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briefing paper

Prospects for an EU–Gulf Cooperation Council Free Trade Area

The World's First Region-to-Region FTA?

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Summary points

- The EU and the GCC have seemed close to an agreement on a region-to-region Free Trade Agreement (FTA) – possibly the first in the world between customs unions – for the last two years. The EU seems keener on an agreement than the GCC.
- An FTA is an element in the EU's Global Europe trade policy strategy and is explicitly linked to energy security concerns.
- The EU is the GCC's main supplier of goods and services, and since the completion of the GCC Customs Union tariffs are low and the economic effects of an FTA are likely to be small, on goods at least.
- There may be economic barriers to the final signing of an FTA on both sides: resistance by GCC states to services and investment liberalization; and resistance in the EU over access for GCC refinery products and chemicals.
- Commentary from the Gulf itself suggests that the EU practice of including clauses on human rights and labour market and environmental regulation may be at the heart of the slow progress from the GCC side.

Introduction

The EU and the members of the Gulf Cooperation Council[1] (GCC) have been negotiating a Free Trade Agreement since 1990. The negotiations were suspended in 1999 to allow the GCC countries to implement their own customs union, which was completed in 2003. Since negotiations restarted in 2003 progress has been fitful, but their imminent successful completion has been a *leitmotif* of EU and GCC statements in recent years (see e.g. Mandelson, 2007). A draft text of a possible agreement was circulated to EU member states for comment in the autumn of 2007 but has not yet resulted in a conclusion to the negotiations. The EU apparently hopes that they will be completed in 2008. Should this happen, it would be the first ever customs union-to-customs union agreement. Depending on how one views the regional status of Cariforum[2] and the EU–Cariforum economic partnership agreement, it may be the first ever region-to-region FTA.

Policy context

The EU, as an entity and through its member states, is a founding and active member of the World Trade Organization (WTO). It is a key player in the Doha Development Agenda (DDA) negotiations. Although Qatar hosted the launch ministerial conference of the DDA in Doha, GCC members have taken a less forward position in WTO negotiations. Only Bahrain and Kuwait were founding members of the WTO. Qatar and the UAE joined in 1996, Oman in 2000 and Saudi Arabia in 2006.

The EU

Trade preferences have been a major tool of EU foreign economic policy since its inception. Currently about 70% of EU goods trade is on a preferential basis (WTO, 2007). This includes agreements in place or under negotiation with the European Economic Area (EEA) and Switzerland, with Turkey and with the countries of the western Balkans, with the African, Caribbean and Pacific (ACP) group of countries, with neighbouring East European and Mediterranean countries, with the EFTA, with the GCC, with Mercosur, with Mexico and Chile, and with the Least Developed Countries, as well as under the Generalized System of Preferences (GSP). These existing agreements and negotiations, the EEA and Switzerland apart, have largely been restricted to trade in goods.

A new phase of EU trade policy emerged in 2006 with the publication of *Global Europe* (European Commission, 2006). *Global Europe* set out a market access strategy (Rollo, 2006) aimed at the emerging trade powers and energy producers, using preferential trading agreements as the main tools. It explicitly included services, investment and regulatory integration (collectively known as deep integration) as well as the more traditional border barriers on goods. The target markets for this new policy are India, the ASEAN countries, the Republic of Korea and Russia, as well as Mercosur and the GCC (where negotiations have long been under way with no signs of a breakthrough). As a result of this policy only the US, Japan and China, among the top trade powers, are not targets of EU bilateral agreements.

The *Global Europe* paper links the GCC agreement and an agreement with Russia as an element in the EU's energy security policy. The mechanisms for directly connecting any FTA to energy security are not clear in either case, beyond the deepening of trade relations and perhaps better access to energy services markets and liberalization of investment regimes.

The GCC

Since the completion of the customs union in 2000, the GCC has been active in bilateral agreements of potential trade agreements. GCC members are in negotiations on, or in discussions about, bilateral agreements with the United States, Australia, New Zealand, China, India, Korea, Singapore, Jordan, Syria and others.[3] An interesting aspect of this is that the agreements on both goods and services under negotiation with the US are with individual member states and not with the GCC as an entity. This casts doubt on the status of the GCC as a customs union. Members of a customs union have a common

1. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.
2. The Caribbean Forum of African, Caribbean and Pacific States, established in 1992.
3. See http://bilaterals.org/rubrique.php3?id_rubrique=141.

external tariff and free movement of goods inside the customs territory. This means that when goods enter the territory of one member they have, in principle, entered the territory of all. Thus one member dismantling its tariff barriers with a third country means, in principle, that all members have removed their barriers with that third country. That is how the EU works and that is why there is a central trade policy executive (the European Commission) that has sole right of negotiation of trade policy with third countries. The fact that this is not true for the GCC suggests that despite ambitions for a single market (and a monetary union), the nirvana of no internal barriers to trade has not yet been attained.

Bilateral trade performance and structure

Goods

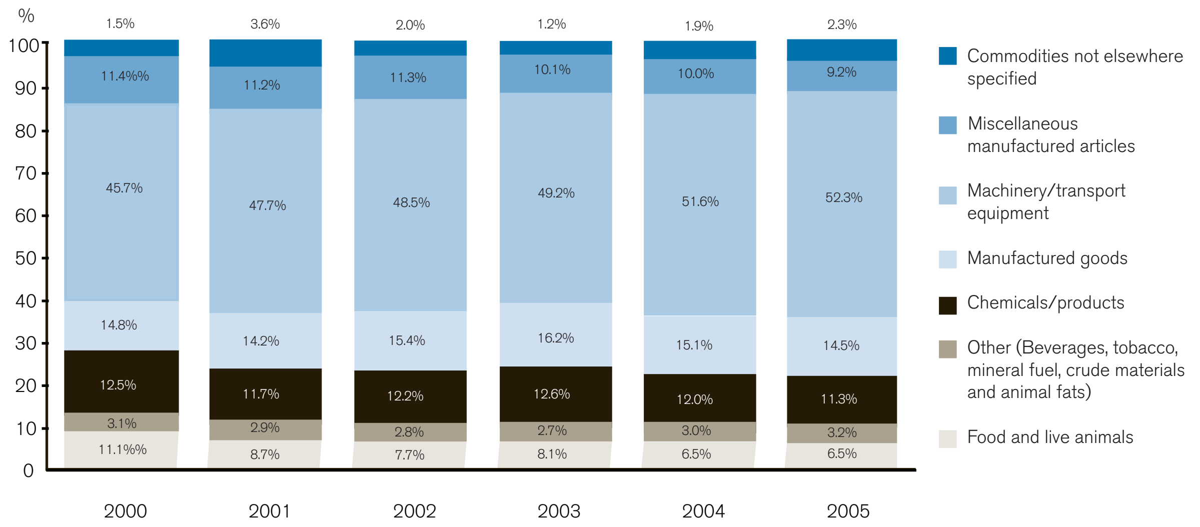
The GCC countries sit on some 40% of the world's oil reserves. Mineral oils, fuels and lubricants represented about 75% of GCC goods exports in 2005; the percentage is likely to be higher now as a result of the recent rise in oil prices. A further 5% or so of GCC exports are energy-intensive products such as petrochemicals and aluminium, where low transport costs give GCC producers, some competitive advantage. To the extent that fuel and feedstocks are supplied at marginal cost of production, GCC refiners and chemical producers may have a very significant competitive advantage over producers in oil-importing countries. The GCC countries run a very substantial surplus on their balance of trade in goods: €135bn, or over 40% of the value of goods exports in 2006.

The EU took about 10% of GCC exports and supplied some 30% of GCC imports in 2006,[4] and was the largest supplier of goods to the GCC. Around half of EU exports to the GCC were of machinery and equipment (Figure 1). The GCC is the EU's 8th largest source of imports of goods, of which oil, petrochemicals and energy-intensive metals account for around 80%. In 2006, the GCC states as a group were the EU's 5th largest export market behind China, and the EU had a trade surplus of €17.5bn with the GCC.

Services

Statistics on services are poor relative to those for goods. According to WTO statistics, the GCC imported about $50bn and exported about $20bn worth of services in

Figure 1: Evolution of GCC imports from the EU-25, 2000–05



Source: Data extracted using WITS from the UN's COMTRADE database

4. European Commission, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113482.pdf.

2006.[5] For the smaller members travel and transport services represented over 70% of imports and exports. The main exception was Kuwait where other commercial services represented almost 60% of exports. No breakdown of services trade is available for Saudi Arabia, so some care should be taken in generalizing about the structure of services trade in the GCC. According to the EU,[6] the GCC took €13bn, or 3.3%, of EU services exports in 2005 (which, compared with the WTO totals for GCC imports, suggests that the EU could have a trade share of around 20% or less in the GCC). Given that the EU's share of global services exports is around 30%, this represents underperformance in a market where it could reasonably expect to be the dominant foreign supplier.

Levels of protection

Goods

Tariffs in the GCC countries fell on formation of the customs union and now average around 5% (Table 1), having dropped on average by around 50% since 2000. As Table 1 shows, tariff structures seem quite flat across sectors, and there are relatively few tariff peaks (where tariffs are more than three times the average). For comparison, the EU average overall tariff is around 4%, but average tariffs on food and beverages are over 10%; those on manufactures are around 4% and on oil and oil products 1.5%.

Services

It is less easy to quantify protection in services sectors since there are no direct trade measures such as tariffs. Rather, it is regulation in the services sector that creates the obstacles to trade, whether deliberately or effectively as an unintended byproduct of the regulation. None of the GCC states have offered to open up services to trade in the WTO. The high proportion of travel and tourism services and the low proportion of business and financial services in imports reinforce the view that services trade is restricted. On the face of it the GCC states have much to gain from services liberalization but they may see this as

Table 1: GCC average tariffs (unweighted) by Broad Economic Category

	2000		2002		2004		2006		
	Average	Domestic peaks	Average	Domestic peaks	Average	Domestic peaks	Average	Domestic peaks	% change in tariffs (2000–06)
Food and beverages	11.29	0	5.38	32	5.18	81	5.02	64	-55.54
Industrial supplies not eleswhere specified	12.17	0	4.77	25	6.23	205	4.82	4	-60.39
Fuels and lubricants	12.03	0	4.6	0	4.93	8	5	0	-58.44
Capital goods (except transport equipment)	11.82	0	4.98	1	5.29	18	4.97	0	-57.95
Transport equipment and parts and accessories	11.82	0	4.89	0	5.53	34	4.53	0	-61.68
Consumer goods not elsewhere specified	12.06	0	6.59	18	7.04	145	4.95	5	-58.96
Goods not elsewhere specified	4	0	6.97	0	4.32	0	4.32	0	8.00
Total trade average	11.95	0	5.18	76	6.05	491	4.88	73	-59.16

Sources: UNCTAD/World Bank WITS and TRAINS databases.

5. Based on WTO trade profiles at http://stat.wto.org/CountryProfile/WSDBCountryPFHome.aspx?Language=E with country figures aggregated by the author.
6. European Commission, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113482.pdf.

a sector which needs protection in order to guarantee high-skilled jobs for their citizens.

The economic effects of an agreement

In goods, the impact of an agreement is likely to be small. GCC tariffs are already low, so giving a preference to the EU is unlikely to displace more efficient producers from the market (an effect known as trade diversion). In any case the EU is the largest trade partner of the GCC, which implies that it is already an efficient supplier. Overall, this suggests that an agreement will lead to an expansion of trade ('trade creation'), with little or no trade diversion, and that for goods at least the GCC states should benefit from the removal of tariffs against the EU.

A wide-ranging liberalization of services in favour of the EU should also lead largely to trade creation since the EU is the world's largest exporter and second largest importer of services, and hence is globally competitive. In addition, the fact that the US is also negotiating FTAs with elements of services liberalization with GCC states will help minimize trade diversion and increase trade creation. Moreover, services liberalization should generate an improvement in efficiency, an increase in demand and, because services provision often requires a local presence, employment. Similarly, liberalization of inward investment rules should help increase the efficiency of investment overall and bring with it technology and know-how that will benefit GCC economies.

For the EU the low levels of tariffs on imports of fuels and petrochemicals imply that an FTA will have a negligible effect on imports and that the removal of GCC tariffs will slightly benefit exports of goods. Access to GCC services markets and for inward investment is the prize.

Negotiating issues

Given how long these negotiations have been going on and the general goodwill expressed in official statements, as well as the low levels of protection on goods trade on both sides, it is hard to see why it has been so difficult to complete an agreement. The answer must lie elsewhere. On goods it may be that the EU refining and petrochemical industry is lobbying against what it sees as unfair competition from Gulf producers with access to fuel and feedstock supplies at below the market price. On the GCC side opening up investment and domestic services markets (energy services in particular) to EU competition could be seen to threaten the high-skilled end of services employment in the Gulf states, even if the total number of jobs increases overall. Local commentary from the Gulf (Weisweiler, 2007) also suggests that GCC states are wary of the policy conditionality that comes with EU trade agreements in the form of social, human rights and environmental clauses: recent lobbying in Brussels by Gulf-based human rights NGOs demanding that the EU should not sign an FTA until human rights improve in the Gulf may underline this.[7] GCC ministers are also heard to complain[8] that the EU keeps changing its demands. This might suggest that EU member states, and particularly those wishing to prioritize the political aspects of any agreement, may be trying to get more from an FTA than the GCC states are willing to give.

EU briefing focuses on trade and investment blockages – notably an unwillingness in the Gulf to give up export duties on energy exports, to open up investment in the energy sector and to liberalize energy services.

Of course it may simply be that, with the plethora of bilateral agreements being negotiated on both sides, plus the faltering DDA negotiations, there is simply not enough time or negotiating resource on either side to make the agreement happen, even with the best of intentions.

Conclusions

The European Commission seems more intent on concluding an agreement than the GCC states (and perhaps some EU member states). Nonetheless it is hard to see what is preventing an agreement being concluded in 2008. But the same could have been said in 2007. Perhaps, at last, the time for an agreement has come, but no one should be surprised if the saga of an EU–GCC free trade area continues.

7. See *Gulf Daily News*, 28 March 2008, at http://www.bilaterals.org/article.php3?id_article=11637.
8. See 'Gulf lacks coordination on key issues in free trade talks', 20 January 2008 at http://bilaterals.org/article.php3?id_article=10981.

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Note: The Sussex Framework is an analytical approach which allows the systematic assessment of the costs and benefits of any given preferential trading arrangement for any given pair of countries or regional groups. It is based in economic theory and allows empirically robust assessments of potential agreements without recourse to sophisticated quantitative methods.

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