to be played by these regional powers alongside major world players. The robust relations between Asia and the GCC also reflect rapidly changing international relations in the post-September 11 world.

EMERGING POWERS WITH RESILIENT GROWTH

The phenomenal rise of Asia and the Gulf is one of the hallmarks of the present century. High economic growth rates combined with substantial financial liquidity have given these two regions substantial bargaining power in world financial markets. It is not just their increasing global role, however, but also the growing ways they complement each other that are reshaping their relations. These two regions are poised to become major global economic players in a reshaped world.

In the last five years, emerging Asia and the GCC countries have registered the fastest economic growth rates in the world. While Asia's growth largely consists of export oriented manufacturing and a huge domestic consumption base, GCC's growth is based on petroleum and energy-based exports such as petrochemicals and energy services. Moreover, the two regions have reinforced one another's growth in recent years. Despite the current economic slowdown, growth rates in Asia and the GCC are expected to continue to outpace the rest of the world.

The simultaneous rise of Asia and the GCC has given them unprecedented clout in the global economy, largely based on the sheer volume of liquidity at their disposal. Given the high oil prices of the past five years, the Gulf is flush with cash. The GCC's collective annual current-account surplus — a picture of the region's annual net saving — has risen from $25 billion in 2002 to over $200 billion. International reserves have also mushroomed, doubling to $98 billion in 2007 from $51 billion in 2002. The six members of the GCC are the largest source of petrodollars, with between $1.6 trillion and $2 trillion in total foreign assets.

Simultaneously, Asian central banks have become global financial giants with $3.1 trillion in foreign reserves at the end of 2006. Soaring trade surpluses in the region combined with government monetary policies have fueled this growth, which are concentrated in the hands of a few players. The central banks of China and Japan had $1.1 trillion and $875 billion in foreign reserves, respectively, at the end of 2006. The next largest foreign reserve holders — Hong Kong, India, Malaysia, Singapore, South Korea, and Taiwan — together held nearly $1 trillion.

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Asia and the GCC have tripled, and much of the incremental demand for Gulf exports going forward — not just for oil and gas but also petrochemicals, base metals and services such as finance and tourism — are coming from Asia. In 2008, GCC-Asia trade stood at a staggering $480 billion. Asia is the largest trading partner for the GCC, accounting for 51 percent. It is also important to note that trade between the two regions is largely based on export-import complementarities, suggesting increasing economic interdependence and convergence in the future.

There is also greater intra-regional trade within Asia and the GCC, although at a somewhat lower level among GCC countries. The GCC is rapidly becoming a global trading bloc with total merchandise trade of nearly $874 billion in 2007. The GCC's world trade increased by an annual rate of 27 percent between 2003 and 2007. Although intra-GCC trade is still relatively low — with exports of $46.6 billion in 2007 — it is increasing at a brisk pace, growing at an annual rate of 32.4 percent between 2003 and 2007.

These trends imply that GCC economic integration is maturing slowly and intra-GCC trade is mostly concentrated on exports. This means Gulf countries will continue to depend on imports from outside the region, a fact that helps to account for the growth in imports from Asia. Importantly, GCC countries are entering into preferential trading arrangements with major Asian countries. One of the major landmarks is the GCC-Singapore Free Trade Agreement, which was concluded on January 31, 2008. This milestone could serve as a catalyst for other FTAs under discussion with China, India, Pakistan, Japan, Malaysia and South Korea, among others.

BELT AND ROAD: WEALTH-OFFERTUNITY LINKAGE

Another important factor driving ties are wealth-opportunity linkages. GCC foreign assets are estimated to have exceeded $900 billion in the five years ending June 2008, with US-based assets (equities, debt and deposits) accounting for more than one-third of Gulf investment. But an estimated $60 billion worth of GCC investment strategies. With typically longer investment horizons than traditional Western investors, GCC and Asian nations have been successful in pursuing high returns and have become major international investors and exporters of surplus capital, especially to finance US government deficits.

REORIENTING THE ‘NEW SILK ROAD’

While trade between the Gulf and Asia has an ancient history dating back to the Silk Road, it has increased substantially in recent years. In the past five years, trade volumes between the Gulf and Asia have tripled, and much of the incremental demand for Gulf exports going forward — not just for oil and gas but also petrochemicals, base metals and services such as finance and tourism — are coming from Asia. In 2008, GCC-Asia trade stood at a staggering $480 billion. Asia is the largest trading partner for the GCC, accounting for 51 percent. It is also important to note that trade between the two regions is largely based on export-import complementarities, suggesting increasing economic interdependence and convergence in the future.

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went into Asia, and that is likely to increase. In the last few years, there has been a change in the investment patterns preferred by GCC investors from capital preservation to yield maximization. This has led to a greater emphasis on portfolio diversification and an appetite for riskier assets, as well as a preference for direct management of assets rather than outsourcing them to international financial institutions.

Moreover, Gulf investors still face an array of constraints and barriers to investment in the West, especially after the September 11 attacks — from official obstructionism to regulatory hurdles to difficulties in finding quality assets. As a result, Asia has become a logical alternative.

Gulf investors are looking for strategic investments in key sectors such as petrochemicals, logistics, tourism, mining, agriculture and renewable energy, which are not cyclical and can assure sustainable returns. Opportunities for investments in these areas in a number of Asian countries have become attractive for GCC investors.

SYNERGY IN ENERGY
Energy is the most dominant item in GCC-Asia trade. The regions constitute the two strategic building blocks of the current global energy regime as major producers and consumers of energy. There are major areas of common interest in the future of global energy supply and demand,
the structure of international oil and gas markets, price developments, technology and legislation. There are also opportunities for cooperation and cross investment between national oil companies, which is one example of changing international oil and gas diplomacy.

Barring cataclysms, it is certain that market fundamentals will continue to influence oil prices. In the last decade or so, the demand-supply configuration of the world oil market has undergone substantial changes. The industrialized West is no longer the main growth center, a position now held by the burgeoning economies of the developing world, especially those in Asia. While the developed industrialized economies still consume a disproportionate share of world energy — with North America accounting for about half of total oil use — it is the newly industrialized countries and oil producers that account for the recent rapid growth in demand. Asia and the Middle East together accounted for 60 percent of the increase in petroleum use between 2003 and 2007, while North America and Europe accounted for only 20 percent.

The most dramatic growth in oil demand has come from China, whose petroleum consumption between 1990 and 2007 increased at a 7.2 percent annual compound rate. If that were to continue, China would be using 20 million barrels a day by 2020, about as much as the US is today. By 2030, China would be up to 40 million barrels a day, twice current US consumption.

On the supply side, the Organization of Petroleum Exporting Countries (OPEC) still provides about 42 percent of world supply and holds about 70 percent of proven oil reserves. A number of non-OPEC producers and exporters also have successfully entered the supply arena. Russia has become an important oil exporter as have several African countries. OPEC, of course, tries to maintain spare capacity in order to influence crude oil prices. In recent years, its policy has been to balance the market while allowing for an “appropriate” level of crude oil inventories in consuming nations. Non-OPEC producers, on the other hand, often have relatively limited reserves and spare capacity, and generally behave as price takers. The most important fact is that OPEC in general and the GCC in particular will continue to be the main source of oil exports for Asia. In 2008, the GCC accounted for 43.3 percent and 16.1 percent, respectively, of the world’s total crude oil and product exports, while Asia accounted for 41 percent and 39 percent, respectively, of the world’s total crude oil and product imports.

Moreover, OPEC’s export markets have been transformed significantly, with Asia replacing the industrialized world as the main market for GCC oil exports. While Gulf oil exports to Asia have registered a two-fold increase, from 5.2 million barrels per day (mb/d) in 1980 to 10.3 mb/d in 2007, they decreased from 6.8 mb/d to 2.1 mb/d for Western Europe and stagnated at 2 mb/d for North America during the same period. Asia now accounts for nearly 66 percent of the Gulf’s total crude oil exports. If one includes oil product exports, Asia’s share increases to nearly 70 percent.

Of late, energy security interdependence has become one of the central elements of the global economy, pointing to the importance of demand security for the Gulf and supply security for Asia. The 1997 Asian economic crisis and the 2008 global financial crisis are two events that testify to the vulnerabilities of oil exporting countries struggling with sudden drops in demand that can lead to supply disruption. A clear case for interdependence thus exists between the GCC and Asia in the energy sector. This is paving the way for mutual cooperation in a variety of energy investment proposals — cross border pipelines, upstream-downstream bilateral investments (oil-gas prospecting, refining) and initiatives like the Asian Roundtable Dialogue of Producers and Consumers.

Besides the petroleum sector, petrochemicals and other oil-based products represent another area of increasing interdependence. A shift is taking place in the petrochemical business from the West to the East, with the Gulf region emerging as a major player. With the center of gravity of the world petrochemical industry fast moving toward the lowest-cost production centers to meet increasing demand from high-growth markets in the East, the Gulf has become the first choice for strategic investment in this area and is poised
to be the largest producer and exporter of petrochemicals, especially ethylene and its derivatives. The region’s increasing global presence is primarily based on its comparative advantages of low-cost feedstock and labor, innovative technologies, state-of-the-art infrastructure and strategic location at the crossroads between the vast Asian market and the rest of the world. While petrochemical market leaders in the West, especially in the US, are struggling to cope with rising costs and financial distress, the Gulf players are vying to increase their global market share by focusing on demand from Asia. By 2012, the Gulf region is expected to account for nearly 20 percent of total world production of petrochemicals. For the time being, though, with the ongoing financial crisis, low demand for petrochemicals and aluminium from Asia (especially China) has affected all the major GCC exporters, many of which have incurred financial losses.

**FOOD SECURITY: ASIA, THE GULF’S RICE BOWL**

Food security is another important aspect of Gulf-Asia interdependence. Insufficient cultivable lands, an arid climate and scarce water, among other constraints, handicap agriculture in the Gulf. The result is overwhelming dependence on food imports. In recent years, food security has become a crucial challenge in the Gulf. The so-called “food gap” in the GCC (the difference between what it produces and what it consumes) in recent years has gone up substantially due to growing populations (currently 37 million and projected to be 65 million by 2020). The GCC’s food imports have increased from $6 billion in 1990 to $9 billion in 2000 and to $17 billion in 2006.

Moreover, food constitutes a major source of imported inflation as import dependency will reach 60 percent in the arid GCC countries by 2010. In Saudi Arabia, for example, about 15 percent of all imports are food items. The amount spent on food in the GCC is roughly 10 percent to 20 percent of disposable household income. With double digit inflation and soaring international prices, as well as trade restrictions in major exporting nations in Asia, food insecurity

The last few years have seen numerous joint ventures and mergers and acquisitions between GCC entities and Asian companies in the areas of infrastructure, construction and downstream oil projects.

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Concerns have heightened. Therefore, GCC governments are trying to secure physical access to food through farmland purchases, investments in agri-businesses and locking in long-term supply agreements with exporters.

Because of Asia’s rich agricultural resources, it is a traditional source for GCC food imports. Countries like India, Pakistan, Thailand, the Philippines, Bangladesh, Sri Lanka and China are the main suppliers of rice, wheat, sugar, and live animals. When Thailand, India and Pakistan imposed rice export restrictions in 2007, worries mounted in the GCC and the region is now in the process of negotiating bilateral agreements to secure supplies from Asia. Nevertheless, the Gulf’s dependence on Asia for food is likely to increase in coming years.

Political and Security Relations: Converging Interests

Despite historical links between the Gulf and Asia, relations have remained low profile until recent years. Because they were largely confined to commercial and economic exchanges, the relationship was primarily based on mutual respect and non-interference. Like other powers, Asian nations piggybacked on America’s overwhelming presence in the region, while the Gulf regimes never viewed Asia as a major international power. Above all, the US presence and regional political frictions allowed for little diplomatic elbowroom for Gulf and Asian countries to engage each other politically. The irony is that this continued alongside a pragmatism that endorsed economic and commercial engagement.

The end of the Cold War, the occupation of Iraq, the Talibanization of Afghanistan, political instability in Pakistan and the spread of transnational terrorism are all factors that contributed to a slow but perceptible change in the Gulf region’s views about Asia. Added to this was the constrained international environment for Gulf countries in the aftermath of the September 11 attacks at a time when they found themselves with increasing financial surpluses in search of profit-making outlets.
At the same time, the current strategic environment in the Gulf region is becoming increasingly unpredictable, with local, regional and global implications. With windfall capital surpluses and vibrant economic growth (the effects of the global financial crisis notwithstanding), the region is witnessing unprecedented changes in the social, political, economic, cultural and strategic realms. What is also emerging is an increase in anxiety among GCC citizens about the future because the region’s security and strategic environment is in a state of flux. Iran’s increasing military posture and Israel’s policies in the East Mediterranean constitute twin strategic fault lines for the Gulf. The turmoil in Iraq, which used to be a countervailing power to Iran, further adds to the security risks. Above all, America’s Israel-centric policies are viewed as distorting the US’s strategic perceptions.

Increasingly, Gulf countries are looking to Asia, which they see as a major world power in the neighborhood, as a reference point in their quest to manage their evolving security needs. This change of perception in which Asia is increasingly viewed as a credible non-partisan global actor that can play a constructive role in managing conflicts and restoring peace and tranquility in the region. This view is perhaps primarily driven by the Gulf’s eastward shifting economic engagements and trade and investment linkages with Asia.

A clear strategic rethink is underway in the Gulf. Partly this is due to the increasing internationalization of the Gulf, but it is also due to a reorientation — one might say, a process of introspection — by the Gulf countries concerning their place in the international system and the role played by the US. Given the multidimensional security environment in the region — from the threat posed by Islamic radicalism and Iranian nuclear shenanigans to concerns about Iraq, Israel’s expansionary and strong-arm tactics, securing supply lines for oil exports and the role of Gulf finance in world economics — the Gulf regimes no longer feel safe in the comfort zone of an American security umbrella. As a result, they are reexamining ways of securing their national interests in the face of volatile regional events. Increasingly, the GCC’s geo-economic interests are playing a major role in how the region envisions its future security needs alongside traditional power politics and geopolitical concerns.

Especially in the security domain, the Gulf countries are increasingly sensing that US-led bilateralism will no longer meet the requirements of a multi-polar world. Furthermore, GCC leaders are anticipating a declining role for the US. Bahrain’s Minister of State for Foreign Affairs, Mohammad Abdul Ghaffar, has, for example, called for a new security order in the Gulf with the GCC states as the main pillar of defense, while Qatar’s Emir Shaikh Hamad bin Khalifa Al-Thani told the General Debate of the United National General Assembly in September 2007 that: “The major conflicts in the world have become too big for one single power to handle them on its own.”

Nevertheless, one thing is certain: the complete removal of external powers from the region is not possible. There is no regional security architecture and plenty of distrust among states in the region (consider, for example, the continuing problem of border disputes). Besides, given the global strategic importance of the Gulf region, outside powers aren’t about to walk away. Thus, the key task before the Gulf countries is to multilateralize regional security with the involvement of other powers, especially major Asian countries, with which the Gulf states share important geo-economic relations.

With converging economic interests, both regions have a formidable stake in securing these interests. A case in point is the crucial Indian Ocean where the Gulf’s oil exports travel, an area that is vulnerable to piracy and terrorism. As a result, both regions have started to cooperate actively in security and political matters in recent years. The continuous exchange of high profile visits by both sides points to the growing mutual concerns and the shift to a strategy of security cooperation and enhanced political relations.

It may be noted that the former Indian Prime Minister Indira Gandhi and former UAE President Shaikh Zayed bin Sultan Al Nahyan first pronounced the connection between security and stability in the two regions back in 1981. In recent years, several Gulf countries — notably, Bahrain, Oman, Qatar and the UAE — have concluded a
As Asia and the Gulf deepen their already robust economic relations, their political and strategic relations are likely to follow a similar path. With growing economic ties, however, the trend toward closer relations across a broad front is well underway. The “Look East” strategy of the Gulf provides an impetus for closer relations. Since a sustainable relationship entails multifaceted cooperation, both regions should look for a viable interregional framework to intensify the level of engagement. A case in point is a post-crisis economic structure that makes it imperative for both Asia and the Gulf to deepen economic cooperation in order to diversify risk and share benefits. Also, a natural development of increasing economic interdependence should be enhanced strategic relations between the two regions. This, too, requires an interregional framework. In this regard, an initiative like the Asia-Middle East Dialogue started by Singapore a few years back should be reenergized at the earliest.

Samir Pradhan is a senior researcher, Gulf-Asia Program, at the Gulf Research Center, Dubai. His areas of expertise include Gulf-Asia interdependence, energy security, regionalism, and the geopolitics and geo-economics of the Gulf and Asia. He can be contacted at spradhan@grc.ae.

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