Gulf-South Asia Economic Relations: Realities and Prospects

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1. Introduction

Economic relations between the Arabian Gulf region[1] and South Asia[2] go back many centuries. The earliest trading between the Tigris and Euphrates and the Indus Valley went along the Gulf coast. The byzantine commercial linkage dates back to the Late Antiquity, which witnessed expansion of sea-borne trade as a direct result of the conflicts between two major centralized empires-Persian and Roman. The enormous output of Arabic Sasanian coinage further demonstrates the acceleration of trade between these two regions. The civilizational link strengthened over the next thousand years, with the British Raj establishing protectorates along the Arabian Gulf coast in the 18th centuray which were administered from Delhi, in order to protect their vital trade route. The major thrust came in the 1970s, with the increase in the price of oil and consequent economic development in the Gulf, which propelled large-scale manpower and goods imports from the Indian sub continent. As a result, the commercial interaction between these two regions intensified, both in scope and in depth ,to reach the current phase of vibrant ties.

Throughout this period, Gulf-South Asia economic relations have developed through a kaleidoscopic of shifting patterns. Today, Gulf and South Asia are on the cusp of an economic renaissance. Gulf-South Asia economic relations are now firmly entrenched in a new strategic geoeconomic tapestry involving energy and petro-dollar investment flowing east from the Gulf and cheap consumer goods, knowledge-driven technologies and migrant labor, flowing west from South Asia. This new economic symbiosis is gaining prominence in the contemporary post crisis world economic order due to the structural comparative advantages of both the regions. Looking forward, it is certain that the economic fortunes of the two regions are fast becoming mutually reinforcing due to increasing economic interdependence.

The main objective of this paper is to analyse various facets of the Gulf's economic engagement with South Asia and highlight the challenges and opportunities for deepening engagement with reference to the current global economic slowdown. After a brief macroeconomic overview of the two regions, the focus shifts to the analysis of trading patterns between them over the last five years. The next section

1 In this paper, the Arabian Gulf region is confined to the member countries of the Gulf Cooperation Council namely, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

2 For analytical convenience, the geographical coverage of South Asia region is confined to large countries namely, Bangladesh, India, Pakistan and Sri Lanka.

deals with interregional investment flows and their outlook in the near future. The next section unravels the intricacies of interregional energy trade which is fundamental to the sustenance of Gulf-South Asia economic engagement. Then, follows a section on the labor movement from South Asia to the Gulf. The next section highlights South Asia's significance for Gulf's food security. The last section summarizes the main points and highlights the prospects for enhancing engagement in the future.

2. Neo-economic powers with resilient growth

The phenomenal economic rise of the GCC bloc and South Asia led by India is one of the hallmarks of the present century. High economic growth rates combined with the Gulf's substantial financial liquidity have given these two regions increasing bargaining power in the global economy. It is not just their increasing global role, however, but also the growing ways in which they complement each other that are reshaping their relations. These two regions are poised to become major global economic players in a reshaped world. Table 1 depicts latest macroeconomic trends of the GCC and South Asia.

Table 1 Broad macroeconomic indicators, 2008

Macro Indicators	Gulf Cooperation Council	South Asia
Population, total (millions)	37.8	1552
Population growth (annual %)*	3.8	1.4
Surface area (sq. km/thousands)	2572.3	4293
Nominal GDP (current US$ billions)	1073.2	1542.6
Nominal GDP Per capita (current US$)*	43650.2	1162.5
Real GDP growth rate (Annual % change)*	8.1	5.3
Inflation, end of period (annual %)*	10.6	8.7
Current account balance, Billion Dollars	282.2	-34.5
FDI Inflows (billion$)	63.4	48.8
FDI Outflows (billion$)	29.7	17.8

Note: * simple average
Sources: International Monetary Fund, *World Economic Outlook*, October 2009; UNCTAD, *World Investment Report,* 2009; World Bank, *World Development Indicators*, 2008.

Since 2003, GCC and South Asia have embarked on a higher growth trajectory, making the two regions fastest growing globally (See Figure 1). This dynamism is broad-based and is a sub-regional phenomenon. Among the contributing factors to the dynamism have been the ability of South Asia to mobilize domestic resources and structural transformation in favor of services and industry; and the GCC's oil fuelled economic boom and accelerated economic diversification with mega investments in cluster industries, particularly in metal and petrochemical byproducts and services sector. The growth outlook for 2010 and 2011 for both regions continues to remain robust, despite the global slowdown although some deceleration in growth is expected.

Figure 1 Real GDP growth rate (annual percent change)

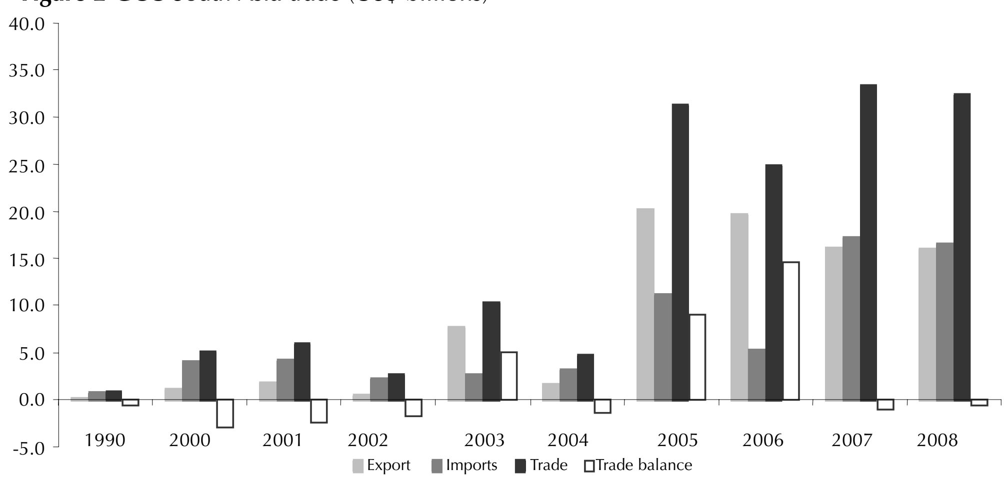
Note: e means estimated; p means projected.
Source: IMF Data Mapper, October 2009

3. Bilateral trade: high growth in volume, yet, less diversified

Trade between the Gulf and South Asia has an ancient history dating back to the Silk Road. While trade along the Silk Road sank into oblivion due to the downfall of the Roman Empire; trade between the Gulf and the sub-continent remained brisk, to such an extent that the Indian rupee was widely circulated as currency in the Gulf countries from medieval times onwards. Particularly in the early and mid 20th century, the Indian Rupee was widely adopted as legal tender in the Gulf countries and even adopted as local currency, in the form of the Gulf rupee between 1959 and 1966.

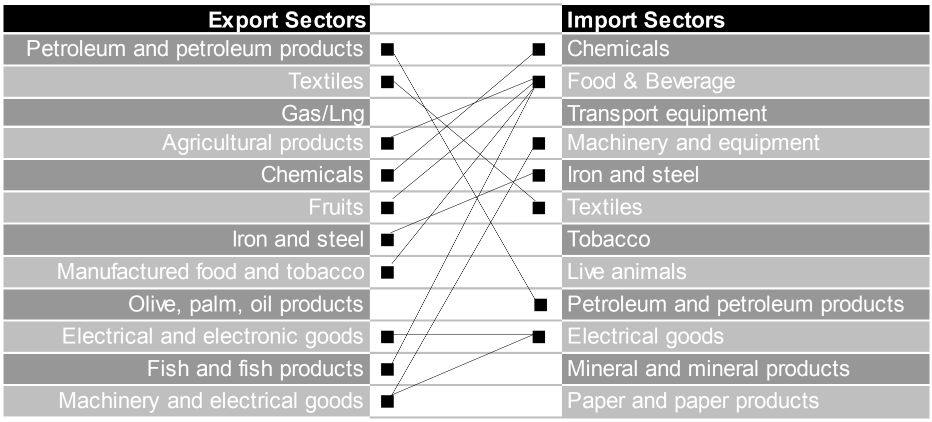
Over the last decade, trade relations between the two regions have developed by leaps and bounds. In the past five years (2004-2008), trade volumes between the Gulf and South Asia have increased more than six-fold, and much of the incremental demand for Gulf exports going forward - not just for oil and gas but also petrochemicals, base metals and services such as finance and tourism - are coming from South Asia and the Asia region as a whole. In 2008, GCC-South Asia trade stood at $ 32.4 billion (See Figure 2).

Figure 2 GCC-South Asia trade (US$ billions)



Source: UN COMTRADE Database, 2009.

Figure 3 Trade complementarities, GCC-South Asia, 2008



Source: UN COMTRADE Database, 2009.

South Asia is one of the major Asian trading partners for the GCC, accounting for nearly 5 percent of GCC's world trade. It is also important to note that trade between the two regions is largely based on export-import complementarities, suggesting increasing economic interdependence and convergence in the future (See Figure 3).

Moreover, recent growth resurgence in both regions has been accompanied by their more vigorous participation in international trade and South Asia in particular has emerged from the past five years with a deeper integration with the world economy. There is also greater intra-regional trade within South Asia and the GCC, although at a somewhat lower level in comparison to other regions. The GCC is rapidly becoming a global trading bloc with total merchandise trade of nearly $833 billion in 2008. The GCC's world trade increased by an annual rate of 27 percent between 2003 and 2007. Although intra-GCC trade is still relatively low - with exports of $46.6 billion in 2007 - it is increasing at a brisk pace, growing at an annual rate of 32.4 percent between 2003 and 2007. These trends imply that GCC economic integration is maturing slowly and intra-GCC trade is mostly concentrated on exports. This means Gulf countries will continue to depend on imports from outside the region, a fact that helps to account for the growth in imports from South Asia. Simultaneously, GCC is increasingly emerging as global exporters in terms of petrochemicals and processed metals in which South Asia is import dependent due to increasing regional demand.

However, until today, the trade profile is not so diversified and also heavily concentrated on the consumption patterns and consequent imports of goods catering to the South Asian expatriates living in the GCC[3] and GCC's energy exports (oil and gas) to the subcontinent. For example, empirical evidence[4] shows that India has huge export potential in the GCC countries except UAE and Saudi Arabia. This is mainly

3 Karayil, Sajitha Beevi 'Does Migration Matter in Trade? A Study of India's Exports to the GCC Countries', *South Asia Economic Journal*, 2007, Vol. 8, No. 1, pp. 1-20.

4 Pradhan, Samir Ranjan, 'India's Export Potentials in the GCC: A Gravity Model Analysis', UNESCAP, ARTNeT Report, Bangkok, 2007, available under *www.unescap.org/tid/artnet/pub/gcc_pradhan.pdf*

due to the fact that both Saudi Arabia and the UAE are India's largest trading partners in the GCC, so unless India's export profile to these countries is diversified, the existing potentials cannot be exploited.

Importantly, there are structural barriers that continue to hamper seamless economic exchange between these two regions. GCC countries face formidable barriers, in terms of higher duties on their exports to South Asia in general and India in particular. Whereas, exports from South Asia face a nominal duty of 5 percent and in many cases a lower rate ranging from 1.5 percent to 2 percent in the GCC. In addition, South Asia's inadequate trade infrastructure hampers GCC exports with cost escalation and longer administrative procedures for trade facilitation. Transitory policies, such as export restrictions, also act as a dampener in GCC-South Asia trade. In 2007, India's export ban on non-Basmati rice had a direct negative effect on the rice prices in the GCC, as it is a lifeline consumption item of majority of South Asian expatriates. Moreover, in the aftermath of the current economic downturn, South Asia led by India is increasingly becoming protective, while the GCC is, as usual, liberalizing as they are more import dependent[5]. For example, as of 2010-01-25 (12.14 pm), India is reported to have undertaken 12 trade distortionary measures, affecting GCC member states. Although it is premature to gauge the exact impact on the GCC, it is certain that protectionist state measures could act as a major hindrance to augment economic relations between the two regions.

Of late, GCC countries are entering into preferential trading arrangements with major Asian countries. One of the major landmarks is the GCC-Singapore Free Trade Agreement, which was concluded on January 31, 2008. This milestone could serve as a catalyst for other FTAs under discussion with South Asian countries such as India and Pakistan. Even though bilateral negotiations for an FTA with India started in 2004, the progress is slow due to lack of policy consensus on both sides. Therefore, in the current global trade environment, seething with protectionist tendencies, GCC and South Asia need to re-energize policy strategies in order to enable a level playing field for sustaining their burgeoning trade relations.

4. Bilateral investment: wealth-opportunity linkage

Another important factor driving ties are wealth-opportunity linkages. GCC foreign assets are estimated to have exceeded $900 billion in the five years ending June 2008, with US-based assets (equities, debt and deposits) accounting for more than one-third of Gulf investment. But an estimated $60 billion worth of GCC investment went into Asia, and that is likely to increase. In the last few years, there has been a change in the investment patterns preferred by GCC investors, from capital preservation to yield maximization. This has led to greater emphasis on portfolio diversification and an appetite for riskier assets, as well as a preference for direct management of assets rather than outsourcing them to international financial institutions.

Moreover, Gulf investors still face an array of constraints and barriers to invest-

5 For detail trends pertaining to state measures undertaken as a response to the current global economic downturn in South Asia and the GCC, see Global Trade Alert Database at *http://www.globaltradealert.org/site-statistics* .

ment in the West, especially after the September 11 attacks - from official obstructionism to regulatory hurdles to difficulties in finding quality assets. As a result, Asia has become a logical alternative - with China and India ranking first and second, respectively, for new global investments from the Gulf. Liberalized investment regimes, ease of entry and exit, high rates of return and favorable geopolitical trends all favor strategic diversification into Asia. The last few years have seen numerous joint ventures and mergers and acquisitions between GCC entities and Asian companies in the areas of infrastructure, construction and downstream oil projects. Joint investment funds like the Saudi-India Investment Fund, Kuwait-India Investment Fund, among others, have also emerged. Gulf-based investors announced some $150 billion in long-term infrastructure investments in Asia in 2005-2006. The Dubai International Financial Centre has suggested that the GCC countries could pump as much as $250 billion into Asia over the next five years.

It is apparent that the current financial crisis and the pernicious effects on the real economy of both regions are having an impact. This is largely reflected in a drop in demand for oil, petrochemicals, related service sectors and manufacturing. But South Asia's strong economic fundamentals and GCC's cumulative capital surplus could help mute the negative effects. The outlook for oil prices remains uncertain, but prices should average around $60 a barrel in 2009, not far below the average for 2007. A slight increase to around $75 a barrel is envisaged for 2010 as global demand begins to recover, largely based on strong demand in Asia. Given this, GCC capital outflows are expected to amount to about $430 billion between June 2008 and June 2010.

Moreover, because developed countries have been the chief victims of the global financial crisis, Gulf sovereign wealth funds are rethinking their approach to Asian markets. While many Western economies are in the grip of recession, India's GDP growth for 2008-2009 has been revised to 7-7.5 percent, down from 9 percent. According to one report, GCC investors are set to increase their allocations to the Asian region from 30 percent of their portfolios to 40 percent, and shift away from riskier equity-linked and real estate assets to real economy assets in Asia with secure rates of return. GCC investors are looking for strategic investments in key sectors such as petrochemicals, logistics, tourism, mining, agriculture and renewable energy, which are not cyclical and can assure sustainable returns. Opportunities for investments in these areas in a number of Asian countries have become attractive for GCC investors.

However, the main hindrance has been lack of institutional arrangements to facilitate bilateral investment, which therefore again highlights the importance of a preferential agreement. As it is being widely recognized that both regional economies are resilient and on their way back to fundamentals early from the current crisis, they need to rethink on policies that need to diversify their economic engagement inter-regionally and thereby boost world economic growth.

5. Synergy in energy

Energy is the most dominant item in GCC-South Asia trade. The regions constitute the two strategic building blocks of the current global energy regime as major producers and consumers of energy. India has emerged as a major consumer of energy and energy security is vital to the nation maintaining the current high rates of GDP growth. India's consumption of oil is expected to grow from the 2005 level of 2.5 million barrels per day to about 3.1 million barrels per day by 2010. It is estimated that by 2015 Pakistan's demand for oil will increase to 31 million TOE (tonne of oil equivalent) and for gas to 57 million TOE, even if electricity generated from hydro power and coal is virtually doubled. Domestic production meets only 18 per cent of Pakistan's oil consumption and 33 percent of India's. For considerable periods of time the strain on the Pakistani economy was ameliorated by "concessional" imports from the GCC. Even now Saudi Arabia is helping the Pakistani government in coping with the adverse impact of a phenomenal increase in oil prices. Also, both India and Pakistan have ambitious plans for augmenting domestic power generation through a mix of development strategies, but they also pursue strong diplomatic initiatives to import energy from outside sources. With India's petroleum consumption pattern switching to more environment friendly natural gas, there is huge demand for natural gas in recent years. There are number of LNG projects currently in place in India to meet increasing demand from transport sector, industrial sector and demand for power generation. In 2004, India for the first time imported LNG from Qatar for its Dahej plant in the state of Gujarat. Notwithstanding a moratorium on new LNG projects in Qatar, it has pledged to increase supplies to India during Prime Minister Manmohan Singh's visit in 2008.

One important aspect of energy interdependence between the two regions is the fact that while higher economic growth has resulted in increasing imports of crude oil by South Asia from the GCC region, due to the robust refining sector in South Asia particularly in India, exports of petroleum products to the GCC market, and UAE in particular, is on the rise in the last three years (See Table 2). India boasts of the world's largest and most sophisticated grassroot refinery at Jamnagar in Gujarat, operated by private energy giant Reliance Ltd. Thus, given the future trends of increasing energy trade between the two regions, there is outstanding potential for cooperation in the energy sector in order to address the vulnerabilities of energy security. For GCC, South Asia, as a secure stable export destination, bears importance given that its' traditional industrialized markets, especially the US and Europe, have not only diversified their import sources, but have also become highly energy efficient in terms of declining share of petroleum in the energy mix. With such a backdrop, GCC and South Asia should look for cooperation across the oil value chain from the wellhead to distribution. Given the favourable refining fundamentals in India, GCC exporters should look for setting up refineries in India in order to service the large South Asian market. Simultaneously, South Asian countries should look for viable investment opportunities in the GCC upstream sector. Moreover, there are major areas of common interest in the future of global energy supply and demand, the structure of international oil and gas markets, price developments, technology and legislation. There are also opportunities for cooperation and cross investment between national oil companies, which is one example of changing international oil and gas diplomacy.

Table 2 GCC-South Asia energy trade, 2006-2008

GCC's Exports to SAARC	Value in US$ thousands		
Product label HS-4 code	2006	2007	2008
2709-Crude petroleum oils	19138505	1295118	32158328
2710-Petroleum oils, not crude	4910369	1501079	8086699
2711-Petroleum gases	1695563	2888516	3188721
2713-Petroleum coke, petroleum bitumen & other residues of petroleum oils	28699	1615	80984
2712-Petroleum jelly; mineral waxes & similar products	11741	26684	12349
GCC's Imports from SAARC	**Value in US$ thousands**		
Product label HS-4 code	**2006**	**2007**	**2008**
2710-Petroleum oils, not crude	16337	54708	1620673
2713-Petroleum coke, petroleum bitumen & other residues of petroleum oils	34284	35150	104901
2707-Oils & other products of the distillation of high temp coal tar etc	4447	4052	44329
2712-Petroleum jelly; mineral waxes & similar products	2186	3604	7293
2709-Crude petroleum oils	24	1	446
2711-Petroleum gases	73	95	0

Source: TradeMap database, 2009.

6. Manpower bonanza

The discovery of oil and manpower shortages in the Gulf precipitated phenomenal labor migration to the region. Given the population pressure and bleak economic prospects at home, South Asian laborers flocked to the Gulf in search of employment and higher wages. The predominance of employees from the Indian sub-continent in skilled and unskilled occupations from the 1930s and their prominent role as unskilled workers, filled the vacuum in supply left by shortages of local Gulf labour. As the oil-led development process gathered momentum to the modern era, the flow of South Asian laborers increased.

Currently, around 6.5 million South Asians live in the GCC, making them the single largest expatriate community (17% of the total resident population). The South Asian expatriate community could be categorized into four broad groups, viz., (a) unskilled workers, employed in construction companies, municipalities, agricultural farms and as domestic workers; (b) skilled and semi-skilled workers; (c) professionals, such as doctors, engineers, accountants, employed in government and private sectors; and (d) businessmen.

There are large numbers of South Asian expatriate community institutions active in the GCC. In UAE almost all major Indian academic institutions, particularly in management and technology, are present, and similarly educational institutions from Pakistan are also present. Other professional bodies, such as the Indian Charted Accounts Association are also active in the GCC. UAE (Dubai) is the only Islamic country in the World to have a Hindu Temple to accommodate the religious activities of the large Hindu expatriates from South Asia.

However, one of the major economic consequences of the large expatriate population in the GCC is the fact that there are fiscal and income redistribution effects in the host country to contend with. This is primarily the cause of anxieties among Gulf nationals, as foreigners remit huge sums of money to their home country as their status is purely temporary in the host countries, and a sense of uncertainty leads to high propensity to remit. Further, in the absence of suitable policies, especially relating to managing the migration process, this huge amount of capital flight is detrimental to the future growth of the respective economies. Nevertheless, with liberalizing and accommodative policies such as in the real estate sector in the UAE, South Asian expatriates have turned into entrepreneurs directly investing in big projects.

7. Food security: South Asia, the Gulf's rice bowl

Food security is another important aspect of Gulf-South Asia interdependence. Insufficient cultivatable lands, arid climate and scarce water, among other constraints, handicap agriculture in the Gulf. The result is overwhelming dependence on food imports. In recent years, food security has become a crucial challenge for the Gulf. The so-called "food gap" in the GCC (the difference between what it produces and what it consumes) in recent years has gone up substantially due to growing populations (currently 38.8 million and projected to be 65 million by 2020). The GCC's food imports have increased from $6 billion in 1990 to $9 billion in 2000 and to $17 billion in 2006.

Moreover, food constitutes a major source of imported inflation, as import dependency will reach 60 percent in the arid GCC countries by 2010. In Saudi Arabia, for example, about 15 percent of all imports are food items. The amount spent on food in the GCC is roughly 10 percent to 20 percent of disposable household income. With double-digit inflation and soaring international prices, as well as trade restrictions in major exporting nations in Asia, food insecurity concerns have heightened. Therefore, GCC governments are trying to secure physical access to food through farmland purchases, investments in agri-businesses and locking in long-term supply agreements with exporters.

Because of South Asia's rich agricultural resources, it is a traditional source for GCC food imports. Countries like India, Pakistan, Bangladesh, and Sri Lanka are the main suppliers of rice, wheat, sugar, and live animals. When India and Pakistan imposed rice export restrictions in 2007, worries mounted in the GCC and the region is now in the process of negotiating bilateral agreements to secure supplies from South Asia. Nevertheless, the Gulf's dependence on South Asia for food is likely to increase in coming years. This calls for a more action-oriented approach, in the form regional cooperation in the food sector for a long term mutual beneficial relations.

8. Conclusions

An increasingly complex pattern of economic interdependence is reshaping economic relations between the Arabian Gulf region and South Asia, making each vulnerable to, and sensitive towards, the other and providing the foundation for potential cooperation. Although energy is the cornerstone, it is multidimensional, including trade, investment, labor migration, remittances, and food security, all of which link the two regions.

With the current global economic downturn, GCC and South Asia are faced with a new global economic order in which both the regions are set to play a larger role in future. While there are cataclysmic effects affecting both, there is tremendous potential for both regions to continue the impressive growth momentum in the future, due to their structural comparative advantages and growing complementarities. Therefore, both the regions should institutionalize the relationship for a sustainable future. While it is simply unthinkable that an interregional framework between the Gulf and South Asia might take shape (due to divisions and conflicts in the South Asia region), yet, bilateral frameworks may nevertheless prove to be a formidable tool for expanding the relationship. In this regard, policy-makers should re-energize FTA negotiations in order to leverage the impetus provided by the current economic crisis for a sustainable economic engagement. Given the economic buoyancy in both regions, FTA would provide a level playing field for addressing the short-term economic vulnerabilities due to the current crisis and would foster broad based sustainable economic engagement in the long run.

Thus, GCC-South Asia economic relations herald a new era of intensive cooperation. While regionally, GCC and South Asia have become important economic power houses, globally they are set to play a larger role in order to safeguard their economic interests by synergizing complementarities. The economic resilience of both the regions to overcome the current economic crisis signifies the economic potential of mutual beneficial relations. The next logical course for both regions is to strive for a consensus in order to lay the foundation for a robust economic engagement with win-win propositions, whichin turn calls for policy synergies.

About the author

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