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Patterns of Arab Gulf exports: implications for industrial diversification of increased inter-Arab trade

Introduction

The development of a strong and viable industrial structure has long been a major economic objective of the nations making up the Gulf Cooperation Council (GCC).[1] For many of these states, industrial development is the key to successful economic diversification and the main assurance of continuing self-sustaining growth. Following the large increases in oil revenues in the 1970s, Gulf governments have directed a substantial portion of their huge development outlays towards the creation of an adequate industrial infrastructure and the establishment of certain major state-owned heavy industries.[2] The recent turnaround in the world oil market and thus in OPEC revenue prospects has produced a challenge for Gulf industrialization: perhaps earlier than expected, it is now being reevaluated in terms of the time, capital and hopes invested in it.

In studying the process of industrialization in the Gulf, both proponents and critics have arrived at negative assessments in recent years.[3] For those who advocated industrial development as a path towards greater self-reliance and reduced dependence on foreign products, progress has been slow and often extremely costly, relative to the gains achieved by other developing countries, especially those in East and Southeast Asia.

Given the somewhat limited domestic markets of the Gulf states,[4] a key to the ultimate success of their industrial strategy will be the ability of these countries to develop industrial exports.[5] The purpose of this paper is to examine some of the problems the Gulf states are encountering in their attempts at increasing such exports. Have exports to certain regions aided industrial development more than exports to other areas? Have exports affected the industrial development of all the Gulf states in a similar manner, or are there significant country-by-country differences?

Industrialization models

Prior to 1970, the aim of developing country industrialization was import-substitution. Initially, this type of industrial policy attempted to break the existing division of coun-

1 The Gulf Cooperation Council was formed in February, 1981, and is composed of six Persian Gulf states: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Hereafter, collectively these states will be referred to as the „GCC countries" or the „Gulf states."

2 In the first half of the 1970s, the public sectors of the six Gulf states invested close to $560 million in manufacturing industry representing 4.8 per cent of their total development expenditure during that period. In the second half of the decade, total investment in industry rose to $15 billion or close to 14 per cent of total investments. In the 1980-85 period the figure rose to $40 billion representing 13 per cent of total investments. See Henry T. Azzam, The Gulf Economies in Transition, (London: Macmillan, 1988) pp. 121-122.

3 For a brief assessment of this debate, see Azzam, The Gulf Economies in Transition, chapter 8.

4 Most of the GCC states have quite small populations: Bahrain — 0.5 million; Kuwait — 0.6 million; Oman — 1.5 million, Qatar — 0.5 million; Saudi Arabia — 12.8 million; and, the United Arab Emirates — 1.9 million. Sources: respective 1992 Country Reports prepared by the Economist Intelligence Unit, London.

5 Atif A. Kubursi, Oil, Industrialization and Development in the Arab Gulf States, (London: Croom Helm, 1984) p. 2-4.

tries between the producers and exporters of raw materials on the one hand and exporters of manufactured goods on the other. It singled out processes using raw materials previously exported or under-exploited and favored bulky products (cement, other building materials, and furniture) or those with short shelf lives (certain processed foods).

Although import-substitution proved to be a useful first step in building an industrial structure, and still has an important role to play in the Gulf, on its own it cannot lead to full industrialization. Several factors limit the efficacy of import substitution. Its functionally defined role of substituting only for existing categories and quantities of imports is not a progressive or dynamic policy suggesting secondary stage efforts to substitute for the intermediate and capital goods brought in to build and operate the import-substitution plant.[6]

Moreover, the success of an import substitution policy is gauged by its ability to meet existing levels of demand. There is no great pressure to increase local use of a particular product in the interest of greater economies of scale, or to challenge the appropriateness of the import product being substituted or the technology by which it was produced when still an import.

Another factor limiting the efficacy of import substitution is its inability to contribute positively to the balance of payments. Most often, a country remains essentially a low unit price commodity exporter and an importer of a wide range of manufactured goods, leaning towards machinery and industrial feedstock. Import substitution eases but does not eliminate the trading disadvantage of a developing country vis-à-vis the industrialized world.

The arrogation of monopoly rights, often to state-owned entities, is another development associated with, but not necessarily demanded by, the adoption of import substitution policies in the manufacturing sector. The lack of market-inspired competition can, in certain circumstances and without other corrective measures, lead to quality deterioration, uncertain attitudes towards profit, lack of interest in technological innovation and acquiescence if depressed market conditions create idle capacity.

In contrast to these typical limitations, in many of the Gulf states import substitution industries have grown up in the private sector and in a much less protected environment. Consequently, competition on pricing and quality has been intense and manufacturers are now prepared to enter export markets. Those industries utilizing gas (both associated and non-associated) are capital intensive and heavy, in direct contrast to those normally associated with export-orientation. They use gas either as feedstock and energy source, as in petrochemicals and nitrogenous fertilizers, or as an energy source, as in basic metal industries with a high energy content such as steel and aluminum. Capacities are at internationally established maximum feasibility levels, processes are very much state-of-the-art, and the export market is worldwide comprising industrialized and developing countries, except in the case of steel which tends to be regional.

It is too early to judge the success of this form of industrialization, both in terms of profitability and encouragement of local finished plastic and metal products industries. However, difficulties have already arisen in selling products into saturated and protected markets. Some analysts decry the concentration of Gulf manufacturing efforts on intermediate chemical products, claiming an increased dependence on industrialized

6 Of course, in a few industries (for example, vehicle assembly) there are attempts to increase use of local inputs.

markets for purchase of the product and for supply of the machinery to produce it. Nevertheless, arguments along the line of „better to be industrialized right or not at all" seem rather unrealistic.

Apart from the debate over whether to develop export-oriented or import-substitution industries, there is also the question of whether to opt for capital or labor intensity in industrializing. Industrial investment in the less densely populated oil-producing Arab countries has emphasized capital intensity and a high level of automation.[7] Job creation is absolutely not a priority in the industrial development of the Gulf states, with the exception of Bahrain. Apart from likely technological dependence, the problem with capital-intensive industries is their much more limited income distribution function. One effect of this over a wide spectrum of industries is to curtail local demand for goods. Of course, this might have the effect of enhancing the appeal of entering export markets for some categories of industry.

Problems facing Gulf exporters

In the Gulf states, as in many other newly industrializing countries, a pronounced division has developed between import substitution industries and export-oriented industries. The former have included building materials, finished plastic and base metal products, clothing and detergents; the latter textiles, leather goods, certain agro-industrial products, petroleum products, petrochemicals, fertilizers, and base metals. There have always been certain areas of overlap, especially where a limited local market exists for export-oriented goods. In recent years, the need for all industries to be export-competitive has been emphasized as the limitations of import-substitution became clearer.

Several other factors have encouraged industries in the Gulf states to adopt an export orientation. First, state authorities have liberalized exchange regulations to allow exporters to retain foreign currency earned for their own further needs. Indeed, in the open oil based economies of the Gulf, currencies are freely convertible and no capital controls exist.[8] Second, many building material industries, in particular, have been constructed with capacities that, while economically sensible, are not sustainable by the local market alone.[9] This has happened both by design, in instances where a degree of regional exporting was envisaged in the original business strategies, or by default as the local market has not lived up to expectations. Exporting becomes a necessity to maintain or expand capacity and to avoid dependence on the business cycles of one market alone.

Although the Gulf states are not necessarily major producers, in nearly all traded manufactured goods they have been prevented from free trade to a greater or lesser extent, depending principally on the degree to which sales have been directed toward the European Community, American, or Japanese markets.[10] The advanced industrial na-

7 Kubursi, Oil, Industrialization and Development in the Arab Gulf States, pp. 16-17, and 102-104. The lack of large pools of low-cost labor effectively eliminates a large subset of industries (many textiles, consumer goods and even some capital goods).

8 These qualities permit the use of useful proxies for economic activity when data is unavailable. For example, in the case of Kuwait and several other GCC countries, the total value of monthly check (cheque) clearings provides a good proxy for non-oil sector production in nominal terms. See Economist Intelligence Unit, Country Report — Kuwait, No. 3 (1992), (London: EIU, 1992) p. 6.

9 Economist Intelligence Unit, Country Profile — Saudi Arabia 1991-1992, (London: EIU, 1991), p. 22.

10 EIU, Country Profile — Saudi Arabia 1991-1992, p. 23.

tions have erected numerous barriers to industrial imports from developing countries in order to protect their own industries. The methods used have included quantitative restrictions such as quotas, banning all imports above a certain value or volume, import duties imposed after duty-free ceilings have been triggered, and anti-dumping duties. There are also non-tariff barriers such as quality control and the insistence on unreasonable specifications.

For the GCC countries, as early as 1986 the situation had deteriorated to the point where the European Economic Community (EEC) had imposed protective duties on seven of Saudi Arabia's new petrochemical exports, on urea exports from Kuwait and on methanol exports from Bahrain. The tariffs ranged between 8 and 14.5 per cent and were imposed automatically as soon as very low duty-free ceilings (no more than $1-2 million of each product) were breached.

In fact, the Gulf states have so far fared no better than other developing countries in gaining access to the EEC market, especially with regard to their major industrial export to date — petrochemicals. At one point the EEC imposed 13.4 per cent custom duties on polyethylene from Saudi Arabia claiming that Saudi exports of this product exceeded 15 per cent of annual EEC consumption.[11] The imposition of such duties, given the high cost of production and ancillary plant, means that those industries in the Gulf show little if any economic return, especially if the cost of energy and feedstock is calculated at world prices.

Several analysts have gone so far as to argue that EEC duties are an attempt to undermine the viability of Gulf petrochemicals industries.[12] They see EEC actions as an attempt to destroy the principle of downstream development of the oil industry in the Gulf, and thus to abort plans underway in the Gulf to create a varied and integrated economy in the region.

It is clear that oil dominates Gulf exports to the EEC with petrochemicals remaining a small share of GCC exports to the Community. Overall, in 1990, 92 per cent of total exports from Oman, 92 per cent from Kuwait, 91 per cent from Saudi Arabia, 84 per cent from Qatar, 78 per cent from Bahrain, and 68 per cent from the United Arab Emirates were in the form of crude oil or refined oil products exports.[13]

EEC decision makers have used a variety of reasons to justify their exclusionary actions. Thus they have pointed out that Saudi Arabia exceeded the ceiling agreed upon under the GSPA. Realistically, it is clear that the entry of Saudi petrochemicals to European markets came at an awkward moment since the economic slowdown in the early 1980s badly affected European petrochemical industries, leaving them with 15-20 per cent idle capacity. This led to the closure of some 20 plants with the loss of 7,000 jobs

11 Azzam, The Gulf Economies in Transition, p. 144.

12 Ramzi Zaki, „Exporting Growth Potential Hindered by Lack of Co-ordination," Arab Industry Review 1986/87, p. 21.

13 Data derived from respective 1992 Country Reports published by the Economist Intelligence Unit. The relatively low figure for the UAE reflects the aftermath of the Iran-Iraq War and the 1990-91 Gulf War. The UAE has benefited substantially from the reopening of the Iranian market and from its ability to service the reconstruction demands of Kuwait following the Gulf War. Exports from UAE light manufacturing have risen and re-exports have benefited from port and related transport activity. While the benefits going to the UAE from Kuwait's misfortune will soon abate, nevertheless the UAE's gain from its location as a transport and business center is probably permanent — mainly because the lower Gulf is now seen as more secure than the upper Gulf (see Economist Intelligence Unit, Country Report — United Arab Emirates, No. 3 (1992),(London: EIU) p. 5. Although Kuwait is expected to have earned about $7 billion from oil exports in 1992, naphtha and petrochemicals are expected to yield only $300 million (see EIU, Country Report — Kuwait, No. 3 (1992), p. 5. Even in the case of Saudi Arabia, petrochemicals and plastics account for only 6 per cent of export earnings (see Economist Intelligence Unit, Country Report — Saudi Arabia, No. 3 (1992), (London: EIU) p. 3.

around the EEC.[14] In line with the recommendations of an OECD study, by 1990 even more plants closed in an attempt to balance supply and demand and stem the tide of rising losses.[15]

The Gulf states argue that the introduction of petrochemicals (particularly those from Saudi Arabia) was not the cause of the decline of European petrochemical industries. The problems of recession and uneconomic production existed long before Saudi Arabia began exporting its products. As they see it, European petrochemical industries expanded their productive capacity on the basis of incorrect estimates of future demand, with the result that they installed surplus capacity.

A consistent position has been taken by the Gulf states on this issue. First, they consider that establishing petrochemical and refining industries is a natural process for countries depending entirely on the export of crude oil. It is imperative that they take this step in order to diversify their sources of income and to industrialize and develop their countries. They further believe that such a position conforms to the principle of international division of labor. In any case, the volume of products from GCC states is not that large — Saudi Arabia's target is to attain only 5 per cent of the global basic petrochemical market. Even with all the Gulf petrochemical producers on stream, the region produces no more than 6 per cent of the world's petrochemicals — an amount representing no more than one year of projected global industry growth.[16]

Second, in the 1970s through to the mid 1980s, (and to a large extent even today), EEC exports entered the GCC countries under relatively low customs duties. For Saudi Arabia, under tariff reforms introduced in 1973 and 1974, wide ranging reductions and exemptions were announced, although relatively high duties were retained on locally produced goods to protect domestic industries. Duties on most items were raised to 4 per cent in 1984 in conformity with Saudi Arabia's GCC partners and to 7 per cent in 1985 for revenue reasons. The 1988 Saudi budget raised the basic rate of import duty from 7 to 12 per cent and brought virtually all items (excluding some foodstuffs) into the import duty category. All goods previously subject to a 10 per cent protectionist tariff saw this raised to 20 per cent, and a number of new items were afforded protection for the first time at the rate of 20 per cent. In 1988 some items of a development nature were exempted from the new customs regime. Even with these changes, imports for projects licensed under the Foreign Capital Investment Code continue to enjoy wide customs exemptions.[17] Similar tariff changes have occurred in some other GCC countries.[18]

14 Zaki, „Exporting Growth Potential," Arab Industry Review 1986/87, p. 21.
15 Azzam, The Gulf Economies in Transition, pp. 142-145.
16 Azzam, The Gulf Economies in Transition, p. 143. Even Gulf states which have not been exporting petrochemicals may soon become important new producers. For example, the Abu Dhabi National Oil Company(ADNOC) is reportedly considering a possible entry into world scale petrochemical production. Exploratory marketing surveys are currently underway. If the project is deemed feasible it is expected that sometime during 1993 ADNOC may award a front end engineering design contract for the ethylene cracker and the other process trains for a 300,000 t/y polyethylene plant. For further details see, Economist Intelligence Unit, Country Report — United Arab Emirates, No. 3 (1992) (London: EIU, 1992). Although proposals for Abu Dhabi to diversify to petrochemicals are not new, the current impetus seem to be based on the extra low cost gas resources that are now being developed. In the case of other Gulf producers, expansion of productive capacity is the order of the day. For example, the Qatar Petrochemical Company (QAPCO) is undertaking a $400 million expansion aimed at increasing the company's ethylene production capacity from 300,000 t/y to 470,000 t/y over the next three year period. QAPCO is taking advantage of the increased availability of gas following the coming on stream of Qatar's North Field, using its output as feedstock. Economist Intelligence Unit, Country Report: Bahrain, Qatar, No. 4 (1992) (EIU: London, 1992) p. 20.
17 EIU, Country Profile — Saudi Arabia 1991-1992, p. 37-38.
18 For example, in Oman, apart from goods imported by the government and by contractors working on government projects, which are exempt, generally all items attract a 2 per cent ad valorem duty except foodstuffs, gold, and alcohol. In 1989 a new law was issued authorizing a 25 per cent duty on imports which compete with local products, and a 50 per cent tax on imported cement was imposed (see Economist Intelligence Unit, Country Profile - Oman/Yemen, 1992-93,

Third, the low cost of natural gas used as a feedstock in the petrochemical industry is offset by several burdens on Gulf industries including the cost of transport to the petrochemical importing countries, the high capital cost of the industries, the relatively high cost of managing the projects, the rapid rate of depreciation and high expatriate wages. In addition, Gulf petrochemical products, produced mainly from natural gas, are largely basic petrochemicals. Intermediate petrochemicals require many other components which are not currently manufactured in the GCC countries and are therefore imported from abroad. The basic petrochemicals which are exported are themselves feedstocks for final petrochemicals which are in turn exported back in large quantities from the EEC to Arab countries.

Fourth, the most favored nation treatment accorded by UNCTAD to the developing countries means that their manufactured and semi-manufactured products should enter the industrial country's markets with low customs duties or with no duties at all. The Gulf states feel that this should be interpreted as a flexible doctrine which accords preferential treatment to the products of the developing countries in the markets of the advanced countries, without obliging the developing countries to reduce their customs duties on imports from the industrial countries.

Fifth, the EEC does not merely expect to negotiate on behalf of its internal market, but would like to extend the terms of negotiations to limiting qualities exported and distributed worldwide. The EEC seems to think that the new capacity of factories in Saudi Arabia, Kuwait, Canada, and Mexico makes world production capacity exceed current world demand by 10 per cent.

Sixth, the GCC countries consider that failure to reach an agreement may result in reciprocal treatment leading the GCC countries to impose similar custom duties on imports from the EEC.

Finally, the Gulf states recognize the importance of reorganizing the industry and trade of petrochemicals and refined products. They do not consider it right to maintain the status quo of trade relations by protecting uneconomic high cost industries in a manner contradictory to the principles of free trade and international commercial exchange.[19]

From the EEC perspective, there are several other points that need to be considered. First, customs tariffs in the EEC are routinely imposed according to legal regulations followed by the EEC within the framework of its international commitments. Thus, offering customs duties exemptions on products from the GCC countries without granting similar exemptions to all exporters may violate provisions of the GATT.

Second, the Europeans never intended to follow a protectionist policy against GCC petrochemical products and they do not impose quantitative restrictions. They further maintain that there is a misunderstanding and confusion between a pure protectionist policy and resolutions imposing customs duties.

Third, it is argued that low prices of raw materials in the GCC countries give those countries an unfair advantage over the European producers of petrochemicals who have

(London: EIU, 1992), p. 32. In Bahrain duties on imports are generally 5 per cent ad valorem on foodstuffs and necessities, 10 per cent on non-essentials, and 20 per cent on cars. Imported aluminum products are subject to 20 per cent duty, but duty is waived on capital equipment and raw materials imported for the purpose of establishing a new industrial enterprise (see Economist Intelligence Unit, Country Profile — Bahrain / Qatar, 1991-92, (London: EIU, 1991), p. 22. For Oman duty on most goods is 4 per cent with foodstuffs and reading material generally exempt (see EIU Country Profile — Bahrain / Qatar, 1991-92, p. 38.

19 Zaki, „Exporting Growth Potential," p. 21.

fixed excess capacity. There continues to be surplus capacity even though, for example, EEC methanol capacity has been cut.

Fourth, Saudi products are able to compete with other products within the EEC market, even after the imposition of duty. Their competitive position often enables them to sell at prices below the prevailing prices.

Fifth, the Europeans are worried that allowing GCC petrochemical products to enter the EEC without customs duty would be tantamount to dumping, given the geographical proximity of the Arab producers to Europe. They argue this may be further exacerbated by the loss of the European market for these products in the Middle East and Africa as a result of competition from the Gulf producers. This might cause the closure of even more European factories, aggravating the unemployment situation in the ECC countries.[20]

Finally, the Europeans wish to establish an international system to rationalize the production of petrochemicals. They want the United States and Japan to participate in such a system — particularly as some of the Saudi plants are joint ventures, with American and Japanese companies having a marketing responsibility.

The EEC's GSP arrangements for developing countries were first introduced in 1971 after being proposed by UNCTAD in New Delhi in 1968. They allow for duty free access for industrial products from developing countries. In the industrial sector certain products are designated as „sensitive" and their duty free access is subject to two forms of limits: quotas and ceilings. Stringent individual tariffs and quota limits are applied to most competitive products, mainly exported by a small number of newly industrializing countries.

In some quarters it is argued that it is stretching the concept of the GSP to apply it to the Gulf oil states' petrochemical exports. It is pointed out that the petrochemical industries in these states have cost advantages and that they were set up as joint ventures with multinational companies which are themselves responsible for marketing the output. The Gulf oil states, on the other hand, see themselves as seriously limited in their natural resources and argue that despite their oil revenues they face severe developmental problems in the long run. Successful industrialization is therefore vital. However, European Commission officials point out in turn that the United States does not include the Gulf states in its GSP scheme and that the Gulf states seldom complain about America's unfavorable treatment. Instead they become angry that once limits are exceeded under the EEC's GSP, a tariff is imposed by a process that is becoming ever more automatic.

In 1988 it looked as though the EEC would be able to negotiate a two stage trade agreement with the GCC. Terms of the 1988 proposal included provisions for a transition period, of perhaps eight to 15 years, during which nothing would change. This would have been followed by a degree of liberalization in which the EEC petrochemical industry would remain protected by anti-dumping measures, safeguard classes and ceilings. It is felt that these would in fact offer better protection than customs duties which manifestly do not reduce the flow of petrochemicals into the EEC. The GCC states for their part would have had to reduce duties reciprocally to zero in the transitional period, but would also have been offered some protection for their industries through an „infant industries" clause. Ultimately this agreement did not come to fruition.

20 Azzam, The Gulf Economies in Transition, p. 143.

In 1992 negotiations resumed between the EEC and the GCC. The broad nature of the discussions underlined the seriousness of the dispute and the interest of both parties in reaching acceptable answers to a range of trade issues. As a result of these discussions both sides have now resolved to sign a GCC-EEC free trade pact.[21] In general, the GCC has reacted positively to the 1992 proposals for a free trade agreement which allow the GCC to maintain protectionist tariffs on its newly established industries and which sets a shorter timetable than the 1988 proposal for the reduction of EEC barriers to GCC petrochemical imports.[22] Officials appear hopeful that the signing of an GCC-EEC agreement can take place in 1993. However one of the prerequisites for concluding such a pact is the implementation of a unified external customs tariff structure among the GCC countries.[23] As discussed later in this paper, favorable agreements among GCC partners toward that goal and toward the creation of a common GCC market are set to implemented during 1993. Its worth recalling, however, that several previous attempts at economic integration have proven unsuccessful.

In terms of other export markets, the US legislature has several forms of protectionist tariff at its disposal, some of which are mandatory and some of which can only be imposed following complaints by US manufactures of unfair competition likely to endanger their livelihood. Saudi Arabian heavy industries have run into opposition from their American counterparts on just such grounds based on the allegation that the 60 per cent of capital costs provided in the form of a soft-term loans by Riyadh's Public Investment Fund represents an „unfair" subsidy.

The Japanese have tended to take a more accommodating line toward the heavy industrial plans of both their neighbors on the Pacific Rim and of Arab nations. They have moved more quickly than their European or North American counterparts to retire petrochemical capacity so as to make room for the expected supply from other countries, and have invested in more complex downstream plastic plants. The more accepting Japanese attitude towards Arab petrochemical and other exports is attributable to Japan's much more closely coordinated approach to trading relations and Tokyo's acute awareness of the need to safeguard energy supplies.[24] For national security reasons the Japanese have been less willing to dismantle their oil refinery sector. However, similar to petrochemicals, they have been prepared to try and find third party markets for Arab products when necessary.

The Saudi belief that foreign equity participation in their products would assure market access has been found to be only partly true and only in the cases of Japanese and Taiwanese companies. Thus, for example, when the Taiwanese government issued a decree banning imports of urea, it exempted the Al-Jubail Fertilizer Company (SAMAD), in which the Taiwan Fertilizer Company is the joint venture partner. Although American companies enfolded in the remainder of the Saudi projects have expressed their disappointment at European protectionist measures, they have been unable

21 EIU, Country Report: Bahrain, Qatar, No. 4 (1992), p. 13.
22 Economist Intelligence Unit, Country Report: Saudi Arabia, No. 2 (1992), (London: EIU, 1992), p. 27.
23 Economist Intelligence Unit, Country Report: Bahrain, Qatar, No. 3 (1992), (London: EIU, 1992), p. 9.
24 A recent milestone for the Qatar Steel Company (QASCO) is instructive. QASCO is 70 per cent owned by the government with Japan's Kobe Steel and Tokyo Bokei holding the remainder. In 1992 QASCO became the first producer in the region to be accredited with the Japanese industrial standard and clearly it hopes this will boost sales prospects in Japan and the Far East. Partly in anticipation, QASCO is reported to have approved plans to double its production capacity. Economist Intelligence Unit, Country Report: Bahrain, Qatar, No. 2 (1992), (London: EIU, 1992), p. 23.

to force changes and therefore have had to concentrate marketing efforts east of Suez where prices have shown considerable weakness in response.

Over and above the tariff issue, the Saudis have encountered considerable difficulties in establishing independent overseas marketing networks for both their new petroleum product and petrochemical exports. In several cases they have had to entrust (on a temporary basis) the entire marketing effort to foreign partners rather than the 50 per cent basis as initially envisaged. Other Arab producers with a longer experience of independent oil and oil product marketing to build on seem to have adapted to marketing their new industrial output with greater ease, although their sales targets have been considerably smaller. Nevertheless, even for some of them foreign equity participation is seen as perhaps a necessary route to market access. A 1992 agreement between the Qatar Fuel Additives Company (QAFAC) and foreign shareholders is illustrative. QAFAC's plans to build a $600 million methyl tertiary butyl ether (MTBE) and methanol plant include a $120 million equity position held by France's Total and Canada's International Octane. These two shareholders have agreed to take up to 50 per cent of the plant's output.[25]

Disillusionment with sales prospects in the more advanced industrial nations has forced some of the Arab industrial ventures into less conventional marketing techniques, such as taking share holdings in potential purchasing companies in countries with large markets, for example, China, or Turkey. India has also emerged as a major purchaser of Arab fertilizers, somewhat showing a preference for barter deals involving Indian engineering contracts. India has struck deals with Jordan, Saudi Arabia, Qatar, and Kuwait. A recent agreement is instructive: in 1992 the Qatar Fertilizer Company (QAFCO) announced a $400 million expansion of its production capacity of ammonia and urea. In justifying this expansion, QAFCO stated it has signed a three year deal with India for the sale of 100,000 t/y of ammonia, a deal representing 15 per cent of current capacity.[26]

New Delhi has also expressed an interest in establishing joint venture factories in the Arab world with firm buy-back arrangements to cover the cost of Indian technology. Very recently, both India and Pakistan have undertaken new actions to boost trade between South Asia and the Gulf. For example, in addition to establishing a joint Omani-Indian commission on economic and technical cooperation, in June 1992 New Delhi announced that it was removing a range of restrictions imposed on Omani imports. The requirement for Oman to buy Indian goods against exports was also withdrawn.[27] Similarly, Pakistan recently established a commission on economic and technical cooperation with Oman and reassured Oman of its willingness to receive more Omani imports as the sultanate's manufacturing industries expand.[28]

Barter or countertrade might have applications in trading with other developing countries, and is being employed in more and more contracts with industrial nations where established trading firms are to be found which can be persuaded to market Gulf petrochemical or aluminium products. Since other Arab countries like Egypt, Syria, Morocco and Algeria found that broad trade agreements with the old Soviet Union and its partners in the now defunct Comecon proved a useful means of exporting in-

25 EIU Country Report: Bahrain, Qatar, No. 2 (1992), p. 18.
26 EIU Country Report: Bahrain, Qatar, No. 4 (1992), p. 20.
27 Economist Intelligence Unit, Country Report: Oman, Yemen, No. 3 (1992) (London: EIU, 1992), p. 13.
28 EIU, Country Report: Oman, Yemen, No. 3 (1992) p. 13.

termediate and consumer industrial goods, it is not surprising that there was increased contact and exploratory trade talks between the Gulf states and Comecon before the latter's ultimate collapse at the end of the Cold War.

Despite some success in exporting industrial products, given global market conditions and expanding productive capacities, the Gulf states need to reexamine the prospects for enhancing their exports to other countries within the region.

Contribution of inter-Arab trade to industrial diversification

Within the Arab world, multi-good barter arrangements have been worked out which often represent a useful means of establishing complementarity in trading patterns. A trade payments clearing system operated in non-convertible currency between Arab central banks can also encourage trade in industrial goods, without pre-specification of volumes and goods. Arab countries are also beginning to address the issue of government involvement in encouraging and facilitating non-traditional exports, through export exhibitions and other promotions, and through export credit, insurance and other financial support.

In examining the amount of trade between the Gulf states, several positive factors encourage the growth of such trade and several negative factors retard its growth. Positive factors include geographical proximity, and thus reduced transport costs; high per capita income and thus high demand for imports; the absence of exchange controls in most states in the region; the absence of customs barriers or quotas in most states; and, finally, a high tendency in the region to import.

The increase in the volume of trade in manufactured goods between the Gulf states in the past decade is directly related to the huge increase in the national revenues of these states as a result of the increase in oil revenues. Higher per capita income levels created a radical change in consumption patterns with an enormous growth in demand for consumer goods and capital goods.

Even though the greater part of the new demand for commodities was met by imports from the advanced industrial countries, the Gulf states themselves gained a share of the market from re-exports and from the trading of the products of their own industries. Thus these industries are beginning to make an impact, despite the lack of co-ordination in industrial development in the region until recently.

As noted above, given the problems associated with trade to the advanced countries and the limited size of national markets, especially in the GCC region, the possibility of inter-Arab trade is being examined ever more seriously as possible means of furthering the industrial diversification process.[29] A critical question arises concerning whether or not this type of trade has been much of a stimulus to industrialization in other Arab countries. Also, has it been more effective in this regard than trade to the non-Arab developing world or to countries in what was until very recently the „socialist bloc"?

To shed some light on these questions, an analysis was made of the geographical pattern of Arab global exports. Here, we were particularly interested in determining the manner and extent, if any, to which industrial diversification in the Arab countries was correlated to their geographical pattern of trade. More specifically were exports to some regions of the world more conducive to industrial development than exports to other

29 Kubursi, Oil, Industrialization and Development in the Arab Gulf States.

regional areas? Did this pattern change over time as industrial diversification proceeded in the Gulf states?

The main trading areas considered were (a) industrial countries, (b) members of the Arab Monetary Fund (AMF), (c) developing countries and (d) members of the then socialist bloc. To gain some sense of change over time, beginning in 1975 three five year intervals were examined (due to incomplete data for 1985, 1984 was the terminal year).[30]

To determine the relative importance over time of domestic and external markets, size variables were added to the analysis. Three variables were used to proxy the relative economic size of each country: (a) share of Arab Monetary Fund countries' population, (b) share of Arab Monetary Fund countries' Gross Domestic Product, and (c) relative economic size — (a) times (b).

Factor analysis was used as the analytical technique. This method was adopted largely because it allowed for the identification of correlation patterns — was manufacturing development correlated with any exports to one particular region(s)? In addition, factor analysis facilitates the ranking of countries in terms of each of the main dimensions in the data — the ranking in terms of economic size, importance of exports to the Arab Monetary Fund countries and so on.

Using factor analysis also facilitates the construction of an industrial diversification index. Rather than being confined to one arbitrary measure of industrial diversification, such as share of income, a principal component of industrial diversification can be created out of several individual measures. Here the share of industry in total absorption (consumption plus investment) and the share of industrial output in non-oil GDP were used to construct the principal component depicting industrial diversification. In a similar manner, export indices were created for each country's exports to each of the four regions in terms of its share of (a) non-oil Gross Domestic Product, and (b) its share of Gross Domestic Product.

Preliminary analysis indicated that four factors were optimal.[31] Table 1 indicates several results for the initial year, 1975. (See Table 1). First, the main trend in the data set was economic size and exports to the socialist bloc, that is, the larger the country was in terms of its income and population the greater its trade with this group of countries. Second, in a similar manner, manufacturing was most highly correlated with trade to the Arab Monetary Fund countries. The greater the share of exports to non-oil GDP and exports to total GDP, the higher that country's index of industrial diversification. Third, industrial development bore little correlation with exports to the industrial countries — a finding consistent with the discussion in the previous section. Fourth, in terms of their relative ranking on each of these four factors (as depicted by the factor scores, with positive scores indicating above average), Bahrain had by far the greatest share of its output exported to other regional Arab countries. Kuwait was next, with the remainder of the GCC countries scoring relatively low in terms of their exports to countries in the region. Fifth, due to the pattern of oil exports, each of the GCC countries ranked relatively high in terms of exports to the industrialized countries (Factor 3). Finally, with the notable exceptions of Saudi Arabia and Oman, GCC countries did not rank particularly high in terms of their trade with the developing world.

30 Zaki, „Exporting Growth Potential," p. 21.
31 Zaki, „Exporting Growth Potential," p. 21.

Table 1: Arab Monetary Fund Countries: Direction of Exports and Relative Industrialization, 1975 (Standardized Regression Coefficients)

	Factor 1 Socialist Countries	Factor 2 Arab Monetary Fund / Manuf	Factor 3 Industrial Countries	Factor 4 Developing Countries
Socialist / non-oil	0.97*	0.12	0.01	-0.16
Socialist / GDP	0.95*	0.10	-0.03	-0.16
population	0.93*	-0.08	-0.09	0.10
size	0.90*	-0.07	0.05	0.39
AMF exp / GDP	-0.18	0.97*	-0.06	-0.27
AMF exp / non-oil	-0.23	0.92*	-0.01	0.09
Manuf / absorption	0.46	0.88*	0.07	-0.06
Manuf / non-oil	0.33	0.84*	-0.08	0.25
developing / GDP	-0.17	0.61*	0.23	0.42
industrial / GDP	0.02	0.05	1.05*	-0.12
industrial / non-oil	-0.07	-0.14	0.82*	-0.26
income	0.26	-0.14	-0.01	0.94*
developing / non-oil	-0.25	0.28	0.06	0.79*

(Factor Scores)

Manufacturing	AMF Countries	Socialist Bloc Countries	Industrial Countries	Developing Countries
Gulf Economies				
UAE	-0.71	-0.68	1.22	-0.08
Bahrain	3.33	-0.31	0.83	-0.31
Saudi Arabia	0.59	0.02	1.29	3.16
Oman	-0.84	-0.77	1.49	-0.15
Qatar	-0.38	-0.63	1.21	-0.15
Kuwait	1.13	-0.94	0.98	1.70

Notes: ( ) factor scores omitting exports to AMF countries.
Factor analysis based on oblique rotation.
Definitions: GDP = Gross Domestic Product; non-oil = non-oil GDP; absorption = total expenditures (consumption plus investment).
Source: Data from Arab Monetary Fund, National Accounts of Arab Countries, 1974-85 (Abu Dhabi: Arab Monetary Fund, 1987).

In sum, in terms of relative importance to industrial diversification, exports to fellow Arab Monetary Fund countries were the most important, followed by trade to the developing countries, socialist countries and finally the industrial countries.

To determine the relative importance of exports to the Arab Monetary Fund and developing countries for the GCC countries' industrial diversification efforts, factor scores were computed by leaving out of the factor analysis each of these regions (on a one-by-one basis). A fall in the country score on the industrial diversification factor can be interpreted as indicating that exports to this region played a positive role in that country's industrial development. As a basis for comparison, factor scores on the industrial factor for non-GCC countries are also listed (See Table 2).[32]

As the data in Table 2 indicate, first, in general, all of the countries except Saudi Arabia and Kuwait would have had a lower level of industrial development in the absence of trade to the Arab Monetary Fund countries.[33] Second, overall, AMF trade

32 Zaki, „Exporting Growth Potential," p. 21.
33 Zaki, „Exporting Growth Potential," p. 21.

Table 2: Arab Monetary Fund Countries: Impact of Regional Exports on Relative Industrial Diversification, 1975
(Factor Scores — Manufacturing)

	All Regions	Omitting Arab Monetary Fund Countries	Omitting Developing Countries
Gulf Economies			
UAE	-0.71	-1.09(-)	-0.68(=)
Bahrain	3.33	3.00(-)	3.35(=)
Saudi Arabia	0.59	0.94(+)	0.62(=)
Oman	-0.84	-0.99(-)	-1.01(-)
Qatar	-0.38	-0.27(-)	-0.45(=)
Kuwait	1.13	1.11(=)	0.81(-)
Other AMF			
Iraq	na		na
Jordan	0.15	-0.34(-)	0.19(=)
Libya	-0.69	-0.66(=)	-0.79(-)
PDR Yemen	0.07	-0.27(-)	0.10(=)
Yemen AR	-0.71	-0.73(=)	-0.74(=)
Egypt	-0.12	0.39(+)	0.07(+)
Algeria	-0.43	-0.13(+)	-0.28(+)
Tunisia	-0.28	-0.22(=)	-0.23(=)
Sudan	-0.37	-0.26(+)	-0.37(=)
Syrianana	na	na	na
Somalia	-0.01	-0.67(-)	0.02(=)
Morocco	0.00	0.55(+)	0.14(+)
Mauritania	-0.72	-0.75(+)	-0.74(=)

Notes: ( ) change in relative ranking upon removing regional exports.
Factor analysis based on oblique rotation.
Definitions: See Table 1.
Source: See Table 1

was of much greater importance to industrial diversification than trade with the developing world. Oman and Kuwait appear to be the only GCC countries whose industrial diversification efforts were stimulated through exports to developing countries.

By 1980 several significant changes had taken place. (See Table 3). Table 3 indicates that manufacturing and AMF trade had become the main trend in the data, with manufacturing also loading fairly heavily on the size variables. Moreover manufacturing's correlation with exports to developing countries also appears to have increased somewhat. Finally, perhaps as a result of oil exports, the income component of economic size had become strongly correlated with exports to the industrial countries.

Table 4 indicates that by 1980 in terms of relative factor scores the GCC countries were still characterized by having a large volume of trade with the industrial countries and a small volume of exports to the socialist group. Second, with the exception of Saudi Arabia, all of the GCC countries were classified as relatively small, with Oman the smallest followed by Qatar and the UAE. Third, exports to the AMF countries had aided industrial diversification of all of the GCC countries (as evidenced by the reduction of manufacturing's factor score when exports to this group of countries was omitted from the analysis). Fourth, Oman's industrial diversification appears to benefit most from AMF trade, followed by the UAE and Qatar. Finally, developing country trade benefited Oman and Kuwait, but had only a marginal impact on the other GCC countries.

By 1984, after several years of further industrialization in an environment of declining oil revenues, another pattern had developed. (See Table 5). As Table 5 indicates,

Table 3: Arab Monetary Fund Countries: Direction of Exports and Relative Industrialization, 1980
(Standardized Regression Coefficients)

	Factor 1 Arab Monetary Fund / Manuf	Factor 2 Industrial Countries	Factor 3 Size	Factor 4 Socialist Countries
AMF exp / non-oil	0.91*	0.09	-0.15	-0.07
AMF exp / GDP	0.85*	-0.13	-0.23	-0.05
Manuf / non-oil	0.79*	0.07	0.61*	-0.02
developing / GDP	0.73*	0.49	-0.17	0.12
Manuf / absorption	0.73*	-0.23	0.57*	-0.07
industrial / non-oil	-0.12	0.97*	0.02	-0.04
industrial / GDP	-0.07	0.97*	0.08	-0.10
income	-0.07	0.74*	0.66*	-0.02
developing / non-oil	0.47	0.71*	-0.09	0.14
size	-0.06	0.28	0.91*	0.04
population	-0.12	-0.29	0.77*	0.10
Socialist / non-oil	-0.02	0.07	-0.02	0.98*
Socialist / GDP	-0.05	-0.15	0.14	0.94*

(Factor Scores)

	Manufacturing AMF Countries	Industrial Countries	Size	Socialist Countries
Gulf Economies				
UAE	-0.15	1.00	-0.43	-0.75
Bahrain	2.74	-0.38	-0.26	-0.74
Saudi Arabia	-0.04	2.14	1.38	-0.68
Oman	-1.00	0.72	-1.20	-0.62
Qatar	0.36	1.27	-0.86	0.04
Kuwait	1.17	0.91	-0.36	-0.08

Notes: ( ) factor scores omitting exports to AMF countries.
Factor analysis based on oblique rotation.
Definitions: See Table 1.
Source: See Table 1

economic size had increased even more as an impediment to further industrial diversification in the AMF countries. Second, exporting to the AMF had apparently lost much of its effectiveness in furthering industrial diversification. However, this decline was not significantly replaced by exports to other regions.

In terms of factor scores, by 1984 industrial diversification had continued in the GCC countries with Oman the only country with a significant lag in industrial diversification. (See Table 6). As Table 6 also indicates, exports to the AMF and developing country groups were still most significant for Bahrain and Kuwait, followed by the UAE and Qatar. Third, as in the past, the GCC countries had a very high dependence on trade to the industrial countries with trade to socialist countries of little importance. Fourth, all of the GCC countries, with the exception of Saudi Arabia, would have had significantly improved levels of industrial diversification if they had not been handicapped by their small size. Finally, the table indicates that, most importantly, by 1984 the GCC countries (and AMF countries) had lost their ability to significantly compensate for their small size through increased levels of inter-Arab trade.

Table 4: Arab Monetary Fund Countries: Impact of Regional Exports on Industrial Diversification, 1980
(Factor Scores — Manufacturing)

	All Regions	Omitting Arab Monetary Fund Countries	Omitting Developing Countries
Gulf Economies			
UAE	-0.15	-0.68(-)	-0.06(=)
Bahrain	2.75	2.28(-)	2.83(=)
Saudi Arabia	-0.04	-0.21(-)	0.23(=)
Oman	-1.00	-1.65(-)	-1.47(-)
Qatar	0.36	0.04(-)	-0.21(=)
Kuwait	1.17	0.97(-)	0.83(-)
Other AMF			
Iraq	-0.08	0.04	-0.18(-)
Jordan	0.14	0.32(+)	0.25(+)
Libya	-0.91	-1.36(-)	-0.98(=)
PDR Yemen	1.80	0.48(-)	1.27(-)
Yemen AR	-0.88	-0.84(=)	-1.04(-)
Egypt	-0.37	0.85(+)	0.22(+)
Algeria	-0.51	0.27(+)	0.03(+)
Tunisia	-0.22	0.38(+)	0.10(+)
Sudan	-0.78	-0.58(+)	-0.80(=)
Syria	na	na	na
Somalia	-0.46	-0.74(-)	-0.56(-)
Morocco	0.10	1.40(+)	0.57(+)
Mauritania	-0.88	-0.95(=)	-0.95(=)

Notes: ( ) factor scores omitting exports to AMF countries.
Factor analysis based on oblique rotation.
Definitions: See Table 1.
Source: See Table 1

Table 5: Arab Monetary Fund Countries: Direction of Exports and Relative Industrialization, 1984
(Standardized Regression Coefficients)

	Factor 1 Industrial Countries	Factor 2 Arab Monetary Fund Countries	Factor 3 Industry	Factor 4 Socialist Countries
industrial / non-oil	1.03*	-0.16	0.05	0.09
industrial / GDP	1.02*	-0.21	0.04	0.10
developing / non-oil	0.50*	0.35	-0.01	-0.40
AMF exp / GDP	-0.25	1.01*	-0.03	0.04
AMF exp / non-oil	-0.10	0.99*	0.01	-0.02
developing / GDP	0.40	0.53*	0.02	-0.38
size	-0.18	-0.21	0.85*	-0.16
Manuf / non-oil	0.07	0.39	0.73*	0.19
income	0.21	-0.19	0.73*	-0.23
population	-0.43	-0.19	0.71*	0.01
Manuf / absorption	0.23	0.32	0.69*	0.26
Socialist / non-oil	0.16	-0.05	-0.06	0.94
Socialist / GDP	-0.03	0.03	0.00	0.94

Table 5

(Factor Scores)

	Manufacturing	AMF / Devel Countries	Industrial Countries	Socialist Countries
Gulf Economies				
UAE	1.53 (1.44)	0.35	1.36	-0.26
Bahrain	0.22 (0.16)	3.09	0.18	-0.67
Saudi Arabia	1.48 (1.35)	-0.20	0.55	-1.08
Oman	-1.13 (-1.73)	-0.10	1.22	-1.58
Qatar	0.22 (0.28)	0.27	2.10	0.72
Kuwait	1.10 (1.11)	1.10	1.05	-0.99

Notes: ( ) factor scores omitting exports to AMF countries.
Factor analysis based on oblique rotation.
Definitions: See Table 1.
Source: See Table 1

Table 6: Arab Monetary Fund Countries: Impact of Regional Exports on Industrial Diversification, 1984

(Factor Scores-Manufacturing)

	All Regions	Omitting Size
Gulf Economies		
UAE	0.53	1.35(+)
Bahrain	-0.23	0.49(+)
Saudi Arabia	1.48	0.02(-)
Oman	-1.13	-2.00(+)
Qatar	0.22	1.20(+)
Kuwait	-0.42	-0.71(+)
Other AMF		
Iraq	na	na
Jordan	-0.34	0.41(+)
Libya	-0.68	-0.84(-)
PDR Yemen	-0.57	-0.12(+)
Yemen AR	-0.88	-0.90(=)
Egypt	2.27	0.87(-)
Algeria	1.27	0.55(-)
Tunisia	-0.07	0.56(+)
Sudan	-0.07	-0.15(-)
Syria	na	na
Somalia	-1.11	-1.05(=)
Morocco	0.92	1.51(+)
Mauritania	-1.19	-1.19(=)

Notes: ( ) factor scores omitting exports to AMF countries.
Factor analysis based on oblique rotation.
Definitions: See Table 1.
Source: See Table 1

Observations on inter-Arab trade

Despite expanded trade between AMF countries in absolute terms, the results presented in this analysis, particularly those obtained for 1984, suggest that a number of negative factors may now be preventing exports within this group from significantly contributing to industrial diversification. At least ten impediments seem to be at work

including (1) the similarity of industrial output in each state and the lack of co-ordination between public authorities; (2) the development of identical industrial plants in neighboring states (petrochemicals, fertilizers, steel) which has led to increased regional competition not cooperation; (3) with each state at a similar stage in its development and with similar industrialization strategies, there has been a huge demand for capital goods, which are not manufactured in the region; (4) the market in the Gulf states is open to the international market; (5) high domestic demand for some manufactured products leaving no surplus for export; (6) the absence of an export promotion system; (7) the lack of information on export opportunities in neighboring states; (8) minimal import duties on foreign goods from outside the region leading importers to continue importing with higher profit margins than trading in regional goods; (9) the dumping policy practiced by some foreign companies; and, (10) the high cost of production in the Gulf states.[34]

Of these factors, the first is probably most important. Indeed, if we take a look at the relationship between the market and productive capacity for industries established in the Gulf states we find a common pattern throughout the region. There are multiple dimensions to this pattern including:

— export oriented industries set up with production capacities much bigger than local or even regional demand. This has occurred especially in the petrochemical, fertilizer and aluminum industries. Production in these enterprises is linked to export distribution.
— a number of industries established primarily to meet domestic demand with production geared exactly to local demand such as the food and beverage industries. In general these industries do not produce a surplus for export.
— a category of industries with design capacities unable to match domestic demand. The state has to supply extra demand through imports or the factories greatly exceed design capacity, thereby creating production beyond the economically optimal level.
— finally, a category of industries to meet the needs of local consumers while offering surplus output for export. Given limited local markets and problems in finding markets, such industries usually experience considerable idle capacity.

Although the real solution to increased trade between the Gulf states will require long term coordination in industrial development,[35] there are a number of short term measures which can be introduced to improve current levels of trade with tangible results.[36] These include the abolition of import duties for products originating in other Gulf states, removing all obstacles to the free flow of goods between states in the region.

The six states of the GCC agreed to such measures under the terms of the GCC Unified Economic Agreement signed in 1981. It has yet to be fully implemented.[37]

34 Also see the discussion in Azzam, The Gulf Economies in Transition, chapter 8. Some new initiatives suggest greater attention is now being paid to export promotion. For example, in 1992 Oman launched the region's first export promotion scheme, including the creation of a joint-stock company, the National Marketing Company, set up exclusively to promote Oman's non-oil exports in return for a percentage commission on the value of the exports. See EIU, Country Report: Oman, Yemen, No. 1 (1992) p. 13 and No. 3 (1992), p. 14.

35 Kubursi, Oil, Industrialization and Development in the Arab Gulf States.

36 Zaki, „Exporting Growth Potential," p. 21.

37 For a concise discussion of the seven parts and 28 articles of the Unified Economic Agreement see, Kubursi, Oil, Industrialization and Development in the Gulf, chapter 1. The main point of the Agreement is to remove economic barriers between the six member states and encourage joint projects and investments by Gulf nationals. The ground for a common market in the region has, therefore, already been set. Some elements of the Agreement were first put into effect in 1983.

Nevertheless, prospects for the GCC regional market currently look much more promising than during the 1980s. Detailed plans to promote financial and commercial integration were drafted by the GCC secretariat in 1992 indicating that forward momentum towards integration has been resumed. Indeed regional cooperation is now at the top of the GCC agenda. In June 1992 GCC decision makers agreed to a seven year timetable for the establishment of a common market and unified external customs tariff structure. This was followed with an announcement in September 1992 that member states are now committed to implementing a unified system of tariffs by March 1993.[38] Unfortunately details of the tariff system have not been revealed. However, it should be noted that previous proposals gave considerable leeway for individual states to impose varying tariff levels, for example, to protect domestic industries. Nevertheless, some analysts are now predicting economic union by the year 2000.[39]

Consistent with the data presented here, Bahrain is perhaps the most vigorous proponent of developing a GCC internal market.[40] If such a market comes to fruition Bahrain could play an important intermediary role, particularly in finance (based on its offshore banking sector) and industry (for example, in supplying aluminum products to the region) and in having a well-educated work force.

The analysis presented here also suggests that other action may be required against unfair competition from foreign imports.[41] GCC authorities may need to consider the general imposition of protective tariffs to raise the price of imports at least equal to the price of locally manufactured goods, especially if the goods are of equal quality and standards. The earlier decision of the GCC to impose minimum duties on foreign imports of 4 per cent and a maximum of 40 per cent has proven inadequate to meet the problem which exists.

Finally, regional governments may need to consider preferential purchasing of national products by government departments, especially where the local products are of similar specifications and quality to the imported alternative. Import license quotas may be needed to force importers toward commodities manufactured within the region.

By itself, the removal of customs barriers is not sufficient to promote increased trade between the Gulf states. What is required is a drive towards a developed regional economy based on integrated production, with a co-coordinated strategy in foreign trade relations to withstand competition from other regional trade groups. GCC decision makers also need to analyze very carefully the implications for Gulf economies of unfolding regional trading blocs such as the proposed NAFTA (between the United States, Canada and Mexico) and AFTA (between the six members of the Association of Southeast Asian Nations) as well the deeper integration of the EEC economies carried out at the beginning of 1993.

38 EIU, Country Report: Bahrain, Qatar, No. 4 (1992) p. 13. Establishing a unified external customs tariff is one of the prerequisites set by the EEC for a GCC-EEC free trade pact.
39 Economist Intelligence Unit, Country Report: Oman, Yemen, No. 2 (1992) (EIU: London, 1992) p. 8.
40 EIU, Country Report: Bahrain, Qatar, No. 4 (1992) p. 6.
41 Azzam, The Gulf Economies in Transition, p. 122.

In general inter-Arab trade has declined in relative importance as a factor affecting industrial diversification in the Arab Gulf region. Several reasons account for this development including the lack of an integrated manufacturing base; identical parallel development of industries in mutual competition instead of co-operation; the growing disparity in income between the oil producers and the non-producers; and, bureaucratic problems such as differential customs tariffs and quota systems.

Such problems cannot be solved quickly and need a massive program of industrial development in all parts of the Arab world. The basis needs to be laid now for a planned program of co-operation using division of labor to create large markets for viable industries. Still, an agreement signed in 1992 among the GCC states for the promotion of trade between them might provide just such a basis for solving many of the problems if it is fully applied, and even better, if it is extended to other Arab countries. Both of these actions would provide a vast new market for the industrial exports of the Gulf states.

As in many other areas of public policy, this vital economic agenda requires several critical political decisions. In particular, Arab governments need to be actively engaged in:

— linking free inter-Arab trade with Arab economic integration;
— separating trade relations from political relations between Arab states so that trade is not unduly affected by political factors;
— co-ordinating Arab economic and trade relationships to withstand the pressure from other geographic or economic groups; and
— agreeing to a level of protection for Arab products against foreign competition.

In addition to the 1992 agreement between the GCC states, other avenues exist for increasing the flow of inter-Arab trade, for example, bilateral agreements which allow a higher degree of flexibility according to specific circumstances than can be covered in more general international agreements including all Arab countries. There is no doubt whatsoever that the non-oil producing Arab countries could form a critical and logical market for the industries of the Gulf states again in the future as they once did in the 1970s.

Although this paper has emphasized the external factors which currently limit the potential market for Gulf exports, there are key domestic restraints as well. All of the Gulf states have expressed a desire to increase their industrial exports, yet in reality there is a lack of any clear link between investment and production policy on the one hand, and export strategy on the other. Simply put, with the notable exception of the petrochemical industry, there has been a lack of sound assessment of export potential. This omission could and should be readily addressed by each of the Gulf governments.