MORE THAN OIL

Economic Developments in Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates

Australian Government
Department of Foreign Affairs and Trade
Economic Analytical Unit

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The Economic Analytical Unit is staffed with six economists and has produced 41 major reports since its establishment in 1990. Executive Summaries of recent reports, electronic copies of many previous reports and information on how to purchase reports are on the Unit's website.

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EXECUTIVE SUMMARY

Business in the Gulf is booming. And it's not just the oil sector. The economies of Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates have been carrying out reforms to encourage private sector growth and diversify their economies away from oil. While oil remains the dominant sector, oil revenues are being channelled into economic development projects, developing new sectors and attracting a variety of businesses.

The five economies covered in this report – Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates – are home to a population of around ten million people, with a combined GDP of around US$170 billion in 2003, roughly the size of the New South Wales economy. In recent years, they have achieved impressive economic growth – Qatar's per capita GDP now rivals some of the wealthiest countries in the world.

The economies remain highly dependent on oil and gas revenues. The United Arab Emirates and Bahrain are the most diversified economies of the five, and the emergence of the gas industry in Qatar, home to the third largest known reserves of natural gas in the world, has helped the country supplement volatile oil revenues with more stable gas revenues.

Other sectors are emerging. The five governments recognise the need for further diversification and are actively encouraging new industries. The services sector, particularly tourism and financial services, is a key sector in a number of the economies. Energy intensive industries, such as aluminium smelters and fertiliser plants, are also being developed.

Some key challenges remain. Stable economic growth has been difficult because of fluctuating oil prices, and would be assisted by further diversification. Oil and gas revenues continue to be the dominant source of investment funds and significant downturns in price would affect growth. National populations are expanding rapidly but, with private sector labour markets dominated by expatriate workers, finding new avenues of employment for national citizens inside or outside the public sector is a challenge.

RESPONDING TO THE CHALLENGES

Governments are reassessing the large roles which they play in their economies. All five countries, to varying extents, have embraced privatisation as a key tool to increase private sector involvement. Foreign investment restrictions are being relaxed to allow greater levels of foreign ownership, real estate is becoming available for foreigners to buy, a number of taxes targeting foreign companies over local companies are changing and agency laws are being reviewed.

Regional integration, if achieved, should eventually make it easier to do business in the region. The Gulf Cooperation Council (GCC), which also includes Saudi Arabia, is developing as a regional market. The GCC now has a common external tariff, generally five per cent but with a number of exemptions, and has set a goal of monetary union by 2010. The GCC is also attempting to gradually remove other barriers to regional trade and harmonise regulations, but full integration is still some time off.

Despite reforms, a number of obstacles to doing business remain. These include import licensing, product standards, government procurement, business dispute resolution processes, national citizen employment quotas and the remaining foreign investment restrictions and agency laws.

AUSTRALIA – LINKING WITH THE REGION

Australia's trade with the five economies has increased significantly. Exports to these economies have grown more than twice as fast as Australia's total exports to the world over the last ten years. These economies will continue to offer trade opportunities, particularly with the total value of their imports from the world increasing by around 85 per cent over the last five years.

The United Arab Emirates is easily Australia's largest trading partner among these economies, with two-way trade in goods and services valued at over A$3.7 billion in 2004. But the four other economies are also important export destinations – in 2004 Australia exported over A$1.1 billion worth of goods to Bahrain, Kuwait, Oman and Qatar.

Merchandise trade

Automotive exports of around A$700 million are Australia's largest single export item to the five economies, having grown from almost nothing since 1995. Other manufactured exports include telecommunications equipment, car parts and construction-related products.

Australia also exports minerals and agricultural goods, particularly alumina, wheat, meat and livestock, and dairy products. More frequent air connections between Australia and the Gulf have also enabled the export of other agricultural products, such as fresh food. With the region's growing populations and limited domestic production capacity, these export markets are set to expand.

Services trade

Australian exports of services to the five economies include construction-related services, tourism and education, which have been growing at a fast rate, albeit from a low base. The number of tourists from these economies increased by 30 per cent in 2004 to reach almost 30 000 visitors, of which two-thirds were from the United Arab Emirates. Although relatively small in number, these tourists are important as, on average, they spend nearly six times as much as other international visitors.

An increasing number of students from the region are choosing Australia as an education destination. There is potential for further growth as Gulf students look for alternatives to education in traditionally popular destinations and governments focus on education to increase local skills and address employment problems.

Australian education institutions are also becoming active in the region. Institutions such as the University of Wollongong, the University of Southern Queensland and the Hawthorn English Language Centre have established a presence and a number of other Australian education institutions are conducting specific training courses or project work.

Australians tapping into the construction market

Construction-related industries are booming and Australian companies are tapping into this growth. Rising oil revenues have allowed governments to sustain increased capital expenditures to help fuel the surging construction industry. Dubai leads the construction boom, particularly with its appetite for mega-projects often valued in the billions of dollars, but new developments in tourism sectors, increased infrastructure requirements, and the needs of energy-related industries are delivering opportunities across the region. Australian companies are constructing hospitals, redeveloping airports, building mega-projects and supplying building products. Although competition is tight, the market continues to offer opportunities.

LOOKING AHEAD

Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates are facing different futures. The United Arab Emirates, particularly Dubai, has been the regional leader in reforms encouraging private business, but competition, both within the United Arab Emirates and from other economies, is increasing. For Bahrain and Oman, development of non-oil sectors is a more urgent priority as they manage dwindling oil reserves. Kuwait's abundance of oil and gas reserves may act as a restraint on reforms, but provides it with substantial revenues to invest and develop new sectors; Qatar's growing gas revenues are likely to support a number of development plans.

To varying extents, all these economies are focusing on development paths that rely less heavily on oil revenues to provide growth and employment. As they attempt to move away from oil dominated economies, further business opportunities, such as those in education and construction, are likely to emerge. Australia's negotiation of a Free Trade Agreement with the United Arab Emirates is likely to facilitate trade with the region and focus attention on Australian commercial capabilities.

ECONOMIC OVERVIEW

KEY POINTS

- The economies of Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates have achieved impressive growth in recent years thanks to high oil prices and strengthening non-oil sectors.

- Oil revenues remain the greatest contributor to this growth. Oil is the primary export and main source of government revenue in all five economies, including the more diversified economies of Bahrain and the United Arab Emirates.

- Many economies in the region are benefiting from the emergence of gas as an alternative fuel. Qatar, with the single largest non-associated gas field in the world, has plans to become the world's largest exporter of liquefied natural gas.

- Non-oil sectors have also been developing. The services sector continues to be a large sector, with tourism, real estate and financial services all showing strong expansion. The face of the region is changing dramatically as construction of new projects continues.

- Government involvement in each economy remains strong. In recent years, governments have been the primary employer of their nationals and the major source of investment for business.

- Diversification away from oil is a key priority. Governments are seeking growth paths which will eventually be less reliant on government initiatives funded by volatile oil revenues.

- Population growth in the region is among the highest in the world, resulting in a young population – over half the total population is under 30.

- A major challenge facing the Gulf states, as large numbers of their nationals reach working age, is the creation of job opportunities and a workforce with the skills to seize those opportunities.

- Although total employment is increasing, expatriates, who constitute around 90 per cent of the workforce in the United Arab Emirates, are primarily benefiting from this employment growth.

Gulf countries have more to offer than oil. The economies of Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates have instituted reforms to encourage private sector growth and diversification away from oil. Oil remains the dominant sector, but the wealth created from high oil prices is being channelled into economic development projects in an attempt to create a more stable basis for economic growth and employment. Unlike the poor perceptions many people have of the Middle East region, these five economies have achieved impressive economic growth in recent years. If political and social stability continues, they will continue to provide good opportunities for business in generally welcoming environments.

Saudi Arabia has also initiated a number of reforms similar to some of those outlined in this report as it seeks accession to the World Trade Organization and as a leading member of the Gulf Cooperation Council (GCC). It is the largest economy in the region and an important trading partner for Australia. However, it has an economy substantially larger than the combined economies of the five countries covered in this report.[1] It is therefore not included in this report, to allow a more thorough analysis of the other economies, which also are important trading partners. A previous report from the Economic Analytical Unit (then the East Asia Analytical Unit), *Accessing Middle East Growth: Business Opportunities in the Arabian Peninsular and Iran* (2000) includes analysis of Australia-Saudi Arabia trade.

RECENT ECONOMIC PERFORMANCE

Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates collectively have a population of just over ten million people, yet the group's economy is larger than that of many other more populous Middle East economies. With a combined GDP of around US$170 billion in 2003 – roughly the size of the New South Wales economy – they exceed the combined economies of Egypt, Jordan, Lebanon, Libya, Syria and Yemen, which encompass over 120 million people. Moreover, the five economies[2] possess substantial offshore investment portfolios not captured in GDP statistics – the Abu Dhabi Investment Authority alone is estimated to have a portfolio of over US$400 billion.

High oil prices in 2003, 2004 and continuing into 2005, reaching over US$50 per barrel in 2005, have benefited all five economies.[3] Increasing oil revenues have helped create fiscal surpluses and large current account surpluses (Table 1.1). In addition to high oil prices, non-oil sectors have helped drive impressive economic growth. Indeed, one of the region's most diversified economies, the United Arab Emirates, has achieved an average nominal GDP growth of 8.1 per cent per year from 1993 to 2001, with the non-oil sectors averaging a growth rate of 9.6 per cent per year (HSBC, 2003a). The emergence of Qatar's gas industry has also fuelled impressive growth rates, with an estimated nominal GDP growth of around 20 per cent in 2004 (The Planning Council, 2005a). These growth rates are comparable with some of the fastest-growing Asian economies.

1 Saudi Arabia is the largest economy in the Middle East with GDP of US$248 billion and a population of 22.7 million in 2004.

2 Unless otherwise indicated, any reference to the 'five economies' means the economies of Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates.

3 This oil price refers to the OPEC reference basket price (OPEC, 2005).

Despite these strong growth rates, inflation remains minimal. Exchange rates have been fixed, or very closely pegged, to the US$. This has provided the five economies with a stable monetary policy, although recent depreciations in the US$, and hence in regional exchange rates, have raised prices for the region's substantial level of imports.

Table 1.1

Strong economic performance

Summary of key economic indicators, selected Gulf economies, 2003

	Bahrain	Kuwait	Oman	Qatar	UAE
GDP (US$m)	9 606	41 748	21 670	23 604	87 611
GDP per capita (US$)	12 113	16 394	9 262	32 840	19 902
GDP per capita PPP (US$)	17 948	15 878	15 226	27 195	24 164
Population (000's)	698	2547	2 341	743	4 041
Key variables as ratio to GDP (per cent)					
Government consumption	18.6	25.9	22.2	15.6	14.3
Private consumption	41.0	49.6	43.8	15.2	49.1
Investment	19.4	8.6	15.7	26.4	22.7
Exports of goods and services	79.8	54.8	55.9	51.4	97.9
Current account balance	2.1	22.6	4.1	24.4	8.6
Sectoral structure of GDP (per cent)					
Hydrocarbons	24.9	46.6	41.2	58.8	28.6
Agriculture	0.6	0.5	2.0	0.2	2.8
Manufacturing	11.2	7.2	8.3	7.6	13.1
Other industry	5.5	4.7	3.8	7.5	10.2
Services and other	57.8	41.0	44.8	25.8	45.2
Current account					
Merchandise exports (US$m)	6 632	21 795	11 654	13 193	67 135
Merchandise imports (US$m)	5 657	10 987	6 792	4 897	52 074
Foreign direct investment (US$m)	517	67	138	400	480
Growth rates (per cent)[a]					
Real GDP	4.8	2.0	3.6	7.4	5.6
Merchandise exports	6.0	6.0	8.4	17.5	11.4
Merchandise imports	5.4	4.2	5.7	12.3	10.3
Population	2.8	4.4	1.2	4.9	7.1

Notes: a. Average annual growth rate from 1995–2003.

Sources: Central Bank of Kuwait, 2004, 2005; Central Bank of Oman, 2004, 2005; Central Bank of the United Arab Emirates, 2004; Central Statistics Organisation, 2005a; International Monetary Fund, 2005a, 2005b; Ministry of Economy and Planning, 2005a 2005b; Ministry of Finance and National Economy, 2004; Ministry of National Economy, 2004, 2005; National Bank of Kuwait, 2005a; Qatar Central Bank, 2005a; The Planning Council, 2004a, 2005a; UNCTAD, 2004a.

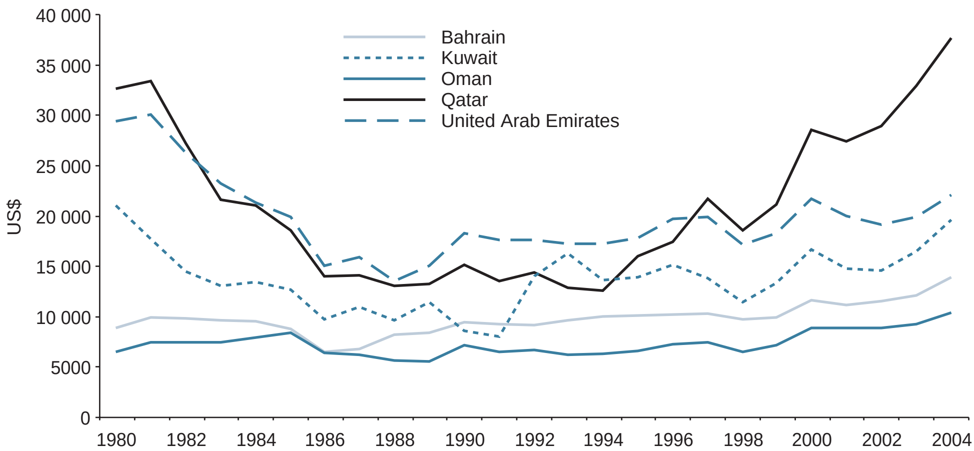
Increasing wealth

The region's economic development is beginning to increase incomes in the five economies, which are now re-emerging as some of the wealthiest in the world. This reverses the downward trend in per capita GDP experienced by a number of the Gulf economies in the 1980s (Figure 1.1).

Figure 1.1

Making up lost ground

Gross Domestic Product per capita, selected Gulf economies, 1980 to 2004



Source: International Monetary Fund, 2005a.

OIL REMAINS DOMINANT

Oil remains the dominant sector within the region. Oil has provided the resources for the region's economic transformation, being used to develop infrastructure, create employment and support local populations. The revenue from oil has flow-on benefits to most other sectors. However, despite this dominance, the rise of gas and non-oil sectors has reduced the reliance on oil in a number of these economies.

Reliance on oil and gas varies

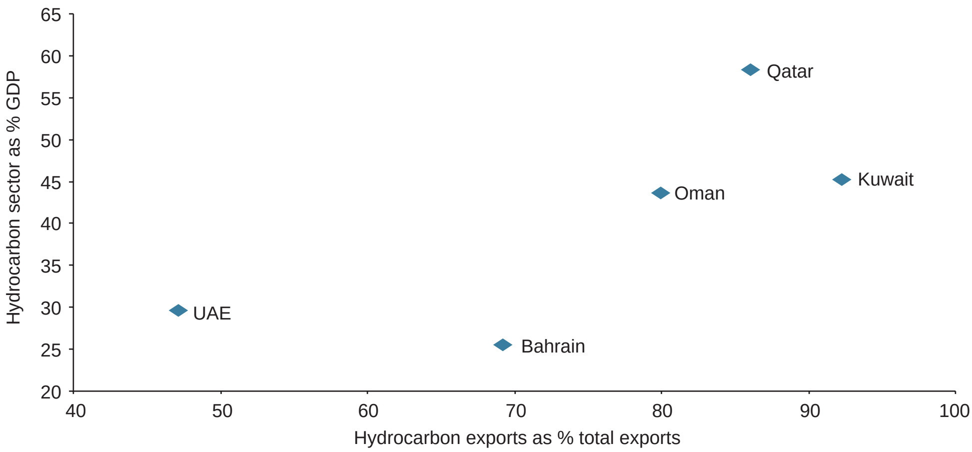
Reliance on oil and gas production and revenue varies across countries (Figure 1.2). Kuwait's economy is highly reliant on its oil industry, while Qatar's oil and gas industries dominate its small economy. Bahrain relies least on hydrocarbons in terms of their contribution to GDP. The United Arab Emirates has successfully reduced its dependence on hydrocarbons from around 60 per cent of its GDP in 1980 to under 30 per cent in 2003. Dubai has led this diversification in the face of its declining oil reserves – hydrocarbons now account for only around five per cent of Dubai's GDP (Dubai Chamber of Commerce and Industry, 2005). As a result, the United Arab Emirates has the least reliance on hydrocarbons as a source of export revenue. However, despite diversification attempts, hydrocarbons continue to be the primary export in all five economies. Similarly, government revenue across all five economies remains highly dependent on hydrocarbon revenues, which in 2003 accounted for at least 70 per cent of total government revenue, excluding investment revenue, in all these economies.[4]

The reliance on oil as a source of hydrocarbon revenue is lessening with the emergence of natural gas production, particularly in Qatar where gas production accounted for 32 per cent of exports in 2003 (The Planning Council, 2004b).

Figure 1.2

Diversification varied across the region

Hydrocarbon exports as per cent of total exports and hydrocarbon sector as per cent of GDP, average 2000–2003.



Source: Central Bank of Kuwait, 2004, 2005; Central Bank of Oman, 2004; Central Bank of the United Arab Emirates, 2002, 2004; Ministry of Economy and Planning, 2004, 2005a; Ministry of Finance and National Economy, 2004; Ministry of National Economy, 2004, 2005; The Planning Council, 2004b.

When will oil end?

The United Arab Emirates (predominately Abu Dhabi) and Kuwait have large oil reserves, estimated to allow production to continue at current levels for over 100 years, while Qatar's estimated reserves are around 40 to 50 years capacity. Other economies in the region face more immediate limitations. At current production rates, Bahrain is estimated to have oil reserves to last less than ten years, while Oman's current estimated reserves will be exhausted in less than 20 years (Figure 1.3).[5]

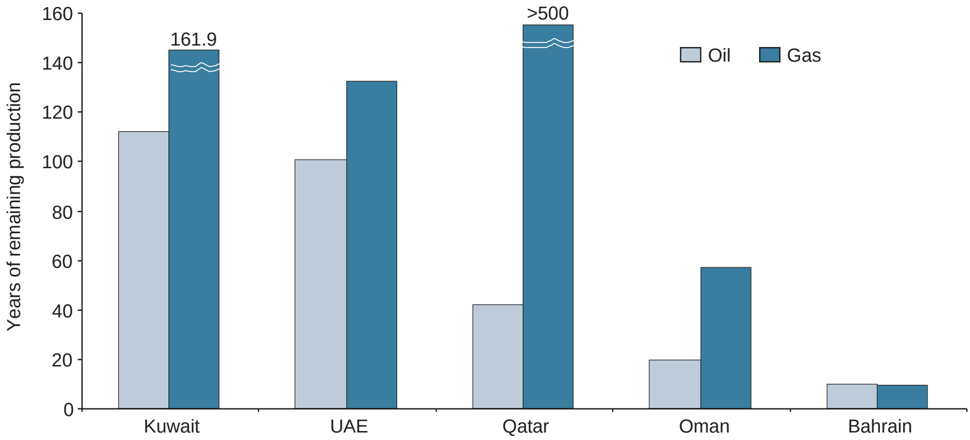
4 To ensure fair comparison, revenues from investment funds have been excluded in those economies which include investment revenues in official figures. For example, Qatar's reliance on hydrocarbon revenues is significantly less when investment revenue is included, accounting for around 64 per cent of total government revenue.

5 Bahrain's reserves reported here do not include Abu Safah oil field. This oil field is shared with Saudi Arabia and run by the state-owned Saudi oil company, Aramco. As at May 2005, Bahrain received around 150 000 barrels of oil per day from Saudi Arabia from this site.

Figure 1.3

Bahrain and Oman with limited oil reserves

Oil and gas reserves, selected Gulf economies, years remaining at current production rates, 2004



Note: The chart shows estimated years of oil and gas production remaining, at current levels of extraction. However, some countries are planning to increase their extraction, most notably in gas production in Qatar, where expansions are underway that will significantly increase production. Even so, Qatar's gas reserves are estimated to last over 200 years, possibly up to 300 years.

Source: BP, 2005; Energy Information Administration, 2004.

The rise of gas

The emergence of natural gas as an energy alternative to oil is important to Gulf economies. In particular, Qatar's North Gas Field is the largest non-associated[6] gas field in the world with proven reserves currently estimated at over 900 trillion cubic feet, equivalent to around 162 billion barrels of oil (OPEC, 2004). Qatar is seeking to utilise these reserves and become the largest exporter of liquefied natural gas by 2010.[7] The United Arab Emirates and Kuwait also have significant reserves of natural gas (Figure 1.3).

While many Gulf economies have traditionally closed oil sectors to foreign interests, many have sought foreign involvement in developing gas projects. Gas developments have enormous potential and billions of dollars are being spent on the sector (see Chapter 4 – *Construction: Tapping into a Growth Market*).

6 Not associated with an oil-field.

7 Qatar's plan is to increase production of liquefied natural gas to around 77 million tonnes per year by around 2010, up from around 15 million tonnes in 2003.

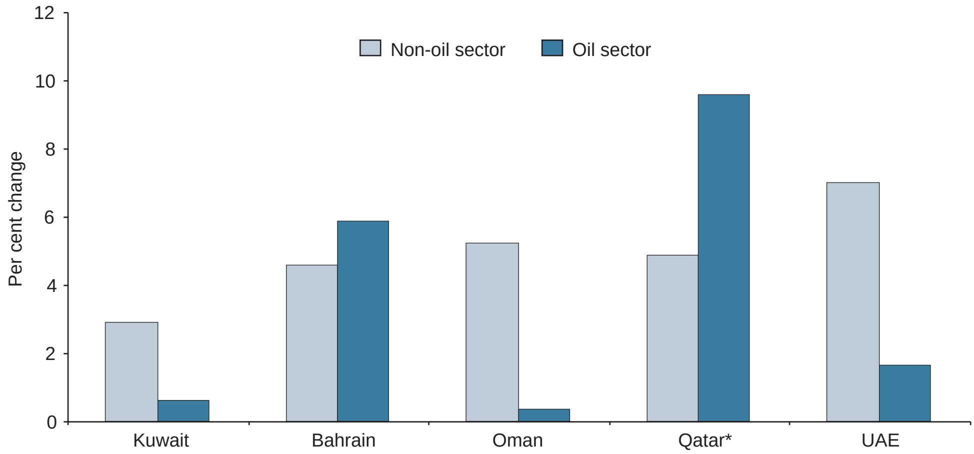
EMERGENCE OF THE NON-OIL SECTOR

Diversification strategies have had some success. Between 1995 and 2003, Kuwait, Oman and the United Arab Emirates have achieved real growth in their non-oil sectors at least four times the rate of growth in the oil and gas sector. Bahrain, over the same period, and Qatar, over the period 1997 to 2002, also recorded strong growth in their non-oil sectors (4.6 and 4.9 per cent respectively), but this was outpaced by even stronger growth in their oil and gas sectors (Figure 1.4).

Figure 1.4

Non-oil sector outperforming oil sector

Average annual real growth, per cent, non-oil and oil sectors, 1995–2003.



Notes: *1997–2002 only.

Source: Central Bank of Kuwait, 2005; Central Bank of Oman, 2004; Ministry of Economy and Planning, 2004; Ministry of Finance and National Economy, 2004; Ministry of National Economy, 2004; The Planning Council 2004a.

Emerging sectors

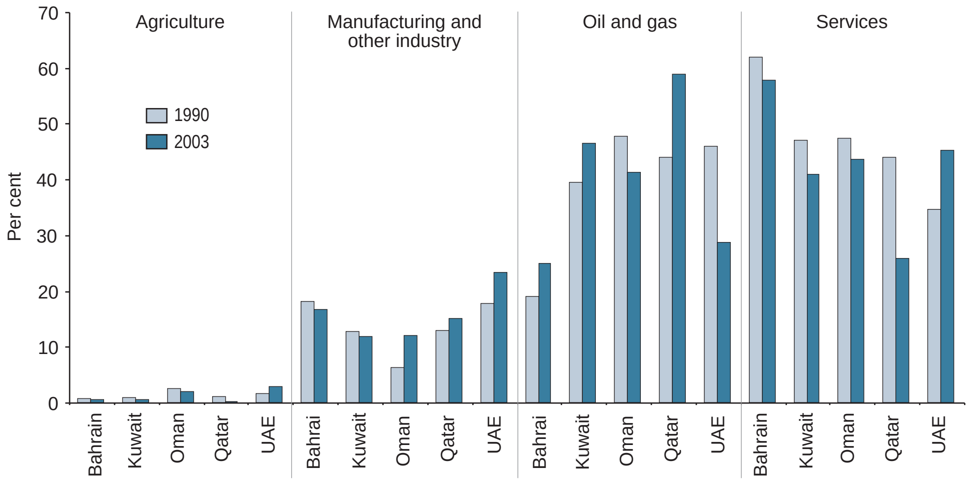
Oil and gas revenues continue to be the driving force in the five economies, with investments from this sector largely enabling the growth of other industries. However, the services sector rivals the oil and gas sector in a number of the economies as a major contributor to GDP. Services account from around 26 per cent of GDP in Qatar up to 58 per cent of GDP in Bahrain (Figure 1.5).

Within the services sector, government remains a major contributor to GDP, but other sectors have emerged. Tourism is playing an increasingly important role in growth throughout the region, particularly in the United Arab Emirates where it is a strong driver of growth and is also driving other industries such as construction. The other four economies also have plans to increase tourism, particularly through ‘mega-projects’, from Kuwait’s island developments to the ‘Pearl of Bahrain’, a series of man-made islands (see Chapter 4 – *Construction: Tapping into a Growth Market*, for further details of these developments). However, the extent to which the region can support a number of tourist destinations and tourist hubs has yet to be proven.

Figure 1.5

Services a major sector

Percentage share of sectors' GDP, five Gulf economies



Note: Manufacturing and other industry is predominately manufacturing. Qatar's manufacturing and other industry data for 1990 do not include other industry, which is a small amount. This is included in the oil and gas data of that year.

Source: Central Bank of Kuwait, 2005; Central Statistics Organisation, 2005a; Ministry of Economy and Planning, 2005a; Ministry of National Economy, 2004; UNCTAD, 2004b; The Planning Council, 2005a.

The United Arab Emirates has developed the broadest services sector in the region. It is the only country where the relative size of the services sector has grown since 1990, with growth in areas such as tourism and financial services. By way of contrast, Bahrain's well-developed services sector largely reflects its position as a financial centre, a role which other governments in the region are now challenging (see Chapter 2 – *Opening up: Economic Reforms in the Region* for discussion on the competition for a financial centre). The opening up of some sectors, such as banking and real estate, and reforms associated with World Trade Organization membership is helping to stimulate competition and growth.

Manufacturing is a smaller sector than the oil and gas sector and all five economies are seeking to stimulate manufacturing and industry, particularly the energy intensive industries where they perceive their comparative advantage lies. Bahrain's significant manufacturing industry is its aluminium industry, while the United Arab Emirate's manufacturing sector, which covers light and medium products in addition to more energy intensive industries, is growing at an impressive pace.[8] In the United Arab Emirates, further growth in this sector is likely with Abu Dhabi seeking to establish itself as a major industrial and manufacturing centre. Oman and Qatar are developing a number of energy intensive projects such as aluminium and fertilisation plants (see Chapter 4 – *Construction: Tapping into a Growth Market*, for further details on these projects). Other industrial production is predominately associated with extraction and processing of oil and gas.

[8] United Arab Emirates' manufacturing sector grew by an average of 13.4 per cent in the period 1993 to 2002 (National Bank of Dubai, 2004).

Despite significant investment in agriculture over the last 10 to 15 years, agricultural production remains extremely limited. In 2001, agriculture's largest share of GDP was in the United Arab Emirates where it accounted for only three per cent of GDP despite enormous growth in the production of fruit and vegetables of around 830 per cent and 508 per cent respectively from 1985 to 2003 (Department of Agriculture, Fisheries and Forestry, 2004). Other economies in the region also have succeeded in increasing production of various agricultural commodities, although often from small bases.[9]

GOVERNMENT INVOLVEMENT IN THE ECONOMY

Governments in Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates continue to play a dominant role in their economies. Oil and gas revenues have allowed governments to make large investments in infrastructure and develop networks of government-owned businesses, without recourse to taxation or foreign investment – major new development projects generally have some form of government funding. Governments also provide a social safety net through subsidised service provision, including free or subsidised water and electricity, and public sector employment. However, they are slowly attempting to shift away from such dominant roles, encouraging the development of the private sector and private investment, particularly through privatisation (see Chapter 2 – *Opening Up: Economic Reforms in the Region*).

Fiscal performance

Fiscal policy is the primary tool used by each government to direct the economy, particularly as all the economies have fixed exchange rates, reducing the effectiveness of monetary policy. For all economies except Bahrain, recent high oil prices have led to soaring government revenues (Figure 1.6) – for example, Kuwait's oil revenues in 2003–04, which made up 92 per cent of total government receipts, were three-times the budget projection for the period (National Bank of Kuwait, 2005b).

Although governments have begun raising expenditure levels (Figure 1.7), particularly in capital and project spending, these increases have not kept pace with the substantial rises in revenues. With official budgets based on conservative estimates of oil prices, higher than expected oil revenues have produced budget surpluses in 2003 in all countries except the United Arab Emirates, shifting governments away from the deficits experienced throughout most of the 1990s.[10]

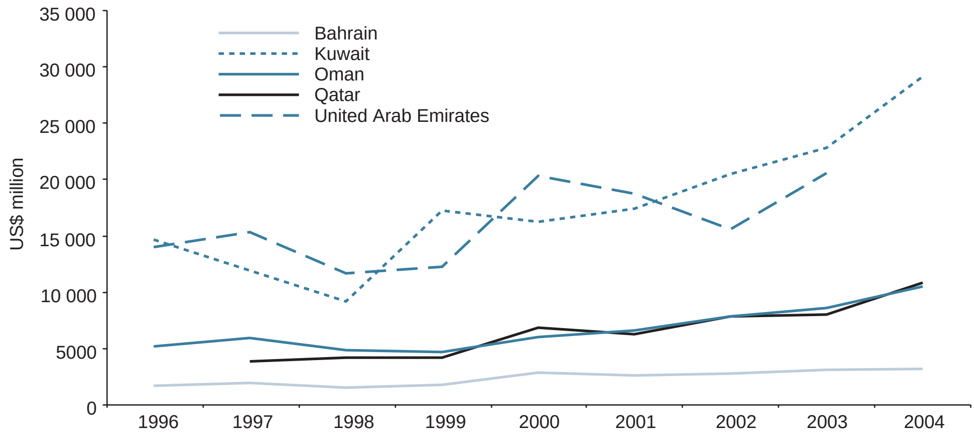
[9] For example, Kuwait increased total fruit production from almost nothing in 1985 to almost 11 500 tonnes in 2003, while Oman increased total meat production from 18 000 tonnes in 1985 to 42 000 tonnes in 2003 (Department of Agriculture, Fisheries and Forestry, 2004).

[10] Governments' official budget estimates often differ greatly from final budget outcomes due largely to official estimates of oil prices. For example, Kuwait's officially predicted government revenue for 2004–05, based on official budget projections of around US$15 per barrel, was KD3.3 billion. However, oil prices of well over US$30 are likely to result in government revenues of around KD8.7-8.9 billion (National Bank of Kuwait, 2005a).

Figure 1.6

Volatile oil revenues

Government revenue, selected Gulf economies, 1996–2004



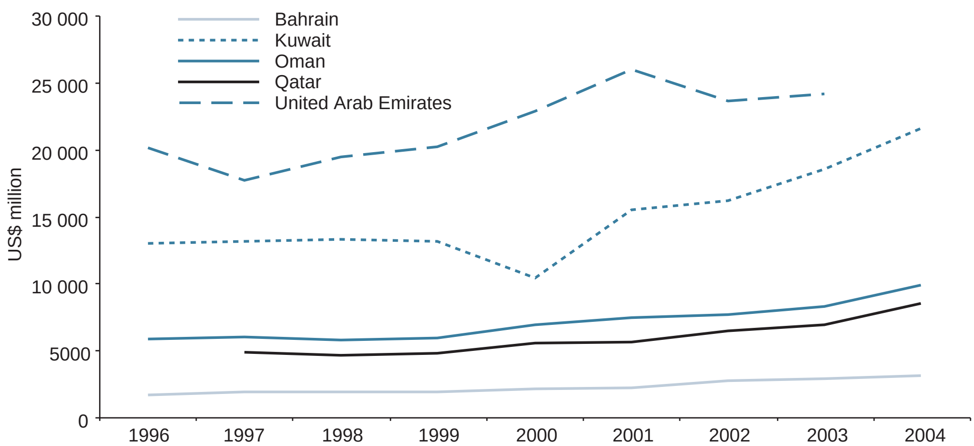
Notes: All data for 2004 are preliminary or estimates.
Qatar and Kuwait budgets are on financial years – 2003–04 budget is reported here as 2003.
Kuwait's budget in 2000 (2000–01) was for 9 months only due to the fiscal year being changed from June–July to April–March.

Source: Central Bank of Kuwait, 2005; Central Bank of Oman, 2004; Central Bank of the United Arab Emirates, 2004; Ministry of Finance and National Economy, 2004; Ministry of National Economy, 2004; Qatar Central Bank, 2005a; The Planning Council, 2004a.

Figure 1.7

Fiscal expansion

Government expenditure, selected Gulf economies, 1996–2004



Notes: All data for 2004 are preliminary or estimates.
Qatar and Kuwait budgets are on financial years – 2003–04 budget is reported here as 2003.
Kuwait's budget in 2000 (2000–01) was for 9 months only due to the fiscal year being changed from June-July to April-March.

Source: Central Bank of Kuwait, 2005; Central Bank of Oman, 2004; Central Bank of the United Arab Emirates, 2004; Ministry of Finance and National Economy, 2004; Ministry of National Economy, 2004; Qatar Central Bank, 2005a; The Planning Council, 2004a.

Governments of the five economies also receive substantial revenues from overseas investment portfolios which are often not included in official government revenue figures. The Abu Dhabi Investment Authority is estimated to have over US$400 billion in investments, while Kuwait's Reserve Fund for Future Generations has an estimated US$75 billion. Careful management of these funds, which can soak up excess liquidity from oil revenues and provide a fund for the future, is essential to provide an alternative source of revenue for governments.

High oil prices are reducing pressure to control expenditure and diversify revenue streams. To date, there has been limited success in diversifying the governments' revenue bases – all five economies are showing very substantial non-oil budget deficits.[11] Reform is particularly important in Bahrain and Oman where other revenue sources will need to be found as oil reserves become depleted.

Debt not a major concern

External debt is not, at present, a significant concern for most of the economies. Qatar has the largest debt burden, with external debt amounting to over 70 per cent of GDP.[12] This debt is a result of significant borrowings for the development of the natural gas sector, the revenue from which is initially being used to reduce its high levels of debt. This debt does not significantly impact on country risk, with credit agencies such as Moody's and Standard and Poors upgrading their sovereign credit ratings in 2003 and 2004 respectively. Bahrain's rising level of external debt, now estimated at around 50 per cent of GDP (Economist Intelligence Unit, 2005a), is also significant, particularly given its limited oil reserves.

INVESTMENT

Despite the substantial liquidity levels in the region, greater private investment, both domestic and foreign, is required to facilitate further growth.

Domestic investment

Limited domestic investment opportunities and high levels of public investment have resulted in low levels of private domestic investment in a number of the region's economies compared with other high-performing economies (Figure 1.8).[13] In United Arab Emirates and Oman in particular, public investment has been an important tool in driving growth, contributing a relatively high proportion of total domestic investment.

[11] The non-oil budget deficit is the balance of the budget excluding all oil and gas revenue. In 2002, the United Arab Emirates recorded a 26.7 per cent deficit (IMF, 2004d), Qatar's deficit was 17.3 per cent (IMF, 2004c) and Oman's was 29.8 per cent (IMF, 2004b).

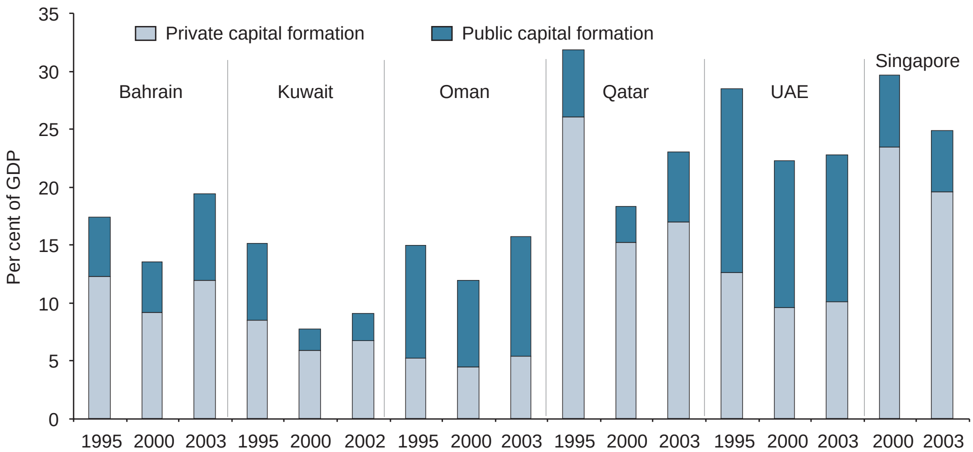
[12] This figure does not take into account the substantial reserves held in the investments of the State Reserve Fund.

[13] The availability of cheap labour also is likely to be a significant factor in low investment levels as it discourages capital investment.

Figure 1.8

More private domestic investment needed

Public fixed capital formation, private fixed capital formation, selected Gulf economies and Singapore, per cent of GDP



Source: CEIC, 2005; Central Statistics Organisation, 2005a; International Monetary Fund 2000a, 2000b, 2004c, 2004e; Ministry of Economy and Planning, 2001, 2005a; Ministry of National Economy, 2004.

The drive for foreign investment

Although most of the economies covered in this report attract more foreign investment, relative to size, than other Middle East economies, they lag behind developed and other developing economies in attracting foreign direct investment (FDI) (Figure 1.9). In 2003, FDI accounted for some 50 per cent of Bahrain's gross fixed capital formation (UNCTAD, 2004a). Other economies have a relatively low reliance on FDI as a source of capital, although investment into Qatar is increasing substantially with continued developments in the gas sector and the United Arab Emirates is attracting significant amounts of FDI. Indeed UNCTAD (2004a) assesses all five economies in this report as being below potential in attracting FDI.

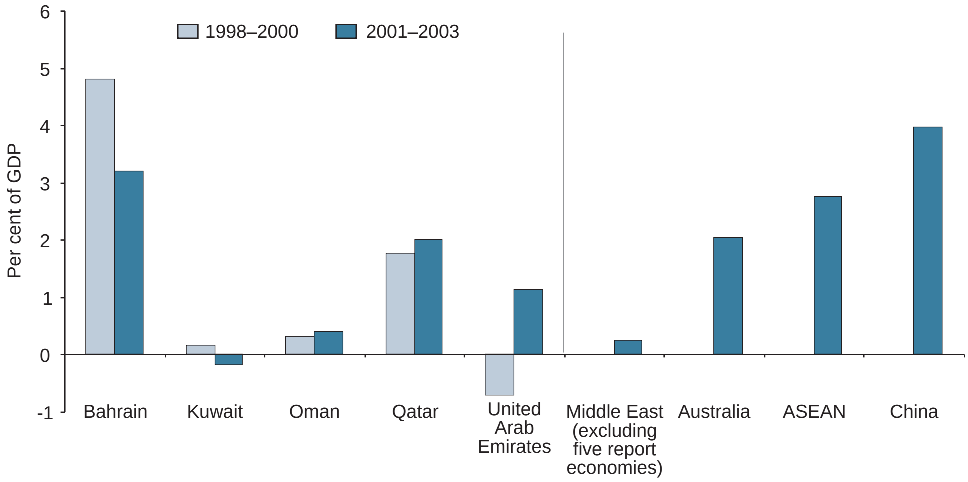
Instability in the broader Middle East region no doubt influences potential investors' views of these economies. However, the low rates of investment are also a result of inward looking policies in the past which have not welcomed FDI.

Governments have been easing regulations to encourage foreign investment (see Chapter 2 – *Opening Up: Economic Reforms in the Region*). Although the five economies have substantial resources to direct towards investment, private investment, particularly foreign investment, brings more than just capital to the economy. Goldstein and Odenthal (2005) find that benefits from foreign investment, such as the transfer of skills and technologies and new employment opportunities, are assets that are currently in short supply in the Gulf economies.

Figure 1.9

FDI remains limited

FDI inflows as per cent of GDP, selected Gulf and other economies, average 1998–2000, 2001–2003



Source: International Monetary Fund, 2005a, 2005e; UNCTAD, 2004a.

ECONOMIC CHALLENGES

The push for economic reform and diversification has primarily been driven by two factors: eliminating volatility caused by oil price fluctuations and accommodating very large population growth.

Oil's unsteady path

Achieving stable growth has been a challenge. Fluctuating oil prices have affected economic growth rates (Figure 1.10). Although average annual real growth over the last ten years has been impressive, ranging from 2.5 per cent for Kuwait to 9.4 per cent for Qatar, real growth rates have varied widely from year to year. Bahrain's more diversified economy displays the most stable growth for the period.

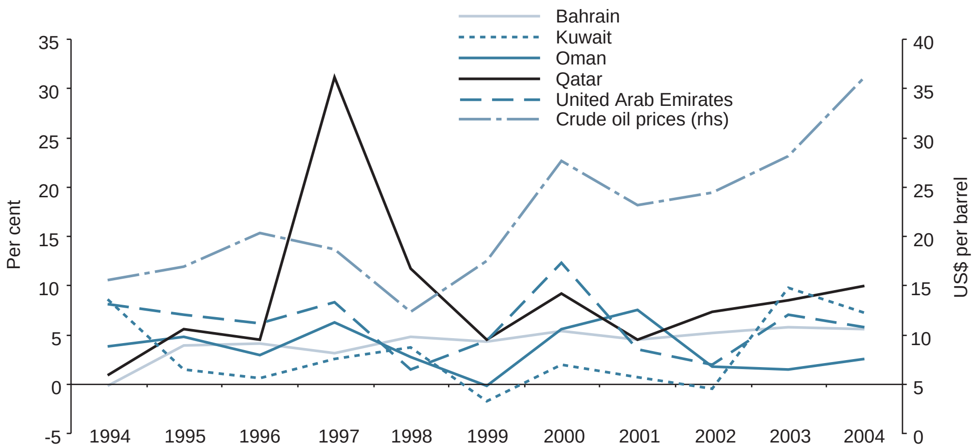
The steadying effect of diversification

The contribution of non-oil sectors to GDP illustrates the surprisingly steady growth of these sectors (Figure 1.11). Indeed, taking the five economies as a whole, nominal GDP growth in non-oil sectors has remained between 4.9 per cent and 11.5 per cent between 1995 and 2003. This occurred despite movements in the oil sector which, during the same period, experienced annual nominal growth changes fluctuating between minus 32.5 per cent and plus 70 per cent.

Figure 1.10

Growth cycle still affected by oil

Gross Domestic Product, constant prices, per cent change, selected Gulf economies, crude oil prices, US$, 1994–2004



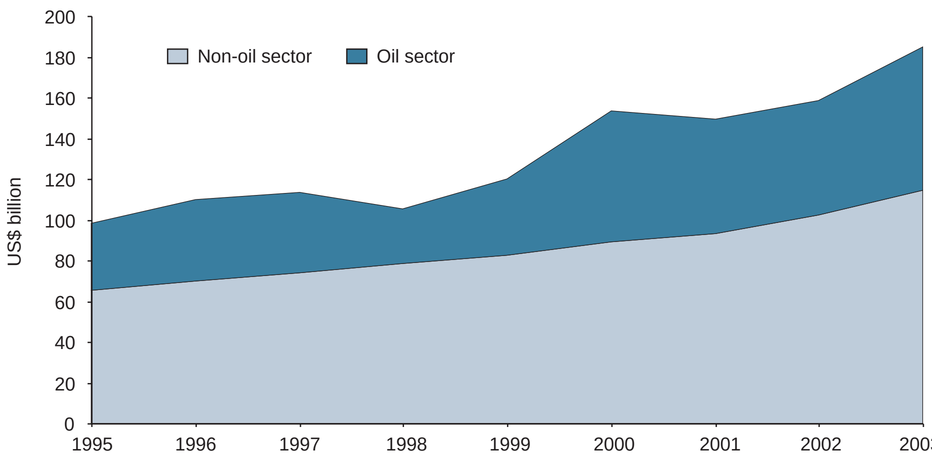
Notes: Crude Oil prices shown here are the OPEC Reference Basket.

Source: International Monetary Fund, 2005a; OPEC, 2005.

Figure 1.11

Non-oil sector steady despite oil fluctuations

Gross Domestic Product, current prices, total of Bahrain, Kuwait, Oman, Qatar and United Arab Emirates, US$ billion, 1995–2003



Source: Central Bank of Kuwait, 2004; Central Bank of Oman, 2005; Ministry of Economy and Planning, 2004, 2005a; Ministry of Finance and National Economy, 2004; Ministry of National Economy, 2003a; The Planning Council, 2004a, 2005a.

The rise of gas also is an important element in strategies to reduce dependence on oil revenues and increase economic stability. Unlike oil, which is largely traded on the basis of world spot prices, gas is sold through long term contracts. Although these long term contracts include oil price changes in the gas pricing formula, gas contracts are a more stable revenue stream than oil sales.

Labour market challenge

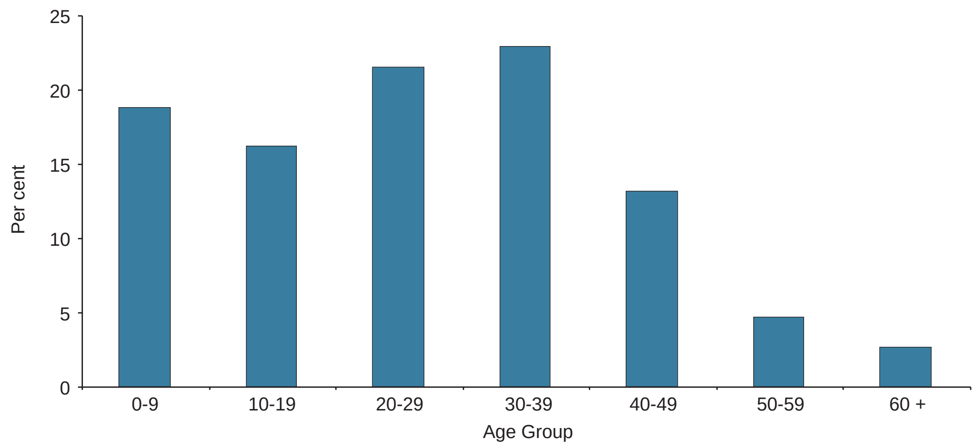
Since the oil boom in the early 1970s, the region has experienced high population growth through both high natural rates and high levels of immigration. Average annual population growth rates between 1975 and 2002 range from 3.3 per cent in Kuwait up to 6.5 per cent in the United Arab Emirates (UNDP, 2004). Of the 177 countries in the Human Development Report (UNDP, 2004), the United Arab Emirates has a higher population growth rate during the period than any other country, followed by Qatar (4.7 per cent), with Oman having the fifth highest growth (4.1 per cent). These population growth rates are among the highest of any regional or income specific grouping in the world.

High population growth rates have created a young population. Looking at total populations, including expatriate workers, over a third of the population in the five economies is under the age of 20 and over half of the population is under 30 (Figure 1.12). A further breakdown of these figures into national and expatriate populations for countries where data are available (Bahrain and Oman), shows more clearly the extent of young nationals beginning to reach working age (Figure 1.13). This is creating huge strains in societies where government has traditionally been the primary employer and support system for national populations. Governments in the region have come to realise that the cost of continuing to provide high levels of support for rapidly growing populations is beginning to challenge their considerable resources, with increasing demand in sectors such as education, power and water, and construction.

Figure 1.12

Total populations young

Population age structure in Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates, 2002

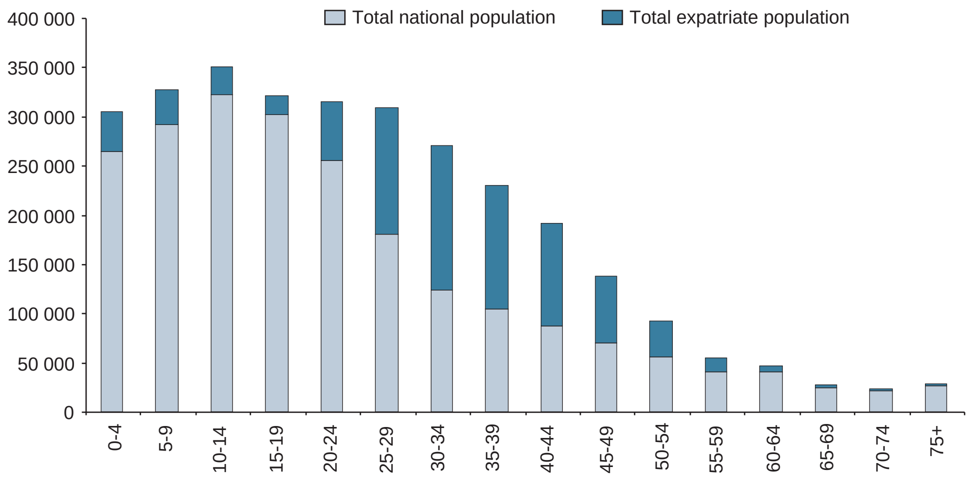


Source: Gulf Cooperation Council, 2004.

Figure 1.13

National populations younger

Population by age group, national and expatriate, Bahrain and Oman, 2003



Source: Central Statistics Organisation, 2005a; Ministry of National Economy, 2004.

Reliance on expatriate labour

The discovery of oil has provided the five economies with the wealth to support large investments in physical and social infrastructure. This investment created a large demand for labour which was unable to be filled solely by small local populations. Countries in the region adopted a welcoming policy to foreign labour which has resulted in relatively high levels of expatriate workers in all five economies; from around 90 per cent of employed workers in the United Arab Emirates down to around 58 per cent in Oman (Fasano and Goyal, 2004; Ministry of National Economy, 2004).

Expatriate workers are the primary source of employees in the private sector. On average, they account for more than 85 per cent of total employed workers in the non-oil private sector while nationals are predominately employed in the public sector (Fasano and Goyal, 2004). Employers' use of expatriate labour is due to a range of factors including lower wage levels, specific skills and experience, higher productivity and willingness to work longer hours and shorter holidays (Ministry of National Economy, 2003b). As Cappeli (2005) highlights, the increase in the supply of unskilled labour has kept wages for lower skilled jobs down, making it unnecessary for employers to compete for workers by offering better pay and conditions. Not surprisingly, public sector jobs have traditionally attracted national workers, with their higher salaries, more generous benefits and, up until recently, ready availability.

The abundance of cheap expatriate workers have provided economic benefits to the five economies; for example, in lowering construction costs. However, in addition to the social issues associated with populations dominated by foreign workers, there are significant economic costs associated with the policy. For example, in distorting the local labour markets, decreasing incentives for capital investment, and in the substantial remittances from workers to their home countries, ranging from around 4.5 per cent of GDP (or US$4.6 billion) in the United Arab Emirates, to 7.4 per cent of GDP in Oman (or US$1.8 billion), and up to over 10 per cent of GDP (or US$1.1 billion) in Bahrain (Ministry of Economy and Planning, 2005a; Central Bank of Oman, 2005; Bahrain Monetary Agency, 2005a).

Unemployment of nationals a growing concern

Strong economic growth has led to increasing employment, but the ready availability of expatriate labour has meant that increasing employment does not necessarily translate to employment opportunities for national citizens, among whom rising unemployment has been a growing concern. Accurate unemployment statistics in a number of the region's economies are not available, or significantly understate actual unemployment. However, many Gulf economies recognise the growing problem of national unemployment, estimated to be up to 15 per cent in Bahrain (Economic Development Board, 2004). The Bahrain Government, for example, released extensive reports in late 2004 which examined its growing unemployment problem and potential solutions.[14]

Governments have remained the primary source of employment for nationals in the five economies, except in Bahrain. Public sector wage bills already represent more than ten per cent of GDP in most of these economies and governments with limited capacity to accommodate the increasing labour force are now looking to the private sector for national employment growth (Fasano and Goyal 2004).

The private sector has become the leading source of employment growth in a number of Gulf economies. Between 1996 and 2000, employment growth in Bahrain, Oman and the United Arab Emirates has been driven by the private sector which accounted for over 80 per cent of new jobs. However, expatriates are generally the primary beneficiaries of this employment growth, encouraging governments to explore policies to create employment for nationals (see Chapter 2 – *Opening Up: Economic Reforms in the Region* for more information on some of these policies and their effect on business).

Education

Limited government capacity to provide public sector employment for the large numbers entering the labour force increases the importance of investment in education. While education is free for nationals of all the five economies, the courses offered often do not reflect the requirements of the market. For example, large numbers of university students undertake courses related to social or religious studies (Fasano and Goyal, 2004). Tertiary education levels remain relatively low, but enrolments have been growing and represent one of the growth areas in trade with Australia (see Chapter 5 – *Australia's Commercial Relationship with the Region*).

[14] The Bahrain Government commissioned a study by McKinsey and Co. which found that over the next decade, Bahrain needs to find employment for around 100 000 new job entrants, almost double the current national labour force. Since 1990, around 70 per cent of new private sector jobs went to expatriate workers. Current trends indicate that unemployment could almost quadruple over the next decade. The report's suggestions for reform, which were still being debated at June 2005, include imposing labour fees for expatriate workers while improving expatriate labour mobility, and eliminating Bahrainisation targets (Economic Development Board, 2004).

LOOKING AHEAD

Oil and gas will continue to drive growth in the Gulf. High oil prices – the OPEC reference basket averaged US$36 a barrel by the end of 2004 and just under US$50 by mid-2005, compared with under US$15 in 1998 – have been the main driver of recent prosperity (OPEC, 2004, 2005). Importantly, while some analysts are predicting a decline in the oil price in the coming years, few are predicting any falls to the low levels experienced in the late 1990s. Additionally, the Gulf is likely to become more important in meeting projected increases in global oil demand in the coming decades. The emergence of the gas industry will also be an important driver of economic growth in the years ahead, assisting the development of energy intensive industries.

In addition to oil and gas, sectors such as tourism, construction, real estate and financial services will continue to provide growth. Construction and real estate markets are booming and recent stock offerings have been oversubscribed, leading some analysts to question the sustainability of the current rate of growth in some sectors. However, planned expenditure and predicted demand mean that the current high rate of growth in sectors such as construction and tourism is likely to continue, at least in the short-term.

Low oil prices in 1998 helped create an appetite for reform and these five economies are moving in the right direction, opening up markets and reviewing the role of the public sector, albeit at different rates (for discussion of reforms, see *Chapter 2 – Opening Up: Economic Reforms in the Region*). These efforts are being recognised. In the World Economic Forum's (2005) *Arab World Competitiveness Report 2005*, Qatar ranks top of the region's growth competitive index, measuring a country's ability to grow on a sustained basis, with the United Arab Emirates, Bahrain and Oman ranked two, three and four respectively out of the 12 Arab states examined.[15]

High oil prices remove some of the immediate pressures for reform, but the governments recognise that diversification insulates against future oil shocks and provides alternative sources of employment. There are, however, significant differences in the urgency and commitment to reform. Within the United Arab Emirates, Dubai has developed as a business and trade centre, creating a strong services sector. Abu Dhabi, despite its significant oil wealth, is also now beginning to focus heavily on developing new industries. Bahrain and Oman have more immediate limits to their oil revenues, so careful implementation of reforms in areas such as taxation and labour and private sector growth will be essential to ensure continued growth. For Qatar and Kuwait, whose substantial hydrocarbon reserves will continue to represent the major sector in their economies for years to come, careful management of the funds generated by these resources, together with continued development of local skills and development of the private sector, will assist in providing steady growth and new employment.

15 Kuwait was not included in the study.

OPENING UP: ECONOMIC REFORMS IN THE REGION

KEY POINTS

- Governments in the region have recognised that future growth and diversification require an active private sector, and that foreign participation and involvement will encourage this. A number of government reforms, including privatisation of government assets, are under way to assist the private sector.

- Foreign ownership limits are being lifted or removed.

- New free trade zones are being set up, following the success of Dubai. The zones will continue to attract businesses, although businesses looking at these zones need to be aware of the positive and negative aspects of location inside a free trade zone.

- Financial sectors have been strengthened throughout the Gulf. Membership of the Gulf Cooperation Council (GCC) has opened economies to regional banks, while restrictions on foreign banks also are being reduced.

- Although the Gulf has minimal taxation, taxes which specifically target foreign companies are being reviewed and some of the disparities reduced.

- Land and residential accommodation are becoming available to purchase by foreigners in several of the region's economies.

- Strategies to increase private sector employment of nationals affect business. These strategies include training and development for national citizens and nationalisation programs, such as national employment quotas.

- A number of non-tariff barriers remain. These include agency laws, import licensing, product standards and government procurement.

Governments of the five economies are focusing increasingly on private sector led growth. Foreign participation and investment is being encouraged, government involvement in traditional services, such as utilities, is being limited and other business conditions, such as taxation, the banking system and property rights, are being reviewed and reformed. Gulf countries are also attempting significant tariff and trade reforms with the adoption of the Gulf Cooperation Council (GCC) Unified Customs Law and the start of negotiations on a number of other trade agreements (see Chapter 3 – *Trade Developments*). A number of non-tariff trade barriers affecting business remain.

SHIFTING AWAY FROM GOVERNMENT OWNERSHIP

Governments have identified privatisation as a key tool to increase private sector involvement in the economy and raise new investment. In addition to having control and ownership of the hydrocarbon sectors, particularly the oil sector, governments in the region have been involved in a variety of companies ranging from basic utilities and telecommunications to meat processing and cement factories. All five governments have privatisation plans that include power and water and a host of other state-owned enterprises. With high population growth and rising demand for services created by this growth, new investment is particularly important in the key areas of power and water.

PRIVATISATION EFFORTS ACROSS THE REGION

Oman was the first Middle East country to allow private investment in electricity. Oman is progressing privatisation of power and desalination plants following the Sultan's issuing of two decrees in mid-2004 setting out the general framework for privatisation and detailed steps for the sale of state-owned assets in the power and water sectors. It already has private investors in its port services and telecommunications and further privatisation in telecommunications is being planned.[16] Importantly, foreign investors are able to take 100 per cent ownership of Omani assets, subject to strict obligations regarding Omani employees. The Government's development plan envisages private sector investment in its privatisation program of around US$981 million from 2001 to 2005 (Ministry of National Economy, 2002).

Privatisation in the United Arab Emirates is being led by Abu Dhabi, which plans to fully privatise its water and electricity companies by 2006. Abu Dhabi has emerged as a regional role model in privatising its power and water sectors through joint ventures with private companies. Abu Dhabi's major privatisation program has been launched with the aim of helping establish itself as a major centre for industry and manufacturing. It has announced plans to privatise a number of other state-owned companies by selling shares to United Arab Emirates nationals. The Government hopes to attract at least US$10 billion in local and foreign investment (Economist Intelligence Unit, 2004). Companies to be privatised include fodder,

[16] Opening of the telecommunications sector was committed to as part of Oman's WTO accession.

cement and steel manufacturers, pipe plants and flour mills. Another significant move by the Government was the approval in May 2005 of a new telecommunications company, still partly owned by Government, which effectively ends the monopoly enjoyed by Etisalat (AME Info, 2005a).

After a late start, Bahrain has recently rapidly developed privatisation plans. Bahrain has plans to privatise postal services and port management, and is in the process of privatising power and water.

Privatisation of the power sector in Qatar has advanced rapidly, with most government power generation plants sold to Qatar Electricity and Water Corporation, majority-owned by the local private sector. Construction has begun on the country's first independent power and water plant, majority-owned by a foreign developer. The Government also has sold some of its equity in a number of industrial companies.

Privatisation in Kuwait has been slower to progress than in the other economies examined, largely due to political opposition. The Government presented a five-year program for privatisation in 2001 and some progress has been made through privatisation in petrol stations, customs and divestment of equity in banks. However, a privatisation bill which was agreed by the Finance committee of the national assembly remains to be passed by the full national assembly. Privatisation of electricity, water, telecommunications and ports can then proceed. In the meantime, the authorities intend to continue identifying public sector entities that do not require explicit legislative approval for privatisation, to be sold to the private sector.

Sources: International Monetary Fund, 2004a, 2004b, 2004c, 2004d, 2004e; Economist Intelligence Unit, 2004, Demir, 2004.

LABOUR MARKET REFORM

To meet the challenge of creating employment for national citizens, governments in the five economies are reviewing labour market conditions and policies to increase private sector employment of their nationals. These policies are being attempted through a combination of mandatory and market-based mechanisms, including ambitious education and training programs for nationals, taxes and charges for non-national employees, and nationalisation programs known as Bahrainisation, Kuwaitisation, Omanisation, Emiratisation, and Qatarisation, involving quotas and targets of national citizens to be employed in private companies.

USING TARGETS TO INCREASE LOCAL EMPLOYMENT

Following the 'nationalisation' of public sector workforces, governments of the five economies have introduced policies for the 'nationalisation' of private sector employment, including:

- **Bahrainisation** – Quotas are in place for the proportion of Bahrainis employed within given sectors and by firms of varying sizes. Every company must have at least one Bahraini employee; those employing more than ten workers must increase the percentage of Bahrainis by five per cent per year up to the Government target of 50 per cent. All new projects should be launched with a minimum of 20 per cent Bahraini employees, to be increased by ten per cent per year. Government contracts are not awarded to companies that fail to meet local labour requirements, and companies employing more Bahrainis typically receive preferential treatment.
- **Kuwaitisation** – Quotas are in place for the percentage of Kuwaiti workers to be employed by companies depending on their type of economic activity ranging up to 50 per cent for banks, although owners of projects can stipulate higher percentages in contracts. Non-compliant companies are subject to an annual fine of KD 100 (around US$335) for each non-Kuwaiti worker in excess of the permitted maximum percentage renewing their work permit or obtaining an authorization of a residency. Such firms are not allowed to conclude contracts, do business, or negotiate directly with the Government; and are not eligible for financial or material support provided by government entities. However, non-compliant companies may be exempted in special circumstances.
- **Omanisation** – Quantitative targets for the proportion of Omanis in total employment have been established in a number of sectors including transport, storage and communications (60 per cent); finance, insurance and real estate (45 per cent); industry (35 per cent); hotels and restaurants (30 per cent); wholesale or retail trading (20 per cent); and contracting (15 per cent). A ban on expatriates working in 36 professions in 44 regions came into force in 2004. Expatriates are excluded from work in areas such as cashiers, drivers, security officers and workers in retail stores and supermarkets.
- **Emiratisation** – Quotas exist for nationals employed in the banking and insurance sectors. In the banking sector, the quota is 50 per cent nationals by 2007. The Government also limits expatriate workers depending on country of origin.
- **Qatarisation** – The Government has a target of 50 per cent nationals in the energy sector by the end of 2005.

Sources: International Monetary Fund, 2004a, 2004b, 2004c, 2004d, 2004e; United States Department of Commerce, 2004a, 2004b, 2004c, 2004d, 2004e; HSBC, 2004a, 2004b, 2004c, 2003b; Ministry of Information, 2004.

This has implications for businesses as most nationals do not have the requisite skills demanded by the private sector, despite education being free for nationals at all levels, and are more expensive relative to their skill levels than expatriate workers.[17] In Qatar's private sector, 43 per cent of Qataris had a tertiary level of education compared with 53 per cent of expatriates; in Oman's banking sector, one-third of nationals had a tertiary level of education compared with 85 per cent of expatriates (Fasano and Goyal, 2004). Businesses therefore may face difficulties finding appropriately skilled employees from the small pool of trained nationals available.

Governments face a difficult choice between the economic benefits of cheap labour versus the need to increase employment of nationals. Increasing unemployment among nationals needs to be addressed, but governments recognise the need to be cautious about possibly disrupting the largest source of employment. Implementing reforms that raise expatriate labour costs or overly restrict expatriate employment, while encouraging national employment, may affect the region's competitive advantage and discourage further investment.

FOREIGN DIRECT INVESTMENT REGULATIONS

The five countries have generally operated economies that have been relatively closed to foreign direct investment (FDI) and consequently have attracted few investors. However, governments have increasingly come to see foreign investment as a useful method of introducing new skills and technology into their economies and of increasing employment opportunities for their nationals.

In 2000, the East Asia Analytical Unit identified some key features of Gulf FDI regimes including:

- difficulty in having effective full foreign ownership outside free trade zones
- the requirement for majority local equity in many types of business, including distribution
- prohibition on FDI in the upstream oil sector (in Saudi Arabia and Kuwait) or inability of new oil companies to enter the oil industry (in the UAE)
- imprecise and inconsistently applied regulatory frameworks.

Reforms are slowly altering these features. In a number of economies, foreign ownership of 100 per cent is now possible in many sectors outside the hydrocarbon sector (Table 2.1). Even within the hydrocarbon sector, foreign investment is being welcomed in some areas, particularly gas — Qatar has rapidly developed its gas industry by welcoming foreign investment. In general, foreign investment is encouraged in targeted sectors, often those that are export-orientated and do not compete with local businesses.

[17] For example, in a survey of executives conducted by the World Economic Forum, an inadequately trained workforce ranks as one of the top two major problems in doing business for Bahrain, Oman, Qatar and the United Arab Emirates (Kuwait not included in the survey) (World Economic Forum, 2005).

Table 2.1

Full foreign ownership now possible

Regional FDI regulations and changes

Economy	Key FDI regulations and changes
Bahrain	Limits for foreign ownership have been raised from 49 per cent to 100 per cent ownership in all but a few key sectors (such as oil and aluminium). Five targeted areas for investment are business and financial services, health care, information technology, telecommunications and tourism. Private investment in petroleum extraction is permitted only under a production sharing agreement with the state-owned petroleum company. Legal foreign control of an existing Bahrain company is not allowed, although foreign investors can own 100 per cent of a new company (except retail stores). A one-stop-shop has been established to facilitate licensing procedures. In general, the Bahrain Government does not license companies wishing to compete with existing government owned companies.
Kuwait[18]	Limits for foreign ownership have been raised to 100 per cent in a number of industries including (but not limited to) infrastructure projects; IT and software development; hospitals and pharmaceuticals; air, land and sea freight; and tourism, hotels, and entertainment. Foreign firms are still not permitted to invest in the upstream petroleum sector, although they are permitted to invest in petrochemical joint ventures. A Foreign Investment Capital Office has been established to process foreign direct investment applications.
Oman	100 per cent foreign ownership is now possible in many industries. New majority owned entrants are barred from most professional service areas, including engineering, architecture, law and accountancy. As part of its obligations under World Trade Organization accession, Oman is opening up many service sectors to full foreign ownership, starting in 2003 with the information technology sector.
Qatar	100 per cent foreign ownership is now possible in key sectors, including agriculture, industry, health, education, tourism, projects involving the development and exploitation of natural resources, and export industries or industries that use modern technology. Foreign ownership of up to 49 per cent is permitted in all other sectors except banking, insurance, real estate and commercial agencies, which are not open to foreign investment.
United Arab Emirates	Foreign investment is limited to a maximum of 49 per cent ownership, requiring a United Arab Emirate's national to own at least 51 per cent of a business. Discussions are reportedly underway to raise the maximum level of foreign ownership of local limited companies above 49 per cent, possibly to 70 per cent or more, in certain sectors. 100 per cent foreign ownership is possible in the free trade zones.

Source: Fasano and Iqbal, 2003; Ministry of Economy and Commerce, 2000; United States Department of Commerce, 2004a, 2004b, 2004c, 2004d, 2004e; HSBC, 2004a, 2004b, 2004c, 2003b.

[18] One important test for Kuwait is opening its oil sector to foreign companies. Kuwait's northern oilfields development, Project Kuwait, has been stalled for a number of years over the issue of foreign involvement.

Free trade zone proliferation

Free trade zones have fast become the investment mechanism of choice for the United Arab Emirates, home to most of the region's current and planned free trade zones. The United Arab Emirates currently has 13 free trade zones, with more planned. The Jebel Ali Free Zone is the oldest in the region and is well established as a business hub. Other centres in Dubai include the Dubai Airport Free Zone, Dubai Cars and Automotive Zone, Dubai Technology and Media Free Zone (encompassing Dubai Internet City, Dubai Media City, and Knowledge Village), Dubai Health Care City, Dubai Metal and Commodities Centre and the Gold Diamond Park. Around eight other zones are under development including Dubai Aid City, Dubai Outsource Zone, Dubai Textile Village and Dubai Flower Centre. The other emirates also have established free trade zones.

Following Dubai's success, other regional economies have developed free trade zones. Two free trade zones exist in Bahrain, one at North Sitra and the other at the Mina Salman port. The Government is also planning to extend the Sitra zone and develop a new zone at Hidd. Oman is establishing a free trade zone at Salahah Port and the Omani Government is reportedly considering the development of further free trade zones in Mazyouna and Musandam. Kuwait has the Kuwait Free Trade Zone, located in Shuwaikh Port and another is proposed for the planned Bubiyan port.

The principal attractions of the free trade zones have traditionally been the allowance for 100 per cent foreign ownership, exemption from all import duties and no local agent requirements for foreign companies. However, despite their benefits, these centres do not necessarily represent the best location for businesses targeting the Gulf market. Companies located in the free trade zones have limited access to the market outside these zones, where they face the same trade and investment barriers, such as foreign investment and local agency laws, as other foreign companies wishing to trade in the Gulf.

The proliferation of free trade zones throughout the region is likely to mean that some centres do not succeed to the extent of previous ventures. However, the benefits that free trade zones offer, including first-class infrastructure, duty waiver, taxation benefits and the potential for property ownership in some areas, in addition to open investment regimes and local agent exemption, are likely to continue to attract certain investors.

STRENGTHENING THE FINANCIAL SECTOR

Although the financial sector in each of the five economies is strong, many of the economies are pursuing reforms to further strengthen and deepen them. Oman, Qatar, the United Arab Emirates and Kuwait have carried out reforms aimed at strengthening financial sector structures, supervision or efficiency, while Bahrain's financial sector remains one of the most vibrant financial sectors in the region. All five economies have also enacted some form of significant anti-money laundering legislation since 2001.

GCC members have opened their banking sectors to other GCC members as part of the continuing evolution towards a single market (see Chapter 3 – *Trade Developments*). With the opening of GCC markets, new competition and markets have allowed some takeovers and mergers. However, competition within the domestic market is very strong, even outside the financial centres such as Bahrain and Dubai.[19] For example, Qatar, with a population of around 700 000 people, has 15 banks, eight of them national, with 103 branches, raising questions of long-term sustainability without some consolidation. More open markets may also assist local banks in diversifying their business, helping them shift away from their current high exposure to public sector debt.

Foreign participation is widespread, although domestic banks still tend to dominate.[20] Some 15 foreign banks operate commercially in Bahrain and 25 operate commercially in the United Arab Emirates. In addition, a number of offshore operations operate out of Bahrain. Kuwait, the last closed banking market of the five economies, is also opening its banking sector to foreign institutions, with three foreign banks licensed to operate by mid-2005. World Trade Organization membership is encouraging further liberalisation in the financial sectors.

The challenge to become the financial centre

A number of economies in the region are competing to establish themselves as financial centres, not only for the Gulf, but for the wider Middle East region. Bahrain has traditionally been the preferred location for regional and foreign banks, having the highest concentration of foreign banking services in the region. The Bahrain Financial Harbour, a US$1.3 billion project to be completed by 2007, is the latest project designed to reinforce Bahrain as a regional centre by providing world-class facilities for financial institutions. Bahrain's attractiveness remains its established reputation and a proven regulatory framework that meets the highest international standards.

The United Arab Emirates is now challenging Bahrain's financial centre status. Dubai's hub role for trade in the Middle East and its relatively attractive lifestyle have already drawn a number of financial institutions to Dubai. The latest push by Dubai is the multi-billion dollar Dubai International Financial Centre (DIFC), a financial free zone, designed to establish the United Arab Emirates as the major financial centre of the Middle East.

[19] By the end of 2004, Bahrain had licensed 367 financial institutions, including 189 banking institutions, a number of which were offshore operations. As at mid-2003, 23 of these financial institutions were commercial banks operating in Bahrain, 15 of which were foreign (Bahrain Monetary Agency, 2005b). In 2004, the United Arab Emirates had 46 banks operating domestically, including 25 foreign banks.

[20] For example, local banks accounted for more than 75 per cent of total assets of all banks in the United Arab Emirates in December 2002 (Budd et al., 2005). The paper by Budd et al. (2005) also suggests that a number of United Arab Emirates' banks suffer inefficiencies due to over-banking and market concentration.

DUBAI INTERNATIONAL FINANCIAL CENTRE

The Dubai International Financial Centre (DIFC) is designed to create a regional capital market, offering investors and issuers of capital world-class regulation and standards. The centre sits outside the normal commercial and civil laws of the United Arab Emirates and was established through separate enabling laws, with a separate judiciary and its own independent regulator.

There are seven primary sectors of focus within the DIFC: Banking Services (Investment Banking, Corporate Banking and Private Banking); Capital Markets (Equity, Debt Instruments, Derivatives and Commodity Trading); Asset Management and Fund Registration (Fund Registration, Fund Administration & Fund Management); Reinsurance; Islamic Finance; Business Processing Operations; and Ancillary Service Providers.

The centre has been designed to accelerate the repatriation of capital, provide new avenues to capital and encourage GCC investment. Through the Dubai International Financial Exchange (DIFX), which is planned to open in September 2005, the centre aims to create a new capital market which will act as a regional financial centre for the emerging GCC states and the rest of the Middle East and North Africa, as well as South Africa, Turkey, Central Asia and the Indian sub-continent. DIFX's focus on the wholesale market, with international participants, is designed to distinguish it from domestic financial exchanges.

The centre is scheduled to be fully operational by 2008. By February 2005, 66 firms had been registered since it was launched in September 2004.

Source: Dubai International Financial Centre, 2005.

Qatar also has announced intentions to attract international banks through the creation of the Qatar Financial Centre. This centre will have an independent regulatory authority and an arbitration centre. Business in this centre will be focused around financing for the substantial gas developments in the economy.

Competition in the financial services sector is increasingly keen and it has yet to be seen whether there is enough demand for two, let alone three, major financial centres so close to each other. Bahrain's strong regulatory system and established position are attractions; however, Dubai's position as centre of the region's business world provides strong competition.

Islamic banking

The Gulf financial sector is also adapting to the continuing growth in Islamic banking. This is the main change underway in the Bahrain financial sector, which has the largest concentration of Islamic banks in the Middle East.

WHAT IS ISLAMIC BANKING?

The most significant principle behind Islamic finance, which follows the Islamic *Shari'a* law, is the prohibition of usury or interest (*riba*). This is prohibited on the basis of unjustified enrichment, broadly seeking to prevent exploitation and the accumulation of wealth and capital and promote equity. Islamic finance also prohibits transactions which contain excessive risk or speculation, such as gambling, and more broadly, transactions in activities or goods prohibited by Islamic Law such as liquor and pork. Profit and loss sharing is also an important principle.

A number of financial instruments exist under Islamic financing. The most popular instrument is *Morabaha*, where a bank agrees to fund the purchase of an asset or good at the request of a client and then resells the goods or assets to that client with a mark-up profit, often through some deferred payment system. Sceptics of this system view it as being similar to conventional interest-based finance, although others argue that important differences exist, such as bank ownership of the asset or good before selling it on, and price mark-ups not increasing due to delays in meeting payments (Al Tamimi & Company n.d.). Other popular instruments focus on profit sharing arrangements such as *Mudaraba* and *Mosharaka*, where profit and risk are shared between parties to varying extents.

Islamic financing, or banking, has grown significantly in recent years. There are currently more than three hundred Islamic financial institutions operating worldwide managing funds of over US$200 billion (Al Tamimi & Company n.d.), with Islamic banks in the Gulf accounting for an estimated ten per cent of total Gulf bank deposits by 2000 (Wilson, 2000).

Source: Al Tamimi & Company n.d.; The Institute of Islamic Banking and Insurance, 2005; Wilson, 2000.

Stock markets developing

Regional stock markets are quickly developing from relatively small bases as the high levels of excess liquidity in the region seek potential investments. Market capitalisation in the GCC doubled between 2002 and August 2004 to reach US$457 billion (Times Online, 2004). Recent public share offerings also have often been massively oversubscribed as people seek to enter these relatively new financial markets, leading to some very rapid stock price appreciations.

Stock markets are gradually opening up around the region. GCC nationals are now permitted to own 100 per cent of companies listed in other GCC stock exchanges (although Qatar retains some restrictions), while non-nationals are permitted to acquire a limited percentage of shares in various markets. Kuwait, with the second largest stock market in the Arab world (after Saudi Arabia), opened the market in 2000 to allow foreigners to own 100 per cent of all listed shareholding companies except in banking. Bahrain allows non-GCC nationals to own up to 49 per cent of most companies listed on the stock exchange, including seven companies where 100 per ownership is possible (Bahrain Stock Exchange, 2005). Qatar also is opening up its market to foreign investors, passing legislation on 4 April 2005 allowing foreigners to own up to 25 per cent of shares in any company listed on the market. Oman's stock market is also open to foreigners, who now own around 15 per cent of the market (United States Trade Representative, 2004a). However, in the United Arab Emirates linked markets of the Abu Dhabi Securities Market and the Dubai Financial Market, opened in 2000, foreign involvement is currently restricted to a maximum of 49 per cent and only in certain companies.

The five stock markets are still relatively small by international standards. However, discussions are underway to link exchanges within the GCC, while creation of the Dubai International Financial Exchange also is designed to provide a larger market.

TAXATION

Company taxation differs between the five economies, but in general, company taxes are low or non-existent as most government revenue comes from oil royalties (Table 2.2).

Table 2.2

Tax take low in the region

Government revenue sources, as a share of total government revenue, per cent, latest year

	Bahrain 2002	Kuwait 1999	Oman 2001	United Arab Emirates[a] 2002
Taxes	12.6	3.8	28.8	14.6
Taxes on income, profits, and capital gains	4.0	0.8	18.4	0.4
Payable by individuals	0.0	0.0	0.0	0.0
Payable by corporations and other enterprises	4.0	0.8	18.1	0.4
Taxes on payroll and workforce	1.5	0.0	2.7	-
Taxes on property	0.6	0.2	0.3	-
Taxes on goods and services	1.9	0.0	1.7	-
Taxes on international trade and transactions	4.6	2.8	5.7	2.9
Other taxes	0.0	0.0	0.1	11.2
Social contributions	5.1	6.2	0.0	-
Grants	3.7	0.0	0.4	-
From foreign governments	3.7	0.0	0.4	-
From general government units	0.0	0.0	0.0	-
Other revenue	78.5	90.0	70.8	85.5

Notes: a. United Arab Emirates data is translated from the International Monetary Fund (2004d) Article IV Consultations, which is not strictly comparable to the data presented in the International Monetary Fund's *Government Financial Statistics* (2003); for example, fees and charges have been included as other taxes in the table above. As a result, data for a number of sections are not included for the United Arab Emirates.

Qatar data not available.

Source: International Monetary Fund, 2003, 2004d.

Although taxation remains minimal, several of the countries operate taxation schemes that target foreign companies over domestic companies. While there is no personal income tax on residents, foreign firms face corporate taxation in Kuwait, Oman and Qatar, while the United Arab Emirates restricts taxation to foreign banks and oil companies.

As part of the push to attract foreign investment, some governments have been reviewing and amending taxation schemes, including reducing disparities between domestic and international company taxation rates. The Kuwait Government is attempting to reduce maximum corporate tax rates applicable only to foreign firms, from 55 to around 25 or 15 per cent. Kuwaiti-owned companies are not subject to income tax, although they must contribute 2.5 per cent of their net profits to both the Kuwait Foundation for the Advancement of Sciences and the National Labour Force Fund.

Reforms in Oman have extended national tax treatment to all companies registered in Oman regardless of the level of foreign participation. Taxes on foreign firms not registered in Oman (for example, an Omani branch of a foreign company) have been reduced to a maximum of 30 per cent of net profits, while the tax rates for local companies have been increased to up to 12 per cent. Finally, foreign ownership has been redefined to any company that has more than 70 per cent foreign ownership (up from 40 per cent). Services performed offshore for Omani companies attract a 10 per cent tax.

Qatar’s corporate income taxation rates target foreign companies and foreign investment in Qatari business ventures. Tax rates range from 0 for profits under 100 000 Qatari riyals (US$27 473) up to a maximum of 35 per cent for profits exceeding 5 million riyals (US$1.37 million). All Qatari-owned firms and GCC-owned firms are exempt from corporate income tax.

Governments throughout the region continue to offer financial concessions to attract prospective investors. Lengthy tax holidays or exemptions, subsidised utilities and soft loans are possible, particularly in the free trade zones or in specific sectors earmarked by government – for example, tourism in Qatar and Oman (for specific sectors, see Table 2.1).

Despite these concessions and low or non-existent corporate taxation, businesses can be faced with a range of indirect taxes. Higher charges for utilities for foreign companies, taxes on residential, office or hotel leases and higher charges for the use of expatriate labour are used in various economies as a method of indirect taxation.

The five economies, together with Saudi Arabia, have been discussing taxation reform, but not to any uniform timetable. Introduction of a sales tax or value added tax is being discussed within the GCC, although no firm commitments have been made.

REAL ESTATE BECOMING AVAILABLE TO BUY

A significant change in the region is the possibility for foreigners to purchase real estate in some areas – foreigners have previously been restricted from all property ownership in the five economies. Bahrain, Oman, Qatar and the United Arab Emirates (Dubai) are beginning to open the way for non-GCC nationals to own properties in selected areas and developments.[21] While the availability of long-term leases in all countries has meant that restrictions on ownership have not been a significant hindrance to foreign investment, these reforms have helped spur the high level of activity in regional real estate markets, particularly as ownership often entitles residents to extended visa arrangements. Dubai's market, in particular, has surged, with some analysts predicting that there is no danger of oversupply until at least 2007, despite expected investments of over US$50 billion between 2005 and 2010 (Economist Intelligence Unit, 2005b).

NON-TARIFF BARRIERS AND OTHER BUSINESS DIFFICULTIES REMAIN

While the GCC customs union should simplify customs procedures and requirements, non-tariff barriers remain, such as local agent requirements, import licensing, product standards and government procurement. Outside these barriers, businesses also often complain of overly lengthy and bureaucratic paperwork procedures required to export to the region.

Use of agents

Local agents have been a key legal requirement used by GCC economies to encourage national participation in the private sector. Bahrain, Oman, and Qatar (only in some sectors) have now eliminated this requirement for product distribution, but in practice, local agents are still helpful in business dealings, particularly in securing government contracts.[22] In other cases, the requirement for a local agent and inflexibility in the use of these agents can act as a significant barrier to business. Outside its many free trade zones, the United Arab Emirates has some of the most stringent rules regarding agents, where foreigners can only distribute their products in the United Arab Emirates through exclusive commercial agents that are either nationals or companies wholly owned by nationals, although these requirements are being reviewed. Kuwait also retains legal obligations requiring the use of local agents for sales, except in free trade zones.

Although agents can be a valuable tool for doing business in the region, termination of agreements with these agents can be difficult; for example, in the United Arab Emirates such agreements may be terminated only by mutual accord between the exporter and the local agent. Although it can be

[21] In the United Arab Emirates, specific laws allowing foreign ownership of property have yet to be finalised, creating some uncertainty as to the exact legal status of ownership.

[22] In Qatar, only firms granted 100 per cent foreign ownership in agriculture, industry, tourism, education and health are excluded from the local agency requirement. Individuals other than exclusive agents are allowed to import products provided they pay a five per cent commission to the registered agent or distributor.

difficult, particularly for smaller companies, businesses should exercise due diligence before entering any agreements with commercial agents or investment sponsors. Good personal relationships may minimise the chances of costly, time-consuming legal action.

Import licensing

Import licenses are required for most products in Kuwait, Qatar and the United Arab Emirates, and these licenses are issued only to nationals. In Kuwait, Bahrain and Oman, importers must be registered with the national Chamber of Commerce. In Bahrain, businesses importing goods must be at least 51 per cent locally owned and registered with the Ministry of Commerce.[23]

The GCC expects to abolish the prerequisite of obtaining an import license for importing any commodity into any of the GCC States, because it conflicts with the requirements of the formation of the GCC customs union and of the single point of entry (Gulf Cooperation Council, 2003a). While this will help potential exporters to the GCC, no details or timeframe for such reforms have been announced.

Product standards

Kuwait, Qatar and the United Arab Emirates have shelf-life requirements that are often shorter than scientifically necessary to preserve freshness. These requirements inevitably discriminate against importers outside the immediate region, given their greater distance to the market (United States Trade Representative, 2004a).

Implementation of unified standards for all national and imported commodities is targeted for 2006 as part of the GCC Customs Union. In the meantime, members have adopted the principle of mutual recognition of the national specifications and standards in GCC States (Gulf Cooperation Council, 2003a).

Government procurement

Foreign businesses face challenges in accessing government procurement, as preferences are given to local companies and transparency is generally a problem. Government procurement is open to all firms, but Kuwait, Oman, Qatar and the United Arab Emirates give a ten per cent price preference to local firms; Oman favours firms that include high local content, including direct employment of Omani nationals. Qatar also gives a five per cent price preference to GCC firms. Kuwait's government procurement policies specify the purchase of local products when available and foreigners can apply for government contracts, but must reinvest 35 per cent of the contract value in an approved offset business venture, although this is being reviewed. This requirement applies to civilian contracts over KD10 million (US$32.9 million) and defence contracts of KD1 million (US$3.3 million).

Transparency in government procurement, both in advertising and assessing tenders, is a problem, but some progress is being made, albeit slowly. Bahrain has a transparent, rules-based government

[23] In Oman, importers can bring in goods without paying a commission to a registered agent, provided the goods are imported through an Omani port or airport. Wholesale food distribution and small grocery retail sales are limited to Omani nationals.

procurement system which also allows some procurement to be conducted through international public tenders open to foreign suppliers. Oman is also increasing transparency in the tendering process by advertising tenders in the local media, international periodicals and on the tender board's website. Despite this progress, procurement practices can discourage potential bidders.

Legal system

Legal frameworks can present a significant obstacle, particularly where business dispute resolution is concerned. The World Bank (2005) states that both Kuwait and the United Arab Emirates require more than 50 different procedures to enforce a contract, and that the average number of days to enforce a contract in the Middle East and North Africa region is around 426 days. In practice, out-of-court settlement is usually the preferred method of resolution, particularly as legal systems often favour national companies over foreign companies. A key legal issue for foreign companies is minimising the likelihood of paying compensation to agents in the event of non-renewal, or unjustifiable termination of agency agreements (East Asia Analytical Unit, 2000).

In Bahrain, Contract Law and Civil Wrongs Ordinance are based on the principles of English common law. Bahrain has a long-established framework of commercial law but courts do not always function properly so dispute settlement can be slow. Out-of-court settlements are an available alternative and Bahrain has two commercial arbitration centres. Only a Bahraini lawyer can argue in Bahraini courts but lawyers of other nationalities can work on cases. Patent and trademark protection is strong and Bahrain has made considerable progress in reducing copyright piracy (United States Department of Commerce, 2004a).

Kuwait has a developed, albeit slow, legal system and a civil code system influenced by Islamic law. Only Kuwaiti courts can adjudicate disputes involving a foreign investor and other parties, although arbitration is permitted and formally recognised in law. The courts are reasonably effective in resolving disputes (East Asia Analytical Unit, 2000; United States Department of Commerce, 2004b). Kuwait was elevated to the Office of the United States Trade Representative's Priority Watch List in 2004 and remained there in 2005 because of what the United States terms 'its failure to address serious and rampant copyright infringement and failure to amend its copyright law' (United States Trade Representative, 2004b, 2005b).[24]

In Oman, the Commercial Court hears business disputes, and the Oman Chamber of Commerce and Industry has an arbitration committee to hear disputes where the amounts involved are small. Oman's copyright protection is generally considered good. All litigation and hearings must be conducted in Arabic (United States Department of Commerce, 2004c).

[24] The Office of the United States Trade Representative has a 'Special 301' annual review that examines in detail the adequacy and effectiveness of intellectual property protection in approximately 85 countries. The Special 301 provisions of the Trade Act of 1974 require the USTR to identify foreign countries that have inadequate and ineffective protection of intellectual property rights. There are four 'lists' in the 2005 review, Priority Foreign Country (Ukraine), Section 306 Monitoring (China and Paraguay), the Priority Watch List, with 13 economies listed in 2005, and the Watch List, with 36 economies listed in 2005.

In Qatar, contracts between local and foreign parties serve as the basis for resolving any future commercial disputes, a process which can be time-consuming. Businesses therefore are advised to consult a local legal firm when signing contracts with Qatari businesses in order to protect their own interests (United States Department of Commerce, 2004d).

In the United Arab Emirates, only nationals may undertake legal practice. Foreign law firms are only allowed to practice as legal consultants and are not permitted to plead cases in the courts. Court proceedings in the United Arab Emirates are time-consuming. There are no juries, and cases are heard by a single judge or a three-judge panel, depending on the nature of the dispute. All evidence submitted to the court must be in Arabic (Council for Australian–Arab Relations, 2005). Costs are not awarded, but frequently courts award simple interest of up to 12 per cent on disputed late payments (East Asia Analytical Unit, 2000).

Documentation

Companies can face lengthy documentation procedures. For foreign companies, company registration can involve a number of agencies and further documentation is required to hire foreign workers. Other requirements, such as legalisation of documents to allow exporting to the United Arab Emirates, for example, can require the involvement of Chambers of Commerce and the United Arab Emirates' Embassy in Australia.

Services trade barriers

Services trade generally remains more highly protected than goods trade. As members of the World Trade Organization, the five economies are committed to liberalising their services sectors, but progress can be slow at times. Where the law for wholesale and retail trade in these economies requires agents, these must be nationals. Legal services are generally out of bounds with regard to practising in local courts, although foreign lawyers can work in a consulting capacity.

Foreign universities operating in the United Arab Emirates seeking accreditation must have individual courses accredited, a costly and time-consuming process, rather than accreditation of the university as a whole. Moreover, accreditation of degree courses generally requires four-year degrees, raising difficulties for Australian universities. GCC nationals require accredited degrees to access public sector positions.

Communications sectors, while gradually being opened in some economies such as Oman, remain largely closed in others such as the United Arab Emirates (despite the licensing, in mid-2005, of a second telecommunications provider which is partly government-owned). Entry into areas such as financial services aimed at domestic markets also faces barriers, including limits on the levels of foreign ownership, restrictions on the number of branches allowed to operate and higher taxation.

TRADE DEVELOPMENTS

KEY POINTS

- Trade is growing rapidly. High oil prices and increasing oil production are raising the value of exports, while larger populations with greater wealth are demanding more imports.
- The region's narrow production base, predominately centred on energy related industries, means reliance on a diverse range of imports covering most sectors.
- Major imports include motor vehicles, mechanical and electrical machinery, and iron and steel.
- As domestic production is focused on similar goods, intra-regional trade is limited.
- The five economies, together with Saudi Arabia, are attempting to develop a common market and currency under the Gulf Cooperation Council (GCC) in order to increase intra-regional trade, assist in economic diversification and stability, and present a more attractive market to foreign investors.
- In 2003, members of the GCC began to implement a Customs Union, with a common five per cent tariff applied to most imports from outside the Union.
- Members of the GCC are also attempting to remove other barriers to regional trade and harmonise legislation.
- Although further integration among GCC members will assist in increasing regional trade, a high reliance on imports from outside the region is likely to continue.
- Europe, the United States, Japan and China are important sources of imports.
- Several major trading partners are negotiating free trade agreements with the GCC, and others are negotiating bilateral free trade agreements with individual economies.

Gulf trade is booming. High oil prices, together with increasing oil production, are resulting in soaring levels of exports which are helping to fund rising levels of imports. The region's narrow production base means it is highly reliant on a broad range of imports, making it an attractive market to exporters across many sectors.

Although trade with the world is substantial, intra-regional trade continues to be minimal. Building on the natural religious, cultural and social ties within the five economies covered in this report and with Saudi Arabia, efforts are underway to create a common market with a single currency within the Gulf Cooperation Council (GCC).[25] The eventual development of a GCC common market will encompass 35 million people, with a combined GDP of around US$400 billion and an average GDP of around US$11 500 per person. If achieved, this common market could expand and diversify intra-regional trade while presenting a larger, more attractive and stable market for exporters and investors to target. However, such an integrated market is still some time off.

Bilateral, regional and multilateral trade agreement obligations are opening the region to products and services from around the world. In addition to the free trade area within the GCC, the GCC member states are also part of a broader Greater Arab Free Trade Agreement, encompassing 17 countries in the region. The GCC is also negotiating free trade agreements with large trading partners and individual members have embarked on a program of bilateral trade deals with key markets.

FOREIGN TRADE VITAL

Foreign trade plays a vital role in all five economies due to the region's limited domestic production capacity. The significance of foreign trade to an economy is often measured by the share of exports and imports in GDP. External trade accounts for between 75 per cent of GDP in Kuwait up to well over 100 per cent of GDP in Bahrain and the United Arab Emirates.

Exports and imports soaring

High oil prices in 2003 and 2004 have helped produce trade surpluses and further strengthened the export growth achieved over the last decade. To meet growing demand, imports have also surged, growing in value by around 85 per cent over the five years to 2004 (Figure 3.1).

[25] The Gulf Cooperation Council is more properly known as the Cooperation Council for the Arab States of the Gulf.

Figure 3.1

Exports and imports showing strong growth

Total exports and imports of Bahrain, Kuwait, Oman, Qatar and UAE, US$ billion, 1994 to 2004

Notes: 2004 figures are preliminary figures only.

Source: Bahrain Monetary Agency, 2005a; Central Bank of Kuwait, 2005; International Monetary Fund, 2005b; Ministry of Economy and Planning, 2001, 2005a; Ministry of National Economy, 2004, 2005; Qatar Central Bank, 2005b.

Qatar's exports have shown the most growth in value over the five years from 1999 to 2004, growing by an average of 22 per cent per year and largely driven by the expansion of the gas industry (International Monetary Fund, 2005b; Qatar Central Bank, 2005b). Bahrain, with the lowest growth in the value of total exports over the five years to 2004, still recorded an average annual growth of around 11.5 per cent per year (Bahrain Monetary Agency, 2005a). From 2003 to 2004 alone, Kuwait's exports are estimated to have grown by more than one third in value (Central Bank of Kuwait, 2005).[26]

There has also has been strong growth in the value of imports – Qatar and the United Arab Emirates are estimated to have seen growth of around 17 and 14 per cent respectively over the five years to 2004, the strongest in the region. Due largely to its strong re-exporting business, the United Arab Emirates is the largest importer in the Middle East, bringing in more goods than larger economies such as Saudi Arabia and Iran.[27] From 2003 to 2004, Oman recorded the largest increase in imports, with an estimated growth of over one quarter in value (Ministry of National Economy, 2005).

26 Based on preliminary estimates.

27 This includes imports into the free zones and non-monetary gold imports. Where possible, all import figures shown for the United Arab Emirates include these items. However, even without these included, imports into the United Arab Emirates are greater than imports into Saudi Arabia.

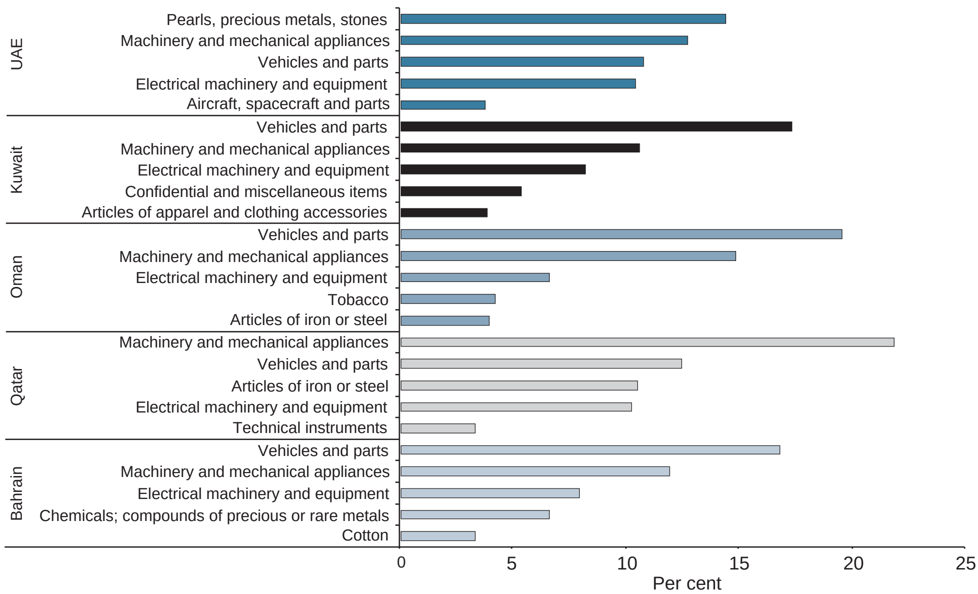
Diverse range of imports

A narrow domestic production base and very limited agricultural production means the five economies rely on a diverse range of imported goods (Figure 3.2).

Figure 3.2

Cars and machinery are important imports

Top five imports as a share of total merchandise imports, latest year available, per cent



Notes: Bahrain, Oman, Qatar and United Arab Emirates charts based on 2003 data. Kuwait's imports use 2001 data.

Source: Central Statistics Organisation, 2005b; Department of Foreign Affairs and Trade, 2005a; Ministry of Economy and Planning, 2005a; The Planning Council, 2005b.

Main trade partners outside the region

The five economies rely on imports from a diverse range of countries, predominately outside the Gulf region, although the size of Saudi Arabia and the importance of the United Arab Emirates as a business hub are reflected in their significance in providing other economies' imports (Table 3.1). China's growing role in world trade is reflected in its rise to become the largest source of imports for the United Arab Emirates, but the established trading partners – Japan, the United States and the European Union – are still the largest sources of imports for the five economies together.

Table 3.1

Japan and US top source of imports for the region, but China important in UAE

Major import suppliers to selected Gulf economies, US$ million, 2003

Bahrain		Kuwait		Oman		Qatar		UAE	
Saudi Arabia	1503.3	US	1659.9	UAE	1736.7	France	997.9	China	5541.0
US	559.7	Japan	1157.2	Japan	1065.5	UK	567.1	Japan	4001.8
Japan	380.4	Germany	1075.7	UK	476.7	Germany	525.3	Germany	3982.8
Australia	283.2	China	742.5	US	355.4	Japan	523.2	US	3861.3
UK	278.2	UK	682.9	Germany	284.7	US	449.2	France	3818.3
Germany	265.4	Saudi Arabia	623.3	Italy	233.7	Italy	315.8	UK	3297.6
UAE	169.0	Italy	564.3	Saudi Arabia	210.2	Saudi Arabia	209.7	Italy	2430.5
France	159.9	Australia	555.2	Australia	201.3	UAE	205.0	India	2256.7
Italy	143.0	France	470.6	India	178.4	Korea	181.4	Hong Kong	1839.2
India	117.9	UAE	317.7	France	156.2	Netherlands	129.7	Korea	1790.5

Notes: Bahrain imports from Australia use Bahrain data, as other data sources exclude alumina and as a result, significantly understate Australian trade with Bahrain.

Source: Department of Foreign Affairs and Trade, 2005b; International Monetary Fund, 2005c; Ministry of Finance and National Economy, 2004.

Exports are dependent on key markets, of which Japan and Korea remain the most important due to their energy needs. Total exports from the five economies to Japan and Korea totalled over US$25 billion and US$11 billion respectively in 2003. In comparison, exports to the next most important export destination, Singapore, totalled just over US$5 billion in 2003 (International Monetary Fund, 2005c).

Free trade zones delivering exports

Free trade zones in the United Arab Emirates have helped diversify the country's exports. Free trade zone exports accounted for nearly 60 per cent of the estimated value of non-oil exports in the United Arab Emirates in 2002 (Central Bank of the United Arab Emirates, 2003). Dubai's free trade zones increased total trade from around AED 21 billion (US$5.7 billion) in 1995 to AED 71 billion (US$19 billion) in 2002, an annual average growth rate of around 19 per cent (Rettab and Moraba, 2004). The most significant of these Dubai zones is the Jebel Ali Free Zone, which accounts for more than 80 per cent of the total value of goods traded by the free trade zones of Dubai with the rest of the world (Rettab and Moraba, 2004).

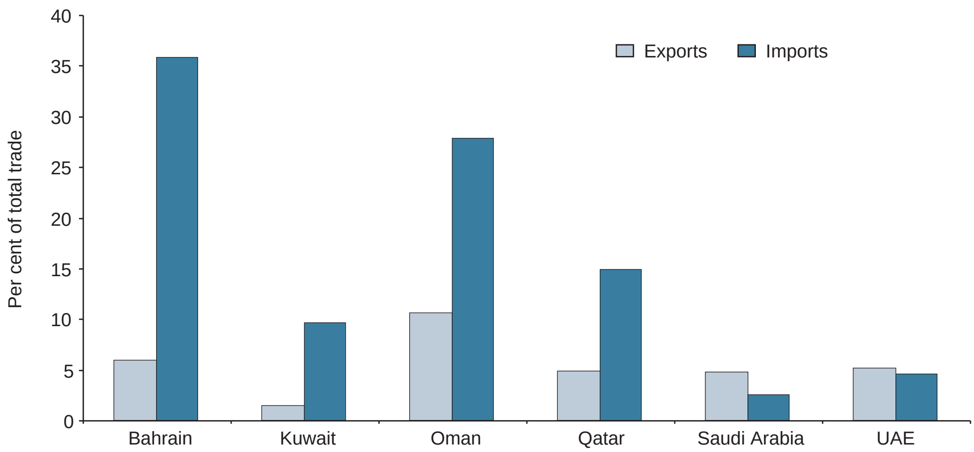
INTRA-REGIONAL TRADE LIMITED

Intra-regional trade is limited due to the similarity in regional economies and in their exports (Figure 3.3) – hydrocarbon exports and energy-intensive industries tend to dominate exports in all economies. Although intra-regional trade tends to be more important among some of the smaller economies, it remains low in comparison with other regions. Intra-regional trade accounts for around 20 to 25 per cent of ASEAN trade, or more broadly for around 40 to 50 per cent of Asian trade, while regional exports in the EU account for around 60 per cent of its total trade (World Trade Organization, 2005). In comparison, intra-regional trade between the GCC member countries accounts for only around five per cent of total GCC trade (International Monetary Fund, 2005c).

Figure 3.3

Intra-regional trade low

Exports and imports with other GCC economies, per cent of total exports and imports, 2003



Note: Bahrain's imports include oil imports and, as a result, are dominated by imports from Saudi Arabia.

Source: International Monetary Fund, 2005c.

Although the degree of intra-regional trade is relatively low, economic links between the countries are already close and further strengthening with the development of the GCC (see below). Considering the similarities in production and exports, Baier and Bergstrand (2004) suggest that GCC countries trade significantly more amongst themselves than might be expected for other similar countries at similar distances and therefore conclude that GCC membership does effectively increase intra-regional trade.

Intra-GCC trade has been growing. The GCC (2003b) reports that intra-GCC trade grew by around 40 per cent from 1995 to 2002. However, while continuing reform within the GCC will stimulate further intra-regional trade, limited domestic production of essential products requires that GCC economies look outside the region for a significant proportion of their imports.

Re-exports important in regional trade

The well established free trade zones within Dubai continue to act as the main re-export centre for the region. United Arab Emirates' registered re-exports are around five times higher than other non-oil exports, amounting to around US$13.8 billion in 2003 (Ministry of Economy and Planning, 2005a).

Despite growing competition from within the region, United Arab Emirates has surged ahead, with re-exports growing by 23 per cent in 2003 after growth of 31 per cent in 2002 (Ministry of Economy and Planning, 2005a).

Re-exports also play important roles in other economies. At US$1.4 billion in 2004, re-exports in Oman are almost 30 per cent greater than the value of other non-oil exports, despite a 25 per cent fall in the value of re-exports since 2002 (Central Bank of Oman, 2005). In 2004, Kuwait's re-exports were around 30 per cent of the value of total non-oil exports (Central Bank of Kuwait, 2005).

Competition to Dubai's hub role

Many economies in the region are seeking to develop markets and sectors as regional hubs or centres. Dubai's busy Jebel Ali port, the first hub for the region and, together with the twin port of Port Rashid, among the top ten busiest ports in the world, is now under increasing pressure from new ports and port developments. Oman's Salahah Port, established in 1998, has quickly developed into a transhipment hub. Oman also is developing another major port at Sohar, while Kuwait has plans to develop a port at Bubiyan Island, largely to tap into Iraq trade. Yemen also has established a port at Aden.

Similarly, while Dubai is expanding its current airport and planning to build a new airport at Jebel Ali, its position as an airline hub is under competition from Doha, where plans are under way to increase airport capacity to handle 50 million passengers per year by 2020, and from Abu Dhabi, which is seeking to expand airport capacity to 20 million passengers by 2010 and over 50 million by 2020 (Ministry of Information and Culture, 2005a).[28]

GULF COOPERATION COUNCIL

Recognising the benefits of greater unity in both security and economic terms, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates formed the Cooperation Council for the Arab States of the Gulf (known as the Gulf Cooperation Council, or GCC) in 1981. Its charter embraces objectives including coordination and integration among member States in all fields, and harmonisation of regulations across the GCC.

One of the first achievements of the GCC was the agreement for free trade among member States in 1983. Under the United Economic Agreement, to which all six member countries are signatories, GCC economies are provided duty free access to all goods produced in GCC states, subject to rules of origin and foreign ownership restrictions.

[28] By comparison, around 30 million passengers passed through Singapore's Changi airport in 2004, while Malaysia's Kuala Lumpur International Airport handled around 20 million passengers in 2004. The busiest airport in the Gulf region, Dubai, handled just over 20 million passengers in 2004.

Despite the free trade agreement, the pace of progress in achieving a number of other GCC goals has not been as great as many would consider necessary.[29] In November 1999, GCC economies moved integration forward, agreeing to move external tariffs to a common range of between 5.5 and 7.5 per cent by 2005. This was subsequently brought forward and implemented on 1 January 2003, with member states also agreeing to create a common market, which includes the free movement of goods, people and capital, by 2007 and a common currency no later than 1 January 2010. Despite these positive steps, further integration to meet these goals is likely to continue to face a number of challenges.

MORE THAN AN ECONOMIC UNION

Unification within the GCC extends beyond economic union. Security, defence and foreign affairs are important aspects of the union. GCC member states believe that aggression on one Member State is an aggression on all of them; and any danger that threatens any one of them threatens them all. Armed forces, which have seen substantial build-up over the last decade, operate a number of joint exercises and there is substantial cooperation in military operations. Similarly, there is a high degree of cooperation on security matters such as border and coastal protection and anti-drug trafficking.

Cooperation also extends to transport and communication. GCC States coordinate infrastructure projects, such as ports and highways, and policies for transport and navigation. Improved transport links between member states are also important, with direct road links planned between Bahrain and Qatar, and Qatar and the United Arab Emirates.

Other areas of coordination and cooperation covered by the GCC include:

- legal: including lessening differences between regulations and laws, and closer relations between legislative institutions and judicial bodies
- science and technology: to foster research in the region
- health: including joint projects, mutual recognition of qualifications and an open market to GCC health firms
- education, including the unification of curricula across the GCC, particularly in the fields of maths and science
- environment
- sports and social areas
- information and media.

Source: Gulf Cooperation Council, 2003b, 2005.

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29 At the 21st GCC summit in December 2001, the slow pace of reform led Saudi Arabia's crown prince to complain that the GCC had not achieved the objectives defined in 1981. 'We have not yet set up a unified military force … We have not reached a common market, nor formulated a unified political position on political crises … objectivity and frankness require us to declare that all that has been achieved is too little and it reminds us of the bigger part that has yet to be accomplished … We are still moving at a slow pace that does not conform with the modern one.' (Middle East Economic Survey, 2002).

A customs union

Under the customs union, member states are to have a common customs law; unified customs regulations and rules applicable in all member states; and unified internal customs, financial and administrative regulations and procedures relating to importation, exportation and re-exportation in the GCC States. The Union also aims for free movement of goods among the GCC States without customs or non-customs restrictions, subject to rules in regard to quarantine and prohibited or restricted goods. Goods produced in any of the GCC States are to be treated as national products.

The GCC has a common external tariff with three levels: a zero rate applying to 419 commodities, including vegetables, fruit, fish, meat, sugar, cement, agricultural machinery and medical items; a five per cent rate applied to most other commodities; and selected higher rates that apply to protected or restricted products. For example, Qatar levies a tariff of 20 per cent on 12 millimetre steel bars, Oman has a 25 per cent tariff on fresh bananas and a 20 per cent tariff on dates and bisoor (dry dates), and Saudi Arabia has some 800 exemptions. Tobacco, alcohol and pork products – where importation is permitted – attract tariffs of 100 per cent or more across the GCC. (See Chapter Five – *Australia – Gulf Commercial Relationship* for an indication of tariffs applied on Australia's major exports to the region).

The common external tariff will eventually be applied at any port of entry to the customs union and the standardisation of customs requirements and procedures should benefit exporters active in multiple GCC markets.

A maximum three year transitional phase was agreed for the implementation of the customs union, beginning in 2003. During this period, certain customs procedures may be applied to intra-GCC goods movement and protective customs on foreign products which are similar to national products are allowed. However, by April 2005, businesses exporting to the region still reported that although movement of goods between GCC countries was relatively easy, some implementation problems meant that a number of obstacles to regional trade still existed, in addition to the tariff exemptions mentioned above.

Further integration

To prepare the way for further integration towards a common market and an eventual monetary union, economies within the GCC have been working to remove other barriers and harmonise legislation. In broad terms, GCC member states have extended national treatment in areas of labour, services and capital to other GCC members. Barriers to free movement of goods and services, labour and capital are being eliminated, investment in member country stock markets is being opened, real estate ownership is possible and national tax treatment has been granted to individuals and corporations of GCC countries.

Telecommunications and financial markets are gradually being opened to other member states and a process of both expansion and consolidation has begun. A harmonised food schedule is proposed for implementation by 2006 and other standards and legislation, such as labour regulation and antitrust rules, are also being harmonised. There is increasing coordination on transport and utilities. An electricity grid linking the GCC countries is expected to be completed by 2008. It is envisaged that full implementation of the Customs Union should also remove the need for businesses to have a distributor in each of the GCC markets, significantly reducing search time and start-up costs.

Towards a monetary union

In December 2001, member states of the GCC agreed to have a common market by 2007 and to adopt a single currency by no later than 2010. The adoption of a Customs Union was the first step towards this. Other areas of convergence, including ratios of government debt to GDP, fiscal balance to GDP, and international reserves ratios, have also been agreed to help build the path towards integration. As most of the GCC countries have operated a fixed exchange rate system against the US dollar for some time, exchange rate volatility between the economies is not an issue, but GCC members face a number of other issues which must be resolved before a single currency is possible.

COSTS AND BENEFITS OF A SINGLE CURRENCY

Although the Gulf Monetary Union has costs and benefits similar to other monetary unions, the similarity of economies within the proposed union is one of the main factors affecting the analysis. Relatively similar economic structures make unification simpler. However, this similarity may also reduce the benefits of unification; for example, it may not reduce the region's exposure to the effects of oil price shocks.

Some of the arguments for a currency union include:

- elimination of currency transaction costs
- greater price transparency and standardisation
- lower inflation and interest rate environment within the GCC through increased fiscal discipline by member countries (though inflation has not been a significant problem in the region)
- elimination of exchange rate risks (though the current policy of fixed exchange rates to the US dollar largely removes this risk)
- increased efficiency in banking and capital markets
- increased trade and investment opportunities, both domestic and foreign, since investors and exporters would be able to target the Gulf as a whole. Domestic investors would also be able to diversify their portfolios within the region without additional currency risks
- greater influence in multilateral negotiations.

Arguments against unification include:

- loss of control over fiscal policy
- difficulties of creating central authorities, such as a central bank (particularly reaching agreement on its location), and managing the convergence of fiscal criteria
- continued instability due to oil shocks, the region's main economic variable: production is dominated by oil, so that unification does not necessarily assist in diversification against price shocks
- limited potential for growth in intra-regional trade: similarity of economies, including exports, means intra-regional trade is unlikely to grow significantly, while local investors in the region will have little choice by way of new industries – portfolio diversification in banking services will still be difficult.

Source: Al-Bassam, 2003; Fasano and Iqbal, 2002; Laabas and Limam, 2002; Omani Centre for Investment Promotion and Export Development, 2004; Popescu and Mustafa, 2001.

OTHER TRADE REFORM

The GCC as a region has been negotiating a free trade agreement with the European Union since 1990. Reports indicate an agreement may be possible by the end of 2005 or shortly after (AME Info, 2005c). Other economies with which negotiations, or discussions, for a free trade agreement have begun include China, India, Pakistan and Mercosur (the South American Common Market).

Individual economies in the region are also embracing bilateral free trade agreements. Although the 2001 GCC economic agreement provides that 'no member state may grant to a non-member state any preferential treatment exceeding that granted herein to member states, nor conclude any agreement that violates provisions of this agreement', this does not appear to have affected the appetite for bilateral agreements. Bahrain and the United States signed a free trade agreement in 2004, unilaterally granting the United States full exemption from customs duties. Although this was Bahrain's second free trade agreement, following one with Thailand, tensions between Saudi Arabia and Bahrain were widely reported following the signing with the United States. Saudi Arabia claimed the agreement was a violation of the GCC Economic Agreement and is imposing tariffs on duty-free US goods moving from Bahrain to Saudi Arabia.

Other GCC governments continue to pursue separate bilateral free trade agreements despite Saudi Arabia's disapproval of such agreements. The United Arab Emirates and Oman are currently negotiating free trade agreements with the United States, and Qatar and Kuwait have also begun discussions with the United States on a possible agreement. Additionally, Kuwait, Bahrain, Qatar and the United Arab Emirates are each in free trade agreement discussions with Singapore, while the United Arab Emirates and Australia have also begun free trade negotiations. All GCC economies except for Saudi Arabia are World Trade Organization members, and Saudi Arabia is currently negotiating accession to the World Trade Organization.

Free trade agreements could potentially impact on Australian exports to the region. A number of Australia's top 20 merchandise exports face a five per cent tariff (Table 5.4). Items such as cars, Australia's largest export to the five economies in this report, are also one of the United States' largest exports to the region. Similarly, Australian dairy exporters face strong competition in the region from the European Union.

Greater Arab Free Trade Area

The five economies are also part of the Greater Arab Free Trade Area which came into full effect on 1 January 2005. This free trade exchange zone comprises Saudi Arabia, Qatar, Bahrain, Egypt, the United Arab Emirates, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, the Palestinian Authority, Sudan, Syria, Tunisia and Yemen. Algeria is in the process of joining the area and the Secretary of the League of Arab States, Amre M. Moussa, also has publicly expressed his hope that Mauritania, Somalia, Djibouti and Comoros federation will join the area shortly (League of Arab States, 2005). The creation of the area is likely to have a positive effect on the re-export business of the Gulf economies. However, the agreement's focus on goods trade, without the inclusion of services, together with the limited extent of intra-Arab trade, is likely to mean that the size of any benefits to the Gulf may not be significant.

IRAQ – A RE-EMERGING MARKET

A number of the five economies are well placed to participate in the reconstruction and development of Iraq. Kuwait is an important conduit for goods into Iraq, particularly with the development and expansion of new ports, while the United Arab Emirates' substantial re-export sector is a likely source for many goods. Some indication of this importance is evident in the doubling of Kuwait's re-exports in the third quarter of 2003 alone (Pereira, 2004) and reports that the United Arab Emirates is emerging as the largest exporter to Iraq, with exports of US$588 million in 2003 (AME Info, 2004), although further growth may be largely dependent on security improvements. Bahrain is likely to benefit as a financier for short term and long term projects in the emerging market.

FUTURE TRADE PATTERNS

The five economies recognise that it is important they develop strong relationships with their major trading partners. They are highly dependent on trade and are enthusiastically developing a combination of bilateral and regional free trade agreements to establish themselves as regional centres. In price-sensitive markets, these new agreements could have significant effects on where the region sources its imports.

Regional integration through the GCC, if achieved, would bring some of the wealthiest economies in the Middle East into one large market. Although full integration is still some time off, closer integration should provide an attractive market to investors and make it easier for exporters.

CONSTRUCTION: TAPPING INTO THE GROWTH[30]

KEY POINTS:

- **A construction boom is changing the face of the region, with new projects attracting billions of dollars in investment.**
- **The region has become an attractive market for the world's building and construction industry. Rising oil revenue has allowed governments to sustain an increase in capital spending.**
- **Dubai leads the construction boom, although other economies are also experiencing very high rates of growth in construction related sectors.**
- **Key drivers of growth in the industry include population growth and the resulting demand for infrastructure; the push for economic diversification, particularly in tourism; the ability for expatriates to purchase property, albeit restricted to certain projects; and new developments in the energy sector. Mega-projects are a feature of the region.**
- **Demand is high for building products and services, telecommunications, power generation, water treatment, parks equipment and landscaping, and for infrastructure such as hospitals, schools, mosques, fire services, new townships, education facilities, airports, sea terminals, highways, leisure and commercial developments, shopping malls, apartment blocks and office buildings.**
- **The boom in the construction industry is revealing some constraints. Resource shortages have affected projects, while rising production costs and lower margins due to high levels of competition have affected profitability. Oversupply is also a concern.**
- **More Australian firms are accessing these market opportunities and participating in major construction trade shows.**

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30 The Economic Analytical Unit is thankful to Master Builders Australia and the Victorian Government Business Office in Dubai for their assistance in providing material for this chapter. The comments about the markets have been compiled from material supplied by Tradex Exhibitions who represent DMG Word Media (Dubai) Limited in Australia for the Big 5 Show in Dubai, from the offices in Dubai of State Governments of Victoria, South Australia, and Western Australia, and exit surveys from firms on Master Builders Australia's programs.

CONSTRUCTION INDUSTRY OVERVIEW

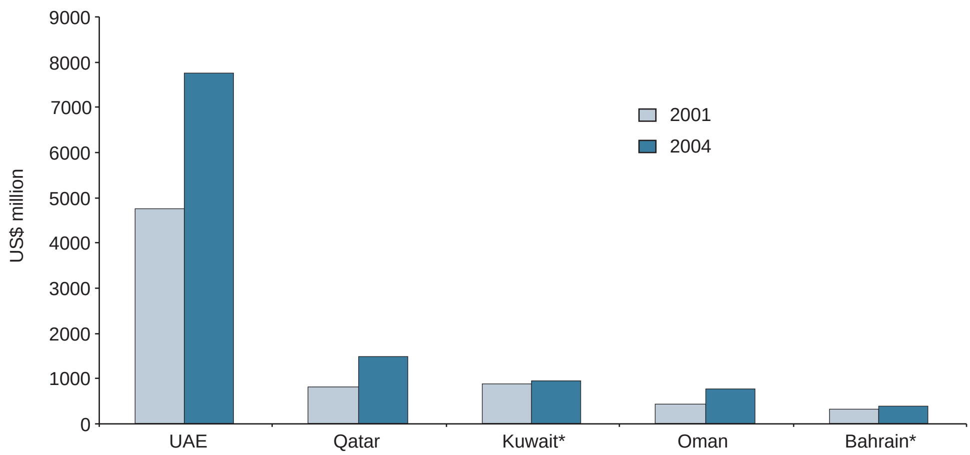
The face of the region is changing. The most obvious sign of economic development is the high level of construction activity. The push to build more diversified and stable economies and provide for growing populations is expanding the construction industry in all five economies. High levels of liquidity resulting from high oil prices, together with cheap expatriate labour, have allowed governments to embark on ambitious construction programs.

The start of the current upturn in the construction market began in 2002 as high oil prices, together with reforms such as relaxation of restrictions on foreign ownership of property, led to a rush of construction activity (Figure 4.1). Major Gulf Cooperation Council (GCC) contract awards have been totalling, on average, about US$3 billion per month; it is predicted that the 2004 total was in the region of US$50 billon, given the host of major projects across the region which moved into the implementation phase. Of this figure, some 60 per cent, or US$30 billion, is in the United Arab Emirates alone and the majority of that is in Dubai (Victorian Government Business Office, 2005a). Much of the current construction program in the Arabian Gulf features mega-projects. In ten years time, the region plans to have the tallest building in the world, the largest tourist park in the world and some of the most innovative construction developments.

Figure 4.1

Construction sector growth

Size of construction sector, 2001 and latest year available, US$ million



Notes: * 2003 data

Source: Central Department of Statistics, 2005; Ministry of Economy and Planning, 2005a; Ministry of National Economy, 2005; The Planning Council, 2005a; Ministry of Finance and National Economy, 2004; Central Bank of Kuwait, 2004.

Much of the investment for this growth comes from the governments. Over the next ten years, spending is set to continue on infrastructure, office and residential accommodation, with high oil prices further fuelling this investment. Capital expenditures of government budgets reflect this trend – for example, Qatar's 2004–05 Budget allocation for major public projects, at QR8883 million, represented an increase of 44 per cent over the previous year's budgeted amount and, due to under-expense, almost double the actual capital expenditure in 2003–04 (Qatar National Bank, 2005). Similarly, Kuwait's budgeted figure for capital and construction expenditure in 2004–05 was a 45 per cent increase over the previous year (Central Bank of Kuwait, 2005). Complementing government expenditure, private investment is also beginning to be an important source of funds for construction.

Market forecasts indicate that there will be at least another three years of rising orders, with the total value of the GCC market for the period 2004 to 2006 projected to reach an estimated US$220 billion (MEED, 2004a). The United Arab Emirates is likely to be at the forefront of this growth, with the construction sector representing both an indicator of, and a catalyst for, rapid economic development.

There are uncertainties in the construction market. Prices for key products are rising, competition among construction companies is very strong, and investment is still largely reliant on oil revenue. In particular, some analysts question whether Dubai's booming real estate market, which has drawn investment from around the region, may begin to suffer from oversupply, particularly if anything disrupts growth in sectors such as tourism. However, demand remains very strong for new projects and developments.

Key market drivers

The major economic challenges facing the five economies, population growth and diversification, are also key drivers in the construction industry. The hydrocarbon markets continue to provide opportunities.

Growing population – growing demand for infrastructure and utilities

In addition to creating demand for housing, high population growth rates are placing strains on existing infrastructure. Power, water treatment and sanitation needs in the Gulf are rising significantly and will require substantial investments in the coming years to meet demand. Demand for power in Dubai increased by more than ten per cent in 2003 (Ministry of Information and Culture, 2005b), while Bahrain's demand for power has grown at an average annual rate of over six per cent in recent years (Ministry of Finance and National Economy, 2004). With some of the highest per-capita water consumption levels in the world, spending on water and electricity projects is likely to increase – both Abu Dhabi and Dubai expect to double electric power output between 1997 and 2010, while the need for water in general and desalination water in particular will triple by the year 2020 (United States Department of Commerce, 2005a). By 2010, it is estimated that around $100 billion will need to be invested in power to meet the five economies' growing power needs (MEED, 2004b).

Besides power and water, other infrastructure projects, including road developments, are receiving increasing funding from governments. In March 2004, Qatar announced that some US$5 billion would be spent on roads, sewage and basic infrastructure developments in the next five years. It is estimated that nearly US$50 billion will be invested in infrastructure projects in Qatar over the next ten years (United States Department of Commerce, 2004c).

Tourism – the push for new growth

The five economies have embraced tourism as a key sector for growth. Dubai was one of the world's fastest growing tourism destinations in 2002 (World Tourism Organization, 2005). In the last five years this trend has led to the development of around 30 new 4- and 5-star hotels in the United Arab Emirates. However, all five economies are seeking investment in tourism industries, and a large number of mega-projects are under way.[31] The enthusiasm for large projects has been contagious and tall office buildings, huge shopping malls, hotel and resort complexes and other tourist infrastructure are all under development. The growth in the number of shopping malls has been led by Dubai, where projects either planned or underway are estimated to triple the Gross Leaseable Area. Over 400 high-rise buildings are under construction or planned in Dubai alone.

Expected increases in tourism and the growth in regional airlines are also fuelling infrastructure growth. Airport passenger throughput in Dubai is expected to double from 15 million in 2002 to around 30 million by 2010 and infrastructure expansions are taking place with US$4.5 billion planned expenditure for the Dubai International Airport. Qatar also is expanding its airport in preparation for the Asian Games in 2006 and as part of the Government's push to become a top destination for meetings, conferences and events tourism.

Construction and the energy sector

Expansion of the gas sector, which is frequently more open to foreign investors than the oil sector, offers significant prospects. Opportunities to participate in a number of upstream activities such as drilling and production remain limited in some of the larger oil producing states; however, opportunities exist in downstream industries, including energy intensive industries.

The United Arab Emirates has plans to raise oil production significantly. The Abu Dhabi National Oil Company (ADNOC), which has controlling shares in all major oil and gas projects in the emirate, plans to increase production capacity from 2.5 million barrels per day in 2004 to 3 million barrels per day by 2006 and 3.7 million barrels per day by 2010, involving investment of around US$10 billion (Ministry of Information and Culture, 2005b). Investment is also planned for the gas sector, with projects in the pipeline worth over US$2.7 billion (United States Department of Commerce, 2005a).

Kuwait's oil sector continues a long trend of expansion following the disruptions of war in the early 1990s. Kuwait's upstream oil sector remains closed to foreign participants, despite Government attempts to introduce legislation allowing private investment in this sector through 'Project Kuwait' – the development of the Northern Oil Fields. This is part of a push to increase production capacity from the current 2.5 million barrels per day up to four million barrels per day by 2020. Other developments in Kuwait include new export facilities (around US$850 million), pipeline replacement, a new refinery (around US$4 billion) and new petrochemical facilities (United States Department of Commerce, 2005b; Gulf Construction Online, 2004a).

[31] Already, there has been significant growth in tourist numbers. Between 1995 and 2002, Bahrain, Oman and the United Arab Emirates all showed an average annual growth rate of tourist arrivals of over ten per cent (World Tourism Organization, 2005).

Qatar's opportunities reflect the growing importance of its gas industry, where foreign involvement is strong. Qatargas II, a project to establish two LNG trains, is estimated at around US$12 billion. Other projects currently under consideration include the construction of additional liquefied natural gas trains, multiple gas-to-liquids plants, new petrochemical facilities, regional gas pipelines, a helium plant, an aluminium smelter, new refined products service stations, and additional onshore and offshore exploration and production.

Oman's focus is on enhancing current oil recovery and aging infrastructure, exploration and production of gas, and development of downstream energy facilities such as fertiliser plants. Expansion of Oman's gas sector is central to the country's diversification strategy. New projects include pipelines, enhanced oil recovery systems, gas processing facilities, refineries and petrochemical plants. Foreign firms have played significant roles in Oman's oil and gas sectors. Projects planned or under way in Oman include a US$1.3 billion oil refinery project in Sohar, a US$1.9 billion aluminium smelter and a fertiliser plant estimated at some US$550 million (United States Department of Commerce, 2005c).

Construction in Bahrain's energy industry has been focused on a US$800 million modernisation of the Bahrain Petroleum Company's refinery, finished in 2004, and a US$1.7 billion expansion of Aluminium Bahrain's (Alba) production to more than 800 000 tonnes – an increase of 50 per cent, completed in mid-2005. The proposed expansion makes Alba the largest smelter in the world outside of Eastern Europe.

UNITED ARAB EMIRATES: A MAJOR MARKET

The United Arab Emirates is the regional centre for much of the construction growth. Major construction projects underway in the United Arab Emirates are estimated to total somewhere around US$30 billion (Victorian Government Business Office, 2005a). On 21 October 2003, at the launch of one of Dubai's 'mega projects', Dubailand, the Crown Prince of Dubai, Sheikh Mohammed bin Rashid al Maktoum, reportedly stated with reference to the ambitious infrastructure and real estate developments in Dubai, 'Some of you doubted the success as you viewed the projects individually. What I have achieved until now is only ten per cent of what I plan to do for the Emirate' (MEED, 2003).

Abu Dhabi is also embarking on a significant program to raise its international profile, developing industrial cities and new tourist centres. With around 90 per cent of the United Arab Emirates oil reserves, Abu Dhabi has the wealth to realise its goals. Restrictive land ownership laws are being relaxed, allowing nationals to purchase property, and major property development companies are being established. The first, Aldar, reports it has 42 projects worth US$74 billion for development over the next ten years (Victorian Government Business Office, 2005b). One of the company's first mega-projects is the al-Raha Beach development, with an estimated cost of around US$15 billion. This development, to be built in phases, will include a hotel, shopping mall, villas and office towers. Other projects, such as the massive Abu Dhabi airport expansion, are also under way.

Building projects under development in the United Arab Emirates include 250 to 300 new towers, new residential districts, large shopping centres and other commercial premises, more than 80 new hotels and various airport expansions.

Growth in the construction industry is benefiting a wide range of associated industries. With more than 50 000 residential units and homes scheduled to be built in the next five years, products and services associated with this sector, such as garden and landscaping, home fittings, bathroom accessories and houseware items, are in great demand.

Dubai's lead

Dubai is pushing ahead with a raft of ambitious projects, such as the Dubai International Financial City and the Dubai Healthcare City, in an effort to keep itself established as the regional hub for commerce, trade and tourism. Development projects are currently valued at US$18 billion (Victorian Government Business Office, 2005a).

Dubai's decision to allow foreigners to purchase property, with the added incentive of the right to residency, has also stimulated the local real estate sector. High net worth Gulf investors are now viewing Dubai as a safe haven for investment.[32]

DUBAI'S MEGA-PROJECTS

Dubai's 'mega-projects' are helping to drive growth in a number of sectors, including construction and tourism. Construction of the Dubai Marina, a US$10 billion project, is well under way and will take 20 years to complete. Construction has commenced on two man-made Palm Islands, costing in excess of US$4 billion. Not content with building two artificial islands which are both five kilometres long and five kilometres wide, plans for a third and larger Palm Island were announced in late 2004.

The World Project, which will feature 200 islands laid out according to the globe, is situated five kilometres off the coast of Dubai and will contain 10 million square feet of beachfront. Work commenced in 2003 and should take five years to complete. The latest project announcement is for Dubai Waterfront. This is projected to take around ten years to complete, with a value in the tens of billions of dollars.

Dubailand, announced in October 2003, will be the world's biggest tourism project and will be completed in stages, with the first stages to be operational by 2007. Dubailand was first estimated to cover a staggering 2 billion square feet, comprising 45 mega-projects and 200 sub-projects with investment of around US$5 billion. By mid-2005, this had been raised to 3 billion square feet with projected investment of around US$9.5 billion. The centre is projected to attract around 200 000 visitors a day.

32 There has been some question over the lack of a law outlining and guaranteeing the legal rights of foreign owners. Mr Mohammed Alabbar, Chairman of Emirates announced mid-October 2004 that the United Arab Emirates Federal law on Properties will be in place in a year's time.

Dubai is also building what might be the world's largest tower, Burj Dubai, at a cost of US$1.6 billion.[33] Other major projects include Dubai Festival City (US$1.6 billion), Dubai Internet City, Dubai Media City, the Dubai International Finance Centre (comprising 13 towers and a host of developments), and the Dubai Light Rail project (72 kilometres of track at around US$3.5 billion). The Dubai Healthcare City (US$ 1.8 billion) is planned to transform Dubai into a global hub for specialised healthcare, research and medical education by 2010.

The rapid pace of development has led Dubai to accelerate development of a new airport at Jebel Ali by over a decade and to now develop Jebel Ali as a giant logistics city. The new airport, which is separate from the Dubai International Airport, will have six parallel runways and the ability to handle 120 million passengers and 12 million tonnes of cargo per year. The first stage is set to be completed in 2009 with total development to take 20 to 25 years.

Source: Victorian Government Business Office, 2005a, 2005b; United States Department of Commerce, 2005a.

OTHER COUNTRIES CATCHING UP

The United Arab Emirates is not the only economy showing strong growth in its construction sector. Other economies in the region are also pursuing mega-project tourist developments and are increasing infrastructure capacity to enable growth. Throughout the Gulf region, for example, an estimated US$8.75 billion will be spent on building, expanding or upgrading airports, not including some of the more recently announced airport expansions such as that in Abu Dhabi (Victorian Government Business Office, 2005a).

AUSTRALIAN COMPANIES GETTING INVOLVED IN AIRPORT REDEVELOPMENTS AND MORE

GHD, an Australian company, is an international professional services company providing leadership in management, engineering, the environment, planning and architecture. GHD Engineering became involved in the Middle East in 2001 with the acquisition of a company, MME, which had offices in Qatar and the United Arab Emirates. Winning the contract for the strategic plan of the Doha 2006 Asian Games, the most significant event for Qatar in the coming years, helped firmly establish GHD's strong reputation in the region.

In 2004, GHD was selected by the Sharjah Government, within the United Arab Emirates, to deliver an expansion and redevelopment program for the Sharjah International Airport. The company is responsible for the detailed design, tendering and construction phase services on behalf of the Sharjah Airport Authority. GHD has also worked on expansions of the Doha and Al Ain airports, and has been involved in planning the US$180 million Dubai Maritime City and a comprehensive traffic study for Doha.

Source: GHD, 2004.

33 The official planned height of Burj Dubai has not been released. However, estimates of its planned height range from 700 metres to 900 metres. In comparison, Petronas Towers in Malaysia is 452 metres high.

Qatar snapshot

Qatar's rapid economic development, following on from the development of its gas industry, has helped fund large construction growth. Strong growth in Qatar's construction sector is expected for the next two to three years due to an unprecedented demand for real estate, an increase in investment opportunities in the construction sector and large government capital outlays. However, with a population of just 740 000, growth opportunities may not be as substantial as in the United Arab Emirates.

Qatar's expanding budget outlay for public projects is likely to generate significant business for the private sector. Indeed, there are likely to be business opportunities across most sectors, with around US$7 billion allocated over the next four years to projects such as bridges, tunnels, roads, drainage, and health and sport facilities, (Foreign Information Agency, 2005). A number of vital projects are being implemented across the country to establish Qatar as a high-quality destination for cultural-tourism and to ready Qatar for hosting the 2006 Asian Games.

The Qatari Government has allocated US$15 billion to tourism projects including:

- eight new 4- and 5-star hotels, adding more than 2550 rooms
- a US$5.5 billion new airport, the first phase to be completed by 2009
- a US$2.5 billion man-made island – Pearl of the Gulf – first phase due to open in 2006
- a 32 square kilometre North Beach development comprising 10 resort hotels, two golf courses, 15 000 villas and apartments as well as commercial and retail shopping areas
- a US$400 million scheme to upgrade and expand sports facilities in the country in preparation for the 2006 Asian Games
- landmark cultural centres including a national museum, a museum of photography and new national library.

Qatar's airport development is one of the most significant in the region. Qatar has begun construction on the first phase, costing US$2.5 billion, of a US$5.5 billion project to build a new airport in Doha. Expansion of the current airport is under way to service the Asian Games in Doha in 2006, but the new airport is projected to eventually handle 50 million passengers a year upon completion around 2015–20. Qatar's tourism strategy envisages that tourists will more than double over the next six years from 400 000 in 2004 to more than a million in 2010 (Qatar Tourism Authority, 2004).

The Public Works Authority has announced that foreign contractors can now bid for public sports mega-projects in Qatar, provided they have an office in Qatar (Victorian Government Business Office, 2005a).

Qatar's largest market – LNG

With the single largest non-associated gas field and the third largest discovered reserves of natural gas in the world, Qatar's development of its gas field has been the single largest driver in the economy in recent years. Qatar's stated goal is to become the largest natural gas and gas to liquid products exporter in the world. The scale of investment required to develop Qatar's gas fields has necessitated foreign involvement, and the Qatar Financial Centre has been established largely to handle the project financing required to expand the sector. Qatar reportedly expects an investment of US$60 billion up to 2010 in its North Field development projects and gas-based industries (Gulf Construction Online, 2004b).

DOLPHIN PIPELINE

The Dolphin project involves building a pipeline from Qatar's giant North field to the United Arab Emirates and Oman. The goal is to link gas networks, creating for the first time a regional energy network. A gas pipeline is currently under construction, which will start out as a 48-inch pipeline in Qatar and finish as a 24-inch pipeline in Oman. Along the way, branch pipelines will deliver gas to other GCC countries. Natural gas has been supplied from Oman to the United Arab Emirates since January 2004. These supplies will continue at least until 2006, when supplies from Qatar are scheduled to begin through the US$3.5 billion project.

Bahrain snapshot

Bahrain is focused on developing its infrastructure sector and diversifying its economic base, with its 2004 budget allocating BD330 million (US$878 million) to development projects (Ministry of Finance and National Economy, 2005).

New projects are planned in tourism, shopping and residential sectors. The expansion of Aluminium Bahrain (Alba), estimated at US$1.7 billion and now completed, and the Bahrain Financial Harbour, estimated at US$1.3 billion, are two of the largest projects in the economy. Other major projects under way include:

- US$1.2 billion Durrat al-Bahrain (Pearl of Bahrain) development – a network of artificial islands
- US$1 billon Amwaj Islands development – a network of artificial islands
- US$ 600 million Al Areen Desert Spa and Resort
- US$530 million Lulu Tourism resort
- a US$1 billion port and industrial area development
- a US$ 200 million airport expansion.

In June 2002, the Government of Bahrain unveiled an ambitious plan to spend US$5 billion on housing and infrastructure projects. In June 2003, as part of the 2003–04 Budget, the Government of Bahrain also announced the allocation of US$237 million for new housing projects.

AUSTRALIAN HOSPITAL DESIGN GROUP: TAPPING INTO BAHRAIN'S GROWTH

The Australian Hospital Design Group (AHDG) is a consortium of architects, and engineering and health care specialist consulting firms. The consortium approach allows the group to carry out a project from initial design through to complete construction, providing the group with the capacity to bid for major projects. The AHDG consortium has been active in the Gulf region for the last four years, but some of its constituent companies have had a longer Middle East involvement.

AHDG, together with their local partner, Ismail Khonji Associates, won a major contract in 2003 to design and construct the A$180 million King Hamad General Hospital in Bahrain. AHDG has also carried out hospital projects in the United Arab Emirates, working with their Emirati partner firm, Al-Hashemi.

Access to Government tenders required a local partner – careful choice of its local partner and good contacts have been critical to AHDG's success.

Source: Australian Hospital Design Group, 2005.

Kuwait snapshot

Kuwait's construction market is being led by government expenditure and public sector contracts, although the private sector also is pressing ahead with a number of commercial and residential projects, with MEED reportedly stating that up to US$8 billion in private investments will be channelled into construction over the next five years (AME Info, 2005d).

There are a number of infrastructure limitations such as existing power, sanitation and parking. Kuwait's infrastructure and real estate development has lagged behind some of the other Gulf economies and recognition of this is leading to large expenditures in infrastructure, including transport projects such as causeways and overpasses.

Kuwait also is seeking to move into the tourist market with plans announced for major tourism construction projects. At the end of 2004, the Kuwait Government announced a project to develop Failaka island into a major tourist destination. Construction of this multi-billion dollar project is expected to take up to ten years.

Build-Own-Transfer (BOT) projects are increasingly favoured in Kuwait where the model is being used for major projects such as a US$1.2 billion new port in Bubiyan, to be operational in 2008 and fully completed in 2016, and the Failaka island developments. Other developments in Kuwait include a 2500 MW thermal power station in Az Zour North, a fourth oil refinery and expanded oil storage facilities, and a range of townships and residential centres.

Oman snapshot

Oman's diversification strategies are focusing heavily on new industrial projects and the gas industry. The Government is pushing ahead with major industrial projects (three fertiliser plants and an aluminium smelter) and developing infrastructure, mainly roads, hospitals and schools and some tourism projects. Oman Oil, with the Abu Dhabi Water and Electricity Authority and Canadian based Alcan, is developing a US$2 billion aluminium smelter project in Sohar. On completion, the plant will have a capacity of 650 000 tonnes per year and is expected to be operational by 2008. Other major projects include the US$805 million tourism development, 'The Waves', and the US$500 million new port at Sohar. In June 2005, Oman announced its latest major project, Blue City. The project, worth an estimated US$15 billion, will include tourist, real estate and entertainment facilities, with construction on phase 1 to begin in late 2005.

ISSUES FACING THE CONSTRUCTION INDUSTRY

The enormous growth in the construction industry is straining the capacity of supporting industries. There is also strong competition between the estimated 5000 construction related companies in the United Arab Emirates (Australian Trade Commission, 2005).

MARKET CONSTRAINTS

The surging construction industry has increased demand for construction materials.

Prices of building materials have risen 20–40 per cent in the United Arab Emirates over the last 18 months as a result of a steep increase in freight rates, a strong euro, and rising demand for building materials both in the region and in Iraq and China. The price of cement increased substantially in 2003 and 2004 as a result of supply shortages, and these shortages have forced halts to some construction projects. In Dubai and Doha, governments have intervened to regulate pricing.

Bahrain suffered from a sand shortage in 2004 as Saudi Arabia restricted the export of sand and aggregate to its neighbours. Construction and development in Bahrain slowed by up to 60 per cent.

Contractors in the United Arab Emirates and Qatar are reporting a lack of sub-contractors with the skills to do quality work; Kuwait contractors are also experiencing difficulty in hiring competent staff and blame the 'Dubai effect' for driving up wages.

Capacity constraints among Dubai's contractors and sub-contractors are resulting in them not bidding for jobs in the other Emirates and other regional economies, driving up prices and allowing new market entrants.

Dubai's high level of growth is also straining current infrastructure. New projects, such as a light rail system, are being developed to lessen traffic congestion, while further investment is needed for other infrastructure, such as power and water.

The rising cost of land and accommodation, particularly in Dubai, is also impacting on business profitability.

Source: Victorian Government Business Office, 2005a.

The growth in both the number and size of contracts has already seen leading international contractors becoming far more selective about what they bid for, generally aiming for high value projects over US$100 million. Local contractors are now regularly winning work in the US$50–100 million range (Victorian Government Business Office, 2005a).

The construction industry has a high dependence on relatively cheap foreign labour. Importing the necessary labour to work on construction projects can sometimes be a time-consuming and difficult process.

A high weighting on price as a major criterion in tenders, without regard to quality, can present a challenge to foreign companies. Personal relationships can also play a role in tender outcomes.

AUSTRALIA IN THE REGION

Although the construction market remains dominated by United States and United Kingdom firms, the Australian presence in the market has increased substantially. Around 34 of the 100 or more Australian firms with offices located in the United Arab Emirates service the building and construction sector in some capacity. They operate across a range of businesses, from the supply of building products to architecture services and engineering and contract management. A number of other Australian companies are likely to supply the industry through local agents.

MAJOR AUSTRALIAN BUSINESSES ACROSS THE SECTOR

Multiplex operates in the United Arab Emirates through its subsidiary, Nasa Multiplex – a partnership arrangement with the local Nasa group of companies. Multiplex has pursued work in the Middle East for over ten years and is now well established as a major business in the United Arab Emirates. The company built the Emirates Towers office complex in Dubai. More recently it has secured contracts for 12 residential towers within the exclusive ‘Burj Dubai Residences Development’ (in the area surrounding Burj Dubai), valued at around A$392 million, and for the first phase of a construction management role within the Dubai Marina, worth around A$160 million. The total value of projects undertaken in the United Arab Emirates by Multiplex since its establishment is over A$1 billion (Joint Standing Committee on Foreign Affairs, Defence and Trade, 2005).

Clipsal opened an assembly operations centre in Sharjah in June 1999. The company chose to locate the centre at the Sharjah Airport International Free Zone which, like other free zones in the United Arab Emirates, offers tax advantages in addition to allowing 100 per cent ownership of the facility. The facility is responsible for the assembly of a number of Clipsal’s products which are distributed throughout the Gulf region, as well as Jordan, Lebanon and Cyprus (Clipsal, 2005).

Other Australian companies operating in the region in construction-related industries include GHD, the Cox Group, WorleyParsons, Grocon, Clough, Woods Bagot and SMEC.

Opportunities associated with construction needs of the region go further than just building development and product supply. For example, Macquarie Bank signed a new venture with Abu Dhabi Commercial Bank to form ADCB Macquarie Corporate Finance focusing on infrastructure in the region, beginning with the development of the second phase of the Industrial City in Abu Dhabi.

OPPORTUNITIES FOR AUSTRALIAN FIRMS

The existing Australian presence in the Gulf region is exciting interest among other Australian companies, and the number there is expected to increase steadily over the next few years.

The potential is excellent for quality products and services. There is a growing awareness in the Arabian Gulf of the competitive nature of Australia's building and construction industry. Australian firms are regarded as refreshing and innovative and Australian standards are generally acceptable.

It is a very competitive market and price competitiveness is important. While price alone will not necessarily sustain long-term market penetration, the awareness that quality has to be paid for is still to develop.

Entering the market

Many Australian companies unfamiliar with the region have found trade shows and annual missions a useful, cost-effective introduction to the construction market. The need to establish direct contacts is particularly important in Gulf markets. The United Arab Emirates has established itself as a centre for major trade shows which attract buyers from the Middle East, Africa and Asia.

The largest building and construction exhibition in the Middle East is the Big 5 Show in Dubai, an annual five-day event that in 2004 attracted over 1600 exhibitors representing 2100 firms and 33 000 business visitors. The public is not admitted. Its value to Australian exhibitors is that 60 per cent of the visitors come from Emirates other than Dubai, from all the GCC countries and other countries as far as India, Greece, Turkey, Lebanon, Syria, the former USSR oil-rich States and North African countries.

Australia's growth in the region is reflected in the growth in its involvement in this show – there were only 8 Australian exhibitors in 1999 but 82 in 2004. The large Australian presence provides a high impact for the Australian firms and matches the countries that have been the traditional suppliers to the region. Australia was the fifth largest national pavilion or regional group in 2004.

In exit interviews conducted by Master Builders Australia (2005), 36 firms interviewed indicated that involvement in the show brought 628 possible projects or direct sales and a host of other arrangements. Importantly, involvement in the show also assisted in introducing businesses to potential business partners, agents and distributors. The survey showed that these firms generally viewed the potential for business in the region as 'very good' to 'excellent' (see Appendix 4.1).

Services sector may require different approach

Exhibitions are excellent vehicles to showcase manufacturers' products, but they are not always suitable for services firms associated with the construction industry. It is not always easy for these firms to mount an exhibition display that adequately demonstrates the firm's competitive advantages without revealing too much of their intellectual property. A structured program including individual business appointments and briefings may be a more suitable option, arranged with key organisations such as the Chambers of Commerce, developers, relevant government authorities in the United Arab Emirates (Dubai and Abu Dhabi), Oman, Qatar, Kuwait and Bahrain. The advantage of such an approach is the ability to draw on business networks through established local contacts. As noted before, personal contacts are a vital part of an export or investment strategy to the Gulf region. It may also be necessary to either establish a local office or develop an association with a local firm, as most clients require a local presence.

APPENDIX 4.1 – AUSTRALIAN BUSINESS PERCEPTIONS

Master Builders Australia (2005) undertook comprehensive surveys of 54 firms from Victoria who joined regional missions in 2002, 2003 and 2004, to ascertain their results and attitudes to the market. The surveys covered 36 manufacturing firms and 18 firms in the services sector.

Manufacturing firms in the building and construction industry

Some key findings of the survey of manufacturing firms in the building and construction industry include:

- over 70 per cent of firms rated the potential for business in the GCC for their own firms as very good or excellent
- almost 50 per cent of firms rated the potential for Australian companies in the United Arab Emirates as excellent
- around 70 per cent of firms rated the potential for Australian companies in the other GCC economies as either very good or excellent.

Individual products that have been successful in the manufacturing sector of the building and construction range are not restricted to particular markets, ranging across a wide variety of goods.[34]

Services firms in the building and construction industry

The assessment of service firms that visited a number of locations outside of Dubai contrasted a little compared with comments made by the Big 5 Show exhibitors. While the expected outcomes for the mission members were positive, they did not have the same facility of demonstrating their products to a mass audience over five days of intensive exposure at the Show.

Further analysis revealed that half of the services firms had not been to the region previously and some of these firms were unsure of what would be needed to convert leads into business. The expectations and time to do business varies between services companies and manufacturers. Not all of the firms visited each location and most of the services firms on the mission indicated that they needed more time to assess the projects that they identified.

Key results of the survey include:

- over 50 per cent of the firms surveyed who visited Dubai assessed the potential for their firm over the next two years as either excellent or very good

[34] A selection of Australian products sold include formwork systems used in construction; steel framed and kit housing; joinery products; hand tools; entrance matting for high rise buildings; heat exchangers; polymer products for plumbing; knitted shade fabrics; sealants and adhesives; cooling towers for industry and commercial plants; air conditioning ducting and fittings, insulation materials and systems, ventilation; laser levelling and measurement equipment; glass (tempered, security and laminated); pumps and valves; stone sculptures; sporting facilities; cement based mouldings and powder; safety equipment; architectural fittings, security locks and systems; swimming pools, spas and chlorination systems; pavers and roof tiles; electrical fittings and lighting products; foundry products.

- those firms who visited other destinations in the region, including Abu Dhabi, Qatar, Bahrain and Oman, generally assessed the potential for their business as fair to good. Firms who visited Kuwait generally regarded the potential for business as very good.

Interestingly, firms were more positive in their assessment of the potential for business for other Australian firms (as opposed to their own firms) in the building and construction sector over the next two years, generally regarding opportunities in all destinations as between good and excellent.

The services firms were also asked about the particular sectors that have immediate and strong market potential. Water management topped the list, given the lack of surface water in the GCC. The region has less than one percent of the world's surface water and these resources are supplemented by expensive and ever-increasing desalination plants. While fuel sources may be plentiful and the costs of fuel negligible, the capital costs of power plants and infrastructure can be enormous. Some of the other services believed to have potential are:

- building and maintenance management
- infrastructure development
- architectural landscaping
- architectural fit-outs for the massive high rise developments
- oil and gas technology
- road and town planning
- waste management, recycling and environment
- personnel deployment and project management
- specialist architectural services, e.g. retail, resorts, high-rise.

Source: Master Builders Australia, 2005.

AUSTRALIA'S COMMERCIAL RELATIONSHIP WITH THE REGION

KEY POINTS

- Australia's commercial relationship with Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates is strengthening, with exports to these five economies growing at more than twice the rate of Australian exports to the world, driven mainly by rapid growth in Australian exports to the United Arab Emirates and Kuwait.

- Cars have become Australia's largest single export to the five economies.

- Primary commodity exports including alumina, live animals and wheat remain important.

- Australia's merchandise imports from the region are largely centred around energy or energy intensive industries, such as fertilisers.

- Services trade with the United Arab Emirates, Australia's largest services partner in the Middle East, is valued at over $1.5 billion. An increasing number of students and tourists from the five economies are coming to Australia, assisted by more direct flights between the two regions. Australia's imports of services from the region are largely in transport services.

- Although tariff barriers are not high, a Free Trade Agreement between Australia and the United Arab Emirates should assist trade, particularly encouraging trade in services.

The commercial trading relationships between Australia and Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates have strengthened over the past ten years, with exports to these five economies growing more than twice as fast as Australia's exports to the world. Australia's importance as an import source varies between third and 14th among the five economies and covers a variety of goods far beyond mineral and agricultural products. Services trade with the region is also substantial. In a sign of the growing importance of the region, Australia established an embassy in Kuwait in 2004 to complement diplomatic representation in the United Arab Emirates and Saudi Arabia, and is currently negotiating a Free Trade Agreement with the United Arab Emirates.

TRADE FLOWS

In 2004, total merchandise trade between Australia and the five economies reached A$3.8 billion, accounting for 1.5 per cent of Australian merchandise trade (Table 5.1). The United Arab Emirates is easily Australia's largest trading partner in the group, followed by Kuwait. Passenger motor vehicles have become our largest single export to the region, with agricultural and mineral products dominating other exports. Oil comprises about half the value of imports from the group.

Table 5.1

Australia's substantial trade with the region

Trade rank, value of trade and share of total Australian trade, A$ million and per cent of Australia's total trade, 2004

	Exports		Imports		Trade	
	Rank	Value	Rank	Value	Rank	Value
		A$ million		A$ million		A$ million
United Arab Emirates	20	1294.1	29	950.7	23	2244.9
Kuwait	30	518.3	50	112.7	39	630.9
Bahrain[a]	39	242.6	49	132.0	43	374.6
Qatar	53	120.0	41	204.8	45	324.8
Oman	40	239.0	116	2.0	54	241.0
Total to five economies		2414.0		1402.2		3816.2
As per cent of Australia's trade with the world		2.1		1.0		1.5

Note: a. Australian exports to Bahrain shown here are drawn from Bahrain import data (converted to A$ using average annual exchange rates for 2004), as Australian data excludes exports of alumina, Australia's largest export to Bahrain, for confidentiality reasons.

Table may not add due to rounding

Source: Department of Foreign Affairs and Trade, 2005b; Bahrain Monetary Agency, 2005a.

MERCHANDISE EXPORTS

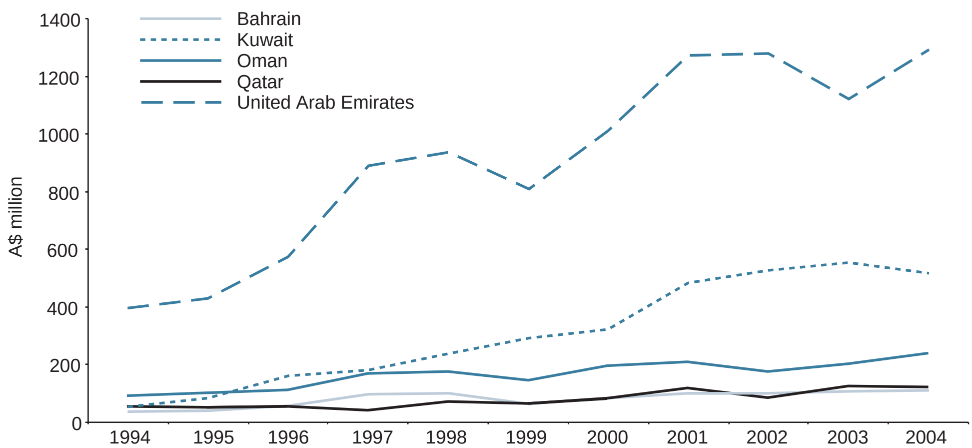
Australia exported A$2.4 billion worth of goods in 2004 to the five economies, approximately the same as to Malaysia. Exports to the region expanded rapidly between 1994 and 2004, driven predominantly by growth in exports to Kuwait, which have increased by 25.5 per cent per year during that decade, and the United Arab Emirates, which have increased by 12.5 per cent per year in that decade (Figure 5.1). Australia's exports to Qatar more than doubled between 1994 and 2004.

Australia's importance as an import source varies among the five economies: third for Bahrain (5.3 per cent of merchandise imports); ninth for Kuwait (3.6 per cent of merchandise imports); 11th for Oman (2.3 per cent of merchandise imports); 12th for Qatar (1.7 per cent of merchandise imports); and 14th for the United Arab Emirates (2.7 per cent of merchandise imports) (Department of Foreign Affairs and Trade, 2005c).

Figure 5.1

Strong growth in exports to Kuwait and the United Arab Emirates

Australian exports to selected Gulf economies, A$ million, 1994 to 2004



Notes: Data for Bahrain do not include exports of alumina.

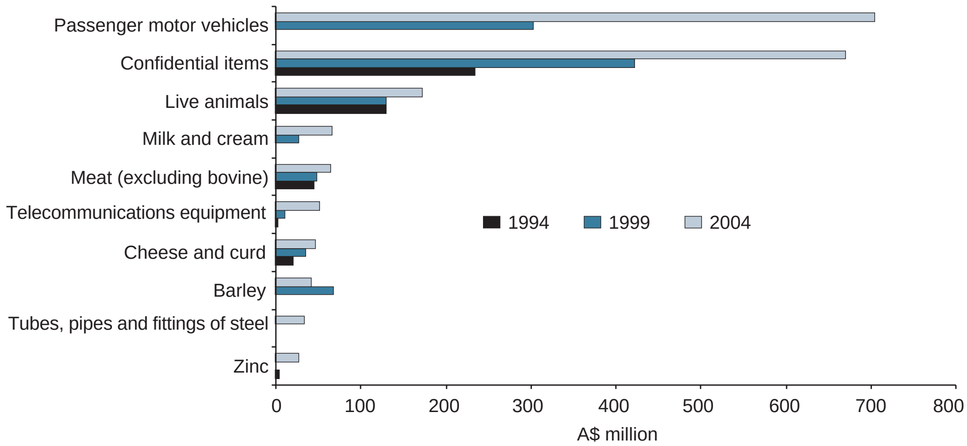
Source: Department of Foreign Affairs and Trade, 2005b.

Australia's top ten merchandise exports are similar for each economy and cover passenger motor vehicles, confidential items (which include alumina, sugar and wheat), live animals, meat (excluding beef), milk and cream, cheese and curd, and barley (Figure 5.2).

Figure 5.2

Passenger motor vehicle exports soar

Sum of Australian exports to Bahrain, Kuwait, Oman, Qatar and UAE, A$ million, 1994 to 2004



Note: Confidential items include wheat, sugar and alumina, except for alumina exports to Bahrain which are not included.

Source: Department of Foreign Affairs and Trade, 2005a.

Manufactures

Although Australia's top ten exports to the region consist mainly of agricultural and mineral products, Australia's exports have undergone a remarkable diversification away from their traditional primary product base over the past ten years. Elaborately transformed manufactures accounted for 46 per cent of exports to the five economies in 2003–04 – more than three quarters of which were cars – compared with 18 per cent in 1993–94.

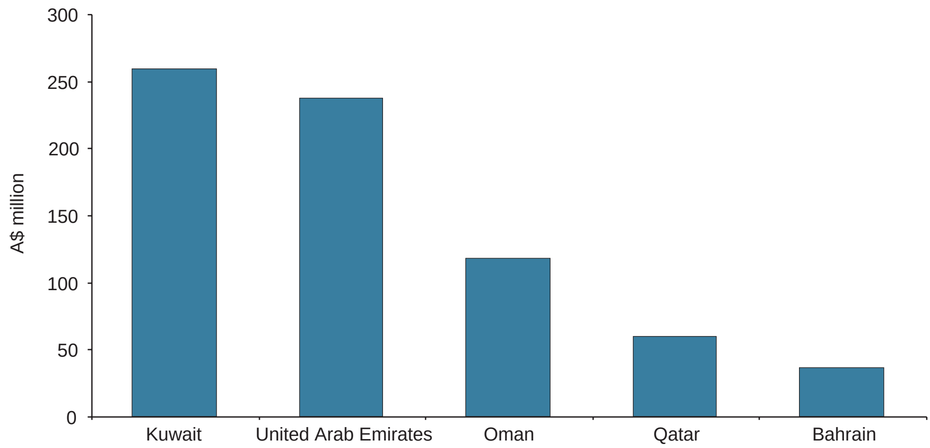
The automotive market

The growth in Australia's car exports to Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates has been nothing short of remarkable. Exports of cars to the five economies grew from almost nothing (A$0.2 million) in 1995 to A$711 million in 2004, with Kuwait and United Arab Emirates the major markets (Figure 5.3). By 2004, automotive exports to the five economies accounted for 23 per cent of all Australian automotive exports. However, while these gains are impressive, changes such as significant exchange rate movements or new trade agreements could potentially favour alternative production centres, reversing these gains.

Figure 5.3

Valuable car markets

Australian automotive exports to selected Gulf economies in 2004, A$ million



Source: Department of Foreign Affairs and Trade, 2005a.

AUSTRALIAN CAR EXPORTS TO THE REGION

Australian car exports to the five economies include Holden, Toyota and Mitsubishi.

The Toyota Camry is popular in the region. The Middle East is easily Toyota Australia's most important export destination, attracting 94 per cent of Toyota Australia's exports in 2004. Most of this trade is with the GCC economies; exports to Bahrain, Kuwait, Oman, Qatar and United Arab Emirates represented around 44 per cent of Toyota's trade with the GCC in 2004 (Toyota Australia, 2005).

The Middle East is the largest export market for Holden, attracting large numbers of its Holden Statesman and Commodore cars (branded as Chevrolet Caprices and Luminas in the Gulf). Customers for Commodore and Statesman vehicles include Middle Eastern police fleets. Cars are engineered to suit Middle Eastern conditions.

Exports of motor vehicle parts are also growing, and now represent Australia's eleventh largest export to the five economies, supporting the rapid expansion of car sales. In 2004, car parts sales were A$27 million (Department of Foreign Affairs and Trade, 2005a).

Other manufactured exports

Other important manufactured exports to the five economies in 2004 include telecommunications equipment (A$51.5 million) and construction related materials and products such as civil engineering equipment (A$7.3 million), and plastic (A$7.1 million) and steel (A$34.9 million) tubes and pipes (Department of Foreign Affairs and Trade, 2005a).

Commodity exports

Mineral exports, including alumina, and agricultural products, including wheat, live animals, meat and dairy products, are also important export items for Australia.

Minerals

Australia's mineral exports to the five economies are dominated by alumina. The United Arab Emirates and Bahrain are significant markets. In 2003–04, exports from Western Australia, Australia's primary alumina producer, to the United Arab Emirates and Bahrain were valued at around A$440 million and A$280 million respectively (Department of Industry and Resources, 2005). Together, this accounted for around 26 per cent of Western Australia's total alumina exports. The construction of extra smelting capacity in Bahrain, Oman and Qatar should continue to drive demand. Aluminium Bahrain (Alba) plans to double its aluminium output, with construction of its expansion project now completed. Oman plans to start construction of an aluminium smelter at Sohar by late 2005 and expects the smelter to be operational by late 2007, while Qatar is also developing an aluminium smelter.

Other significant mineral exports are more variable. For example, exports to the United Arab Emirates of gold were over A$200 million in 2001, but only $0.2 million in 2004; similarly, exports of zinc were under A$1 million in 2000, climbed to almost $100 million in 2003 and were back to A$27 million in 2004 (Department of Foreign Affairs and Trade, 2005a).

Agricultural products

Australia is gradually expanding its range of exports to the region. Although exports of wheat, live animals and meat, and dairy products remain the major agricultural export items, increased air linkages between Australia and the region have allowed other items to become established, such as fresh fruit and vegetables and branded food products.

The volume of wheat (including flour) exports to Bahrain, Kuwait, Oman and the United Arab Emirates was 552 000 tonnes in 2003–04 with an estimated value of around $125 million, up from 344 000 tonnes in 2002–03, with an estimated value of around $100 million (ABARE, 2004).[35] Although important markets, other Middle East markets such as Iraq, Iran and Yemen traditionally are larger export markets for Australian wheat.

The five economies are significant markets for Australian meat and livestock. Exports of live animals are valued at $172 million, with Kuwait being the most significant market of this grouping. By weight, Australian exports account for 42 per cent of the five economies' mutton and lamb imports (Meat and Livestock Australia, 2005). Australia has now signed Memoranda of Understanding with the United Arab Emirates and Kuwait which outline procedures to be followed regarding the live animal trade, including arrangements to guarantee offloading of animals into a quarantine facility if problems arise with a shipment.

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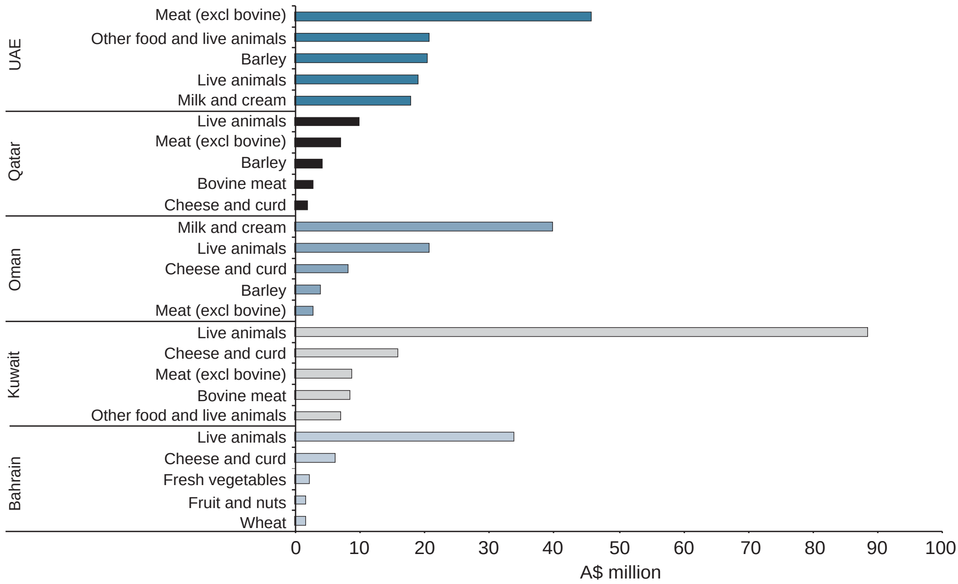
[35] ABARE statistics provide only volume of exports by country, actual value of wheat exports to by country are not published to protect commercial confidentiality. Estimates of export value are Department of Foreign Affairs and Trade calculations based on average price of wheat for the year and published statistics on volume of exports.

The region is also an important market for dairy exports – milk, cream, cheese and curd – taking around five per cent of all Australian exports of these products (Figure 5.4). Australia currently supplies around ten per cent of the GCC dairy import market (Dairy Australia, 2005).

Figure 5.4

Meat and live animals dominant among agricultural exports

Top five Australian agricultural exports to selected Gulf economies in 2004, A$ million



Note: Confidential items, including wheat, are not included in this table except for Bahrain for which data is published.

Source: Department of Foreign Affairs and Trade, 2005b.

The five economies have devoted considerable resources to domestic agricultural production in recent years. As a result, fruit and vegetable output has risen considerably, reducing their reliance on imported agricultural and food items (Table 5.2). Between 1990 and 2002, although agricultural and food imports as a whole grew 5.3 per cent per year, the value of fruit and vegetable imports grew only 1.6 per cent per year over the same period primarily due to increasing domestic production. However, increased domestic production is constrained by access to reasonably priced water production facilities and productive agricultural land. As a result, increasing demand for agricultural goods is likely to require greater imports (Department of Agriculture, Fisheries and Forestry, 2004).

Table 5.2

Regional fruit and vegetable production growing strongly

Production and imports of agricultural and food products, selected Gulf economies, average annual growth, per cent, 1990 to 2003

	Production	Imports
	Percentage change	
Cereals	1.2	5.7
Fruit and vegetables	9.8	1.6
Meat	3.3	1.5
Milk and milk products	3.2	4.2

Source: Food and Agriculture Organization, 2004.

MERCHANDISE IMPORTS

Australia's merchandise imports from the region have grown, on average, by 5.5 per cent per year between 1994 and 2004, compared with 7.6 per cent growth per year for total Australian imports.

Australia imported A$1.4 billion worth of goods from the five economies in 2004, A$798.9 million of which was crude petroleum from the United Arab Emirates and A$244.2 million of which were confidential items. Bahrain and Qatar exported a further A$135 million worth of fertilisers to Australia between them. The only other imports of note (that is, imports worth more than A$10 million) were aluminium (A$36.4 million) and wire products (A$15.7 million) from Bahrain; ethylene polymers from Qatar (A$12.1 million); and liquefied propane (A$42.2 million) and structures of iron and steel (A$18.1 million) from the United Arab Emirates (Department of Foreign Affairs and Trade, 2005a).

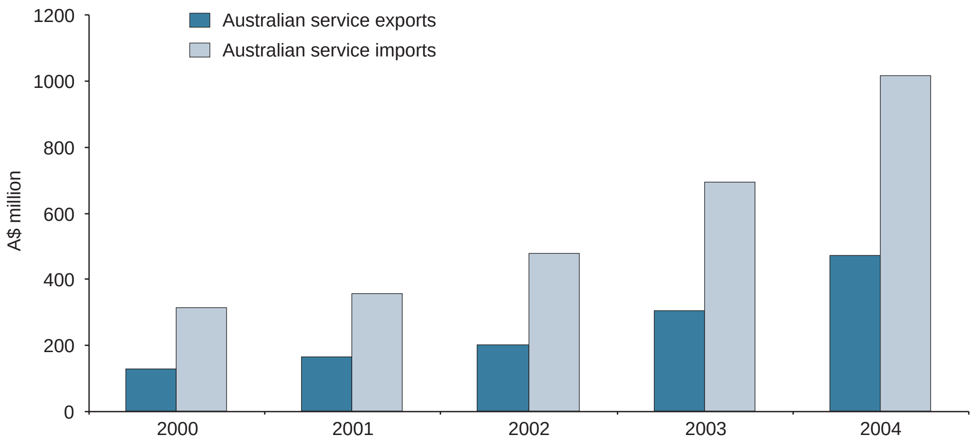
SERVICES TRADE

Comprehensive estimates of trade in services between Australia and the five economies are not readily available. The United Arab Emirates is the only economy where data are available. Services trade between Australia and the United Arab Emirates is estimated at A$1.5 billion in 2004, up from A$443 million in 2000, and comprising over 60 per cent of Australia's services trade with the Middle East (Australian Bureau of Statistics, 2005) (Figure 5.5). Most of the increase can be attributed to a growth in Australia's imports of services, particularly the rapid expansion of Emirates airlines. Australia's exports of services include tourist and business travel, professional services such as architectural and construction services, and education.

Figure 5.5

Australia – a service importer from UAE

Australia's services trade with the United Arab Emirates, A$ million, 2000 to 2004



Source: Australian Bureau of Statistics, 2005.

Tourism

Tourism between Australia and the Gulf has been growing at a fast rate. While the five economies covered in this report do not represent a large market, the number of arrivals into Australia increased by 30 per cent from 2003 to 2004 to reach 29 800 (Tourism Australia, 2005a).

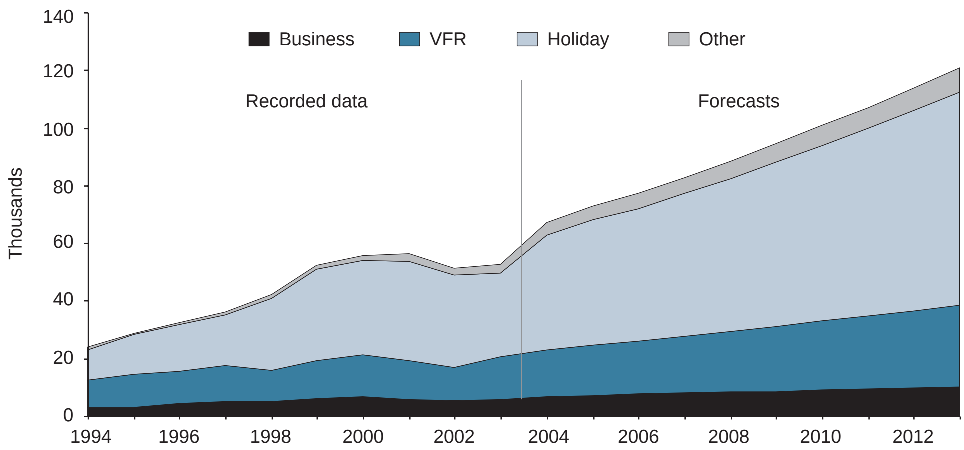
United Arab Emirates is Australia's largest market in the region. Over the past ten years, visitors to Australia from the United Arab Emirates have increased 21 per cent per year compared with total visitor arrival growth of five per cent per year. In 2004, there were 19 846 visitors from the United Arab Emirates, representing over 50 per cent of all GCC visitors. There were fewer visitors from Kuwait (3953), Bahrain (2282), Oman (2261) and Qatar (1497) (Tourism Australia, 2005a).

Growth for the Middle East region, within which the GCC is the predominant group, is forecast to continue at an average annual growth rate of 6.8 per cent (Tourism Forecasting Committee, 2004), continuing the upward trend experienced over the last ten years (Figure 5.6).

Figure 5.6

Strong growth in Middle East visitors expected

Visitor arrivals to Australia from the Middle East, 1994–2003 actual data, 2004–13 forecasts



Notes: VFR – Visiting friends and relatives.

Source: Tourism Forecasting Committee, 2004.

Gulf tourists are important because of their length of stay and spending. Many Gulf tourists travel as part of a large family unit and spend nearly six times as much as other international visitors on shopping items (Tourism Australia, 2005b).

SHRINKING THE DISTANCE

A growing number of airline links between Australia and the Gulf have been a key factor in expanding the trade relationship. Gulf Air has had the longest involvement in Australia, operating direct flights between Australia and the Middle East for over ten years, while Emirates' expansion has been more recent. Emirates have increased their flights per week from three in 1996 to over 40 at present, with plans to go to around 50 by the end of 2005. Qatar Airways is the latest carrier to attempt to enter the Australian market, with plans to begin flights to Melbourne later in 2005.

While the immediate impact of these increasing connections can be felt in such sectors as tourism, other Australian sectors also are benefiting from these links. For example, direct links allow Australian food producers to target the growing Dubai fresh food market, allowing Australian products to reach the market in less than 24 hours.

Australians also are visiting the United Arab Emirates in increasing numbers. In 2003–04, 12 per cent of the 118 600 Australians visiting North Africa and the Middle East went to the United Arab Emirates, compared with 4 per cent in 1993–94, when only 47 100 Australians visited the region. The ongoing expansion of air services between Australia and the region, and the focus which regional governments are placing on developing domestic tourism sectors, are likely to contribute to the continued growth of tourism.

Education

An increasing number of students from the region are choosing Australia as an education destination. Although the numbers are still small relative to students from East Asia, they have grown rapidly off a low base. In 2000, only 239 students from the United Arab Emirates and Oman were enrolled in Australian institutions; by 2004 there were 1447 (Australian Education International, 2005).

In total, 2044 students from the five economies covered in this report were studying at Australian institutions in 2004, representing 36 per cent of all North African and Middle Eastern students enrolled in Australia (Australian Education International, 2005). Around 30 per cent of these students were enrolled in English Language Intensive Courses for Overseas Students (ELICOS) and over 50 per cent were enrolled in Higher Education or Vocational Education. In keeping with the skill requirements of the five economies, students enrolled in Australian higher education mainly undertake studies in management and commerce, followed by information technology and engineering and related technologies (Department of Education, Science and Training, 2005).

In addition to attracting a greater number of students, Australian institutions are establishing a presence in the region. Both the University of Wollongong and the University of Southern Queensland have established campuses in Dubai. The University of Wollongong in Dubai is offering Bachelor degrees in Business Administration, Commerce, Computer Science and Internet Science and Technology, Masters degrees in Business Administration, International Business and Quality Management, and English language programs. Melbourne University Private (now Melbourne University) has opened a Hawthorne English Language Centre college in Oman. The Queensland Government has been involved in the development of the Australian International School, to open in the United Arab Emirates Emirate of Sharjah in September 2005.

Australian education institutions are involved in the region in other ways. For example, the Australian College of Kuwait is a private Kuwaiti vocational training college with links to the Australian Maritime College, Australian TAFE institutes and the University of Southern Queensland. Other Australian institutions with strong links to the region include the University of Queensland, which teaches at and administers Soha University in Oman; Edith Cowan University, which is very involved with Emirates airlines in security training; Monash University, which in December 2004 signed an agreement with Sharjah University to develop medicine and pharmacy degrees; Box Hill TAFE, which has plans to open a campus in Kuwait; TAFE Global and TAFE WA, who are involved in project work in the region; and Griffith University, which attracts large numbers of Gulf students. IDP Education Australia has offices in all five economies.

The outlook for education and training opportunities in the region is good. Expatriate labour is used extensively throughout, but growing unemployment among nationals has encouraged governments to increase expenditure on education, including scholarships to study overseas. With 35 per cent of the five economies' population under the age of 20, there will be a substantial number of young people looking to increase their educational qualifications to better their chances of finding employment.

Additionally, a number of the region's economies are attempting to establish themselves as education centres for the Middle East and Asia markets. Qatar is developing Education City, providing world class facilities to attract international institutions, while the United Arab Emirates is developing Knowledge Village as its bid to become the educational hub for the region. These facilities are likely to attract students not only from domestic markets, including the large numbers of non-nationals, but also from other regional markets.

The United States and the United Kingdom have been the dominant suppliers of education to students in the Middle East. However, student numbers from the Middle East to the United States declined by nine per cent in 2003–04 on top of a decline of ten per cent the previous year, with some of the largest declines coming from the Gulf States. Students from the United Arab Emirates to the United States declined by around 30 per cent in 2003–04 (Institute of International Education, 2005). The United Kingdom continues to be a major destination for students.

UNIVERSITY OF WOLLONGONG – A LONG INVOLVEMENT

The University of Wollongong has been involved in the region for over 12 years through its campus in Dubai (now the University of Wollongong in Dubai). Its long involvement has allowed the University of Wollongong in Dubai to become an established institution with over 1800 students, mainly expatriates, enrolled in its courses. In January 2000 the University became the first foreign university to be licensed by the Ministry of Higher Education and Scientific Research, allowing its courses to be accredited.

The University has also taken advantage of Dubai's Knowledge Village, having gradually moved all its operations to the state-of-the-art centre designed to attract universities from around the world.[36] Although competition is increasing in the education market, the University believes that this will help develop United Arab Emirates as a knowledge hub, further attracting students from across the Middle East and South Asia. With its well established presence and reputation, the University of Wollongong in Dubai believes it is well-placed to tap into this growth.

Source: University of Wollongong in Dubai, 2005.

[36] Knowledge Village reportedly raised rents by 29.4 per cent in mid-2005, impacting on the profitability of the institutions located in the village (Illing, 2005).

As Gulf students look to new markets for education, Australia presents an excellent alternative to the established education providers. The increasing number of flights between Australia and the Gulf also increases trade and tourism linkages, which in turn helps increase awareness of Australia as an education destination. During the Australia – United Arab Emirates Joint Ministerial Commission meeting in March 2005, Ministers of Australia and the United Arab Emirates agreed on the desirability of further streamlining of visa processes and noted the importance of this to United Arab Emirates citizens (Department of Foreign Affairs and Trade, 2005d).

Construction

Australian construction companies have a strong presence in the region across a range of sectors including construction management, architectural services and engineering. The prospects for continued expansion are good as governments provide the infrastructure required for a young and rapidly growing population and invest in new industries and sectors to encourage diversification (see Chapter 4 – *Construction: Tapping into the Growth*).

AUSTRALIA'S INVESTMENT LINKS WITH THE REGION

Although comprehensive data on Australian investment in the five economies or their investment in Australia are not available, what data are available suggest a relatively modest level, but one that has been growing in recent years.

Australian investment

Australian direct investment is growing as the number of businesses involved in the region increase, but still remains relatively modest. In the United Arab Emirates, Australia's presence has risen from two companies at the start of the 1990s to more than 100 companies in 2004. The level of Australian investment in the United Arab Emirates at December 2003 was estimated at A$66 million (Australian Bureau of Statistics, 2004). Some examples of investment in the region include in the construction industry, through the established presences of Multiplex, GHD and Clipsal, and in education through the University of Wollongong in Dubai. The lowering or removal of foreign investment restrictions, greater transparency (see Chapter 2 – *Opening Up: Economic Reforms in the Region*) and a potential trade agreement between Australia and the United Arab Emirates could help increase this investment.

Region's investment in Australia could be greater

Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates export large quantities of capital, fuelled by large current account surpluses. These funds have developed into substantial investment portfolios, with the United Arab Emirates estimated to have over US$400 billion in the Abu Dhabi Investment Authority, while Kuwait's Reserve Fund for Future Generations has an estimated US$75 billion.

Despite these substantial overseas portfolios, the available data indicates that Australia does not receive a high level of investment. The East Asia Analytical Unit (2000) suggested that if Australia's share of the capital were in line with its share of world gross domestic product, it would have received about US$10 billion in investment from the Middle East and around US$2 billion from the Abu Dhabi Investment Authority. However, by 30 June 2002, the level of investment in Australia from the residual Asia grouping, which included all five economies covered in this report in addition to another 33 economies, was under US$1.5 billion (Australian Bureau of Statistics, 2002).[37] Investment funds from the five economies are largely portfolio funds and not direct investments, and tend to be heavily invested in larger markets such as the United States, United Kingdom and EU economies, and Asia. The United Arab Emirates has also underpinned the central importance of negotiating a tax treaty to increase investment and to advance the economic relationship (Department of Foreign Affairs and Trade, 2005d).

Events such as September 11 have caused the five economies to review their portfolio investments and consider further diversification. Australia's strong, stable economy represents a potentially attractive alternative.

OTHER AUSTRALIAN INVOLVEMENT

With around 6000 Australian citizens located in the United Arab Emirates alone, Australia's presence throughout the Gulf is significant. Australian expertise is being heavily used in organising and managing the Asian Games in Doha in 2006, while Australians head a surprising number of Bahrain's major companies – as at June 2005 these included Batelco (telecommunications), Gulf Air, and Alba (Aluminium Bahrain).

GULF AIR – USING AUSTRALIAN EXPERTISE

Australian individual expertise is in demand. Gulf Air, one of the region's leading airlines, which is owned by Governments of Bahrain, Oman and Abu Dhabi and is based in Bahrain, has drawn on Australian expertise to reshape the airline.

Together with the installation of James Hogan as President and Chief Executive of the company in May 2002, a number of other senior Australian managers have been recruited to head areas such as Corporate Strategy, Marketing, Services and Network Alliances.

In 2004, the airline reported a net profit of around US$4 million, compared to a loss of around US$137 million in 2003, despite increasing competition from other regional airlines such as Emirates and Qatar Air and rising fuel prices.

Source: Gulf Air, 2005

[37] The Australian Bureau of Statistics began to publish some investment data on the United Arab Emirates in 2004, separating it out from the residual Asia grouping. However, the investment data is incomplete (Australian Bureau of Statistics, 2004).

AUSTRALIAN MARKET ACCESS

Australian companies and exports generally have good access to Gulf markets, although non-tariff barriers do affect services trade and investment (see Chapter 2 – *Opening Up: Economic Reforms in the Region* for more information on these barriers). In January 2003, the GCC established a customs union, adopting a common external tariff for all members (see Chapter 3 – *Trade Developments*). While a number of Australian exports are duty free, the majority of the top 20 Australian exports to the GCC attract a five per cent tariff (Table 5.4).

Table 5.4

Australian exports attract a five per cent tariff

Top 20 Australian exports to Bahrain, Kuwait, Oman, Qatar and United Arab Emirates, 2003–04

HS 6-digit classification		A$ million	Tariff (per cent)
870323	Passenger motor vehicles, 1500cc to 3000cc	526.2	5
999999	Confidential items	511.6	Unknown
870324	Passenger motor vehicles exceeding 3000cc	259.4	5
010410	Live sheep	178.7	Duty free
790111	Unwrought zinc	86.8	5
040221	Milk and cream, fat content exceeding 1.5 per cent, in solid form, unsweetened	41.9	5
100300	Barley	40.4	Duty free
040630	Processed cheese, not grated or powdered	35.6	5
870899	Vehicle parts and accessories not elsewhere classified for passenger motor vehicles	25.4	5
720310	Ferrous products obtained by direct reduction of iron ore	23.4	5
020442	Sheep (including lamb) cuts with bone in (excluding carcasses and half-carcasses), frozen	18.0	5
020230	Boneless bovine meat cuts, frozen	17.8	5
851719	Telephone sets and videophones (excluding line telephone sets with cordless handsets)	16.8	5
020410	Lamb carcasses and half-carcasses, fresh or chilled	14.8	Duty free
280469	Silicon containing by weight less than 99.99% of silicon	13.9	5
020443	Boneless sheep (including lamb) cuts, frozen	13.8	5
040590	Fats and oils derived from milk (excluding butter and dairy spreads)	13.4	5
980900	Special transactions and commodities not classified according to trade not elsewhere classified	12.0	Unknown
020130	Boneless bovine meat cuts, fresh or chilled	10.2	Duty free
040210	Milk, fat content not exceeding 1.5 per cent, in solid form	9.1	5

Source: Department of Foreign Affairs and Trade, 2004; Dubai Customs, 2005.

Australia is currently negotiating a Free Trade Agreement with the United Arab Emirates. Additionally, Australia has Air Services Agreements with Bahrain and the United Arab Emirates.

AUSTRALIA-UNITED ARAB EMIRATES FREE TRADE AGREEMENT

On 15 March 2005, Australia and United Arab Emirates agreed to begin negotiations on a Free Trade Agreement (FTA). In a joint statement, the Hon. Mark Vaile, MP, Australian Minister for Trade, and H E Sheika Lubna bint Khalid Al-Qassimi, United Arab Emirates Minister for Economy and Planning, said '*… a high quality FTA would remove or reduce barriers to trade in goods and services between the two countries and would liberalise investment flows … It would also, to the extent possible, address and resolve any bilateral impediments in areas such as industrial and technical standards, sanitary and phytosanitary issues, movement of natural persons, and government procurement … Ministers emphasised an FTA would benefit all areas of the economic and commercial relationship but said they expected particularly strong outcomes in trade in services*' (Vaile et al., 2005a).

The Hon. Mark Vaile, MP, Australian Minister for Trade, also said that "*deeper integration with this important trading partner will ensure our trade relationship continues to grow, while providing Australian businesses with a launch pad into other Gulf and Middle Eastern economies*" (Vaile, 2005b).

WHAT AUSTRALIAN BUSINESS NEEDS TO KNOW

Exporting to the Gulf requires careful research and knowledge of the market. Austrade has a network of offices and support services throughout the region. They are able to provide assessments of business potential for visitors and set up structured business programs. The Governments of Victoria, South Australia and Western Australia also provide on-the-ground support for business visitors in Dubai. The Queensland Government has an office in Qatar. Support can also be provided in Australia through the Australia Arab Chamber of Commerce and Industry, or in-country through business organisations such as Australian Business in the Gulf (Dubai), Australian Business Group (Abu Dhabi) and Australian New Zealand Business in Qatar.

Market entry to the region in terms of both exporting and investing requires careful planning and being aware of cultural differences. Businesses should carefully select agents, distributors and joint venture partners, and exercise due diligence to minimise the possibility of legal action which can be time consuming, expensive and hard to win. Local agents, even where not legally required, are commonly used because of difficulties in accessing local markets without them. Choice of an agent is critical, because laws governing agents and their relationship with foreign firms are inflexible, and in legal disputes, courts usually favour local agents. Furthermore, as mass advertising is less prevalent than in the West, agents and distributors are primary marketing tools.

Business relationships and agreements should be given plenty of time to develop, adopting a medium term view of two to three years for initial market entry, and a long term view to servicing clients and maintaining markets (East Asia Analytical Unit, 2000). Companies wishing to bring business clients to Australia should plan trips well in advance as it can take several weeks to secure business visas.

The “Doing Business” series produced by the Council for Australian–Arab Relations provides a range of useful information for companies considering business in the region. The reports in this series cover the United Arab Emirates and Qatar and provide valuable information on how to access these markets. The reports are freely available and can be accessed at *www.dfat.gov.au/caar*.

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