3

Australian trade and investment with the Gulf States

Australia's strategy for engaging with the Gulf States

3.1 Australia has adopted a strategy for approaching trade and investment relations with the region which comprises three key elements.

3.2 The first element of the strategy is to 'encourage countries in the region to pursue economic reform and trade and investment liberalisation'.[1] Such reform is necessary if the Gulf States are to achieve enough sustainable economic growth to provide employment to their young and fast growing countries.

3.3 Australia encourages those states that have acceded to the WTO to conform to WTO requirements. Iran and Saudi Arabia have yet to accede. These measures have already delivered benefits to Australian exporters according to DFAT.[2]

3.4 The second element of Australia's strategy is to develop 'bilateral and regional paths to trade and investment liberalisation'.[3] In pursuing closer cooperation with the GCC and individual Gulf countries, the government hopes to create more economic engagement and therefore access to those economies.

1 DFAT, *Submission No 9*, p 16.
2 DFAT, *Submission No 9*, p 17.
3 DFAT, *Submission No 9*, p 17.

3.5 Australia is currently negotiating investment promotion and protection agreements with the UAE, Saudi Arabia and Iran. Australia is currently exploring options for a possible free trade agreement with the UAE. It is also pursuing an economic dialogue with the GCC countries which may involve a framework economic agreement or an FTA at some future time.[4]

3.6 The final key element of the strategy is the pursuit of bilateral trade facilitation. Australia has in place framework agreements with Bahrain (1979), Iran (1974), Kuwait (1982), Oman (1982), Saudi Arabia (1981) and the UAE (1985). An agreement with Qatar is currently under negotiation. These agreements focus on trade facilitation and bilateral cooperation in economic and technical areas.

Australia's trade with the Gulf States

Merchandise trade

3.7 Australia's merchandise exports to the Gulf countries grew from $1.4 billion in 1993 to AUD 4.2 billion in 2003, an average annual growth rate of 15.8 per cent (see Tables 3.1 and 3.2). They now comprise 3.9 per cent of Australia's total merchandise exports, compared to 2.3 per cent in 1993.[5]

3.8 Over the last five years, merchandise exports rose at an average annual rate of 12.2 per cent. To a large extent this strong growth reflects generally strong regional import demand, as oil prices recovered from their low levels of 1997, and competitiveness effects arising from exchange rate changes. The success of Australian motor vehicle and parts exports - which grew from AUD 129 million in 1996 to AUD 1,885 million in 2003 - has helped drive growth in total merchandise exports to the region.[6]

3.9 Australia's exports to the Gulf countries fell by almost 19 per cent in 2003. DFAT explained the key factors contributing to this fall include the impact of drought conditions on the supply of agricultural exports and valuation effects arising from the strengthening of the Australian

4 DFAT, *Submission No 9*, p 17.

5 DFAT, *Submission No 9*, p 8.

6 DFAT, *Submission No 9*, p 8.

dollar during 2003.[7] Exports of wheat and dairy product also fell sharply in 2003.[8]

3.10 Manufactures exports to the region rose by 2.1 per cent in 2003 reflecting a 14.4 per cent rise in simply transformed manufactures and a modest 1.1 per cent rise in the dominant elaborately transformed manufactures (ETM) category.[9]

Table 3.1 Australia's merchandise trade with the Gulf States (AUD million)

	1993	1999	2000	2001	2002	2003
Australian exports	1,427	2,884	3,88	5,564	5,153	4,193
Australian imports	1,638	1,271	2,820	2,789	2,058	2,377
Balance of Trade	-211	1,613	1,059	2,775	3,096	1,816

Source DFAT, Market information and analysis unit[10]

3.11 There have been significant changes in the composition of Australian exports to the Gulf countries in the past decade (see Chapter 2 for principal exports and imports to each country).[11]

3.12 Key primary commodities remain extremely important to Australian exports to the Gulf countries, but elaborately transformed manufactures (ETMs) have grown to dominate the export mix over the past decade. In 2003, DFAT highlights, ETMs made up over 52 per cent of Australia's merchandise exports to the region, compared with only 15 per cent in 1993.[12]

3.13 As noted above, the growth in ETM exports has been largely driven by exports of passenger motor vehicles and parts.[13] In the last five years ETM exports (excluding passenger motor vehicles and parts) grew at an average annual rate of about 12 per cent to reach AUD 309 million.[14]

3.14 Similar products which have also shown strong growth in recent years include specialised industrial machinery, electrical power machinery, mechanical handling equipment, food processing

7 DFAT, *Submission No 9*, p 8.
8 DFAT, *Submission No 9*, p 8.
9 DFAT, *Submission No 9*, p 9.
10 DFAT, *Submission No 9*, p 9.
11 DFAT, *Submission No 9*, p 9.
12 DFAT, *Submission No 9*, p 9.
13 Parliamentary Delegation to the Gulf States, *Meeting Notes.*
14 DFAT, *Submission No 9*, p 9.

machines, marine craft, aircraft and parts, clothing, footwear and measuring and controlling instruments.[15]

3.15 Defence exports are playing a growing role in our exports to the region. The Gulf countries are among the world's largest markets for defence goods and services, and DFAT explains, Australia has exported defence products and services to the Gulf countries for over a decade.[16]

3.16 Australia's defence exports to the region are small compared to sales by the major European, US, Russian and Chinese defence industries, but they show strong growth according to DFAT. Australian defence exports to the Gulf countries rose from AUD 0.4 million in 1999 to AUD 1.9 million in 2003.[17]

3.17 Significant sales in recent years include Kuwait's purchase of four Tenix-built patrol vessels in 1995 for AUD 30 million and 22 Tenix-built Shorland Armoured Personnel Carriers in 1997 for AUD 16 million. In 2001 the UAE announced it would purchase mine-clearing equipment worth AUD 5.5 million from Australian Defence Industries.

Table 3.2 Selected Australian exports to the Gulf States (AUD million)

	1993	1999	2000	2001	2002	2003
Passenger motor vehicles and parts	7	812	1,357	1,97	1,794	1,885
Confidential items[18]	360	879	1,227	1,312	1,056	841
Live animals	99	130	171	326	381	310
Dairy products	98	205	275	338	331	215
Meat products	144	128	136	235	215	198
Non-monetary gold	7	87	95	466	200	15

Source DFAT, Market information and analysis unit[19]

3.18 There have been significant differences between the rates of growth of Australian exports to individual Gulf country markets over the past decade (Table 3.3).

15 DFAT, *Submission No 9*, p 9.
16 DFAT, *Submission No 9*, p 9.
17 DFAT, *Submission No 9*, p 9.
18 Includes wheat, barley, rice and alumina.
19 DFAT, *Submission No 9*, p 9.

3.19 Exports to Saudi Arabia and Kuwait grew particularly rapidly between 1993 and 2003, and both countries increased their imports from Australia.

3.20 Saudi Arabia is now the largest individual Gulf country destination for Australian exports. In 2003, it imported AUD 1,819 million worth of Australian goods, 43.4% of total Australian exports to the Gulf countries.

Table 3.3 Australian exports to the Gulf States by country (AUD '000)

	Saudi Arabia	UAE	Kuwait	Iran	Oman	Qatar	Bahrain
Value of Exports in '93	304	423	90	436	92	41	42
Value of Exports in '03	1,819	1,122	555	263	201	125	107
Rank in Exports to Gulf countries '93	3	2	5	1	4	7	6
Rank in Exports to Gulf countries '03	1	2	3	4	5	6	7
Share of Exports to Gulf countries '03	43.4	26.8	13.2	6.3	4.8	3.0	2.5
Growth Rate '93 to '03 (%)	26.9	13.4	23.9	0.7	9.3	10.6	11.3

Source *DFAT, Market information and analysis unit*[20]

3.21 Australian exports to the UAE, Bahrain, Qatar and Oman also grew at a healthy rate over the last decade. Iran was, however, a notable exception. In trend terms, Australian exports to Iran showed little real growth over the period, and the country's ranking among Australian export markets in the region fell from first in 1993 to fourth in 2003.[21] Australian exports to Iran are dominated by wheat exports, and these did not keep pace with the rapid growth in ETM exports to the region over the period.[22]

Table 3.4 Selected Australian imports from the Gulf States (AUD million)

	1993	1999	2000	2001	2002	2003
Crude petroleum	983	629	1,776	1,751	947	1,416
Refined petroleum	522	235	404	318	508	170
Confidential items[23]	86	146	221	277	296	328
Fertilizers (excludes crude)	15	76	110	118	97	177
Liquefied propane and butane	1	65	130	89	44	85
Aluminium	3	19	24	32	37	40
Glassware	0	3	8	16	23	17

Source *DFAT, Market information and analysis unit*[24]

20 DFAT, *Submission No 9*, p 10.

21 DFAT, *Submission No 9*, p 10.

22 DFAT, *Submission No 9*, p 10.

23 Includes certain petrochemicals

3.22 DFAT states that Australia's merchandise imports from the Gulf countries are dominated by crude petroleum which, in 2003, accounted for over 70% of imports from the region. Refined petroleum products and petrochemicals are also among the major imports from the region.[25]

3.23 A number of non-oil imports from the region have shown strong growth over the last five years including aluminium, glassware, woven synthetic fabrics, construction materials, jewellery and selected food products.[26]

Table 3.5 Australian merchandise imports from the Gulf States

	1993	1999	2000	2001	2002	2003
Saudi Arabia	714	660	1,450	1,275	1,206	916
UAE	739	288	940	930	382	987
Qatar	84	142	113	385	198	168
Kuwait	64	77	160	122	166	138
Bahrain	13	39	47	50	66	106
Iran	16	28	30	26	38	53
Oman	8	37	79	1	2	10

Source DFAT, Market information and analysis unit[27]

3.24 Saudi Arabia and the UAE are the dominant Gulf country import suppliers to Australia (see Table 3.5) according to DFAT. Over the past decade they have supplied, on average, over 80 per cent of Australia's total merchandise imports from the region.[28] In recent years, imports from Kuwait, Qatar and Bahrain have risen strongly.

Services trade

3.25 The Australian Bureau of Statistics publishes few statistics on Australia's services trade with the Gulf countries. DFAT[29] and the Australia Arab Chamber of Commerce and Industry (AACCI)[30] make this point and explain the difficulties this creates when trying to analyse services trade between Australia and the region.

24 DFAT, *Submission No 9*, p 11.
25 DFAT, *Submission No 9*, p 11.
26 DFAT, *Submission No 9*, p 11.
27 DFAT, *Submission No 9*, p 11.
28 DFAT, *Submission No 9*, p 12.
29 DFAT, *Submission No 9*, p 12.
30 AACCI, *Submission No 2*, p 2.

3.26 This lack of data on services trade is an issue in the inquiry because several submissions were from services exporters, mainly recruitment firms. Their arguments were framed in terms of the returns their service provided to Australia. Clearly without an objective measure of that return, decisions about solutions to the problems are more difficult.

3.27 Accordingly, the committee urges the government to address this problem to allow for more informed consideration of issues related to the trade in services.

3.28 It appears, however, that two-way services trade between Australia and the Gulf countries has grown strongly over the past decade.[31]

3.29 The most obvious services exported are education and tourism and DEST's and DIMIA's submissions provide some insight into the growth in these areas.

3.30 Table 3.6 provides information on student visa granted over the last few years.

Table 3.6 Student visas granted to Gulf nationals

Citizenship	September 2002	September 2003	% variation	December 2002	December 2003	% variation
Bahrain	61	109	79	38	54	42
Iran	421	614	46	430	655	52
Kuwait	73	70	-4	29	24	-17
Oman	271	480	77	124	164	32
Qatar	73	118	62	23	22	-4
Saudi Arabia	135	359	166	76	236	211
UAE	137	255	86	62	86	39

Source *DIMIA*[32]

3.31 Clearly growth has been strong up to 2002-03 in all countries, except Kuwait in the last year where numbers went down substantially and in Qatar where they went down marginally.

3.32 In terms of tourism services Australia has been loosing ground in the region (see Table 3.7). DIMIA attributes this steady fall in tourism numbers arriving in Australia since 2001, to the international security situation.[33]

31 AACCI, *Submission No 2*, p 2 and DFAT, *Submission No 9*, p 12.

32 DIMIA, *Submission No 19*, p 7.

33 DIMIA, *Submission No 19*, p 12.

3.33 One area of rapid growth from a small base has been in educational services. According to DEST the number of Gulf state nationals enrolled in Australian universities rose from just over 300 in 1997[34] to 2,475 in 2003.[35] Figure 3.1 shows the growth trajectory of Gulf student numbers coming to Australia (excluding Iran) and Appendix C shows the country and educational breakdown of those numbers (including Iran).

Table 3.7 Visitor visa grants 2000/01 to date

Country of Citizenship	2000/01	2001/02	2002/03	2003/04 (as at 29 Feb 04)
Bahrain	625	595	542	438
Iran	1,873	1,603	1,574	1,214
Kuwait	3,903	3,697	2,394	1,273
Oman	803	767	706	434
Qatar	410	387	234	171
Saudi Arabia	1,721	1,737	1,552	1,228
United Arab Emirates	4,687	3,563	2,238	1,585
TOTAL	**14,022**	**12,349**	**9,240**	**6,343**

Source *DIMIA*[36]

Gulf States' investment profile

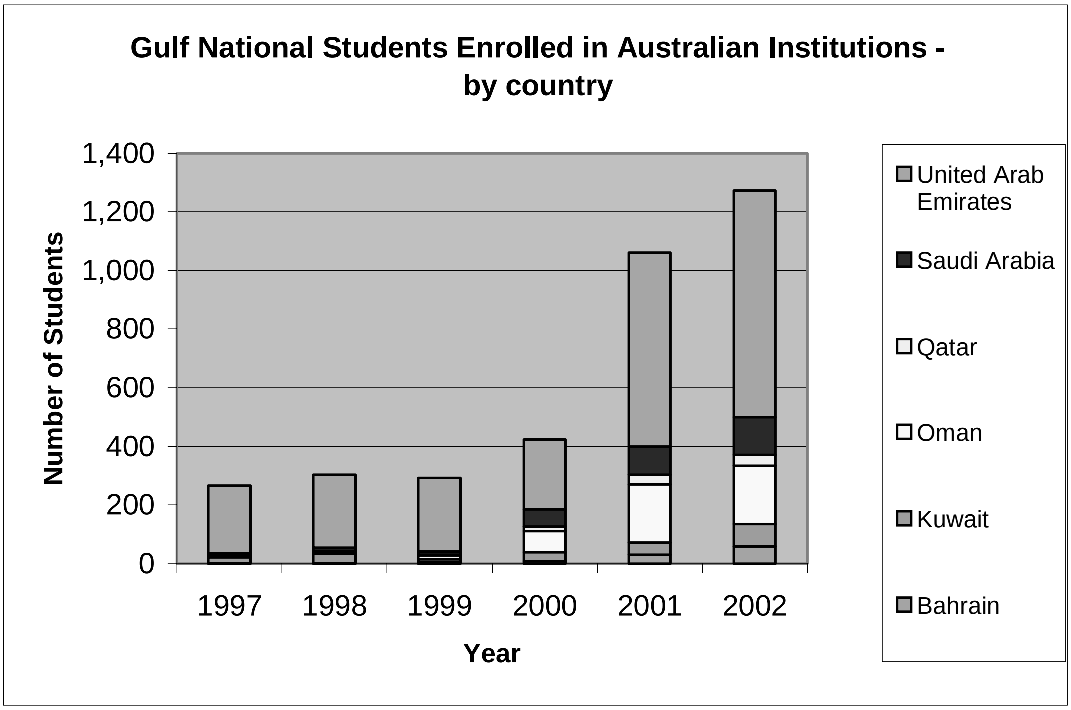
3.34 According to DFAT, the Gulf countries' investment profile is characterised by large net outward investment flows and extensive net foreign assets.[37] The key factor underlying these large outflows is the large current account surpluses which the Gulf countries typically produce. The EIU estimates that the Gulf countries had an aggregate current account surplus of USD 57 billion in 2003.[38]

3.35 The Gulf countries' foreign investment outflows are dominated by portfolio investment. Foreign direct investment (FDI) outflows are relatively modest (an average of USD 1.3 billion per year between 1998 and 2002). DFAT believes the relative scarcity of large manufacturing and service enterprises based in the Gulf countries

34 DFAT, *Submission No 9*, p 12.
35 DEST, *Submission No 17*, p 3.
36 DIMIA, *Submission No 19*, p 12.
37 DFAT, *Submission No 9*, p 12.
38 DFAT, *Submission No 9*, p 12.

(particularly in the non-oil sector) is a key reason for the low level of outward FDI.[39]

Graph 3.1 Gulf nationals enrolled in Australian education institutions – by country



Source *DEST*[40]

3.36 FDI inflows to the region are also relatively modest. Between 1998 and 2002, these flows averaged USD 1.2 billion per year.[41] The modest rate of FDI inflow to the region reflects a number of factors, including restrictive domestic investment regulations, perceived political risk and the ample supply of domestically-generated investment capital.[42]

Australia's investment relations with the Gulf States

3.37 Although comprehensive data are not published, as discussed earlier, it appears that Australian direct investment in the Gulf countries is modest.[43] Anecdotal evidence suggests that there has been a

39 DFAT, *Submission No 9*, p 12.
40 DEST, *Submission No 1*, p 8.
41 DFAT, *Submission No 9*, p 12.
42 DFAT, *Submission No 9*, p 12.
43 DFAT, *Submission No 9*, p 13.

significant increase in the interest of Australian investors in the region in recent years.[44]

3.38 DFAT believes this modest level of Australian investment in the Gulf countries may itself be a potential impediment to trade. Trade associated with direct investment links can often be more durable than the transactional trade that characterises our trade with the Gulf countries.[45]

3.39 There are several examples of successful investment in the region, including the University of Wollongong, Perth-based construction company Multiplex, and professional services consultancy GHD.[46]

3.40 Multiplex has been active in the UAE, through a joint venture known as NASA-Multiplex, since 1997. In that time, it has constructed numerous commercial, tourist and residential buildings, including some of the best-known buildings in Dubai. The total value of projects undertaken in the UAE by NASA-Multiplex since its establishment is almost AUD 1.12 billion.[47]

3.41 GHD's regional offices have been involved in a range of residential, infrastructure and environmental projects in the region. GHD's offices in UAE and Qatar employ about 140 staff.[48]

3.42 Other Australian companies with a presence in the region include Clough Engineering Ltd, Clipsal Australia, the Cox Group, the GRM Group, the Meinhardt Group, Rydges Hotels and Resorts, SMEC, Val Morgan and Worley Ltd.[49]

3.43 Despite restrictive local investment regulations, DFAT argues there are many opportunities for investment by foreign companies in a range of industries in the Gulf States.[50]

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44 DFAT, *Submission No 9*, p 13.

45 DFAT, *Submission No 9*, p 13.

46 DFAT, *Submission No 9*, p 13.

47 1 AUD = 2.68 UAE Dirhams as at 20July 2004. <http://www.oanda.com/convert/classic>

48 DFAT, *Submission No 9*, p 13.

49 DFAT, *Submission No 9*, p 13.

50 DFAT, *Submission No 9*, p 16.

Impediments to Australia's trade and investment links to the region

3.44 To differing degrees, the Gulf countries are working to liberalise trade and investment arrangements. Five Gulf States (Bahrain, Kuwait, Oman, Qatar and UAE)[51] are already members of the WTO. Saudi Arabia is in the process of negotiating accession to the WTO and Iran has submitted an application. But barriers to trade and investment persist in a number of areas.[52]

3.45 Iran maintains high tariffs and quantitative restrictions on a wide range of imports.[53] While the GCC countries impose a reasonably low maximum duty of five per cent on many dutiable items, individual GCC members are able to impose duties of between 12 and 20 per cent on certain 'protected commodities'. As well, alcohol, pork and tobacco products imports face very high tariffs, or outright import prohibitions (see Appendix C for more information on the GCC).[54]

3.46 The Gulf States also impose a range of non-tariff barriers including government procurement policies, licensing and labelling regulations. Exporters often face restrictive agency arrangements when seeking agents for their products in Gulf countries.[55] As well, most Gulf countries impose limitations on the movement of business people which can act as an impediment to trade, particularly services trade according to DFAT. Quarantine and cultural issues can also act to inhibit trade. One example is the religious prescriptions in relation to the livestock trade and the sale of some processed foodstuffs.[56]

3.47 Widespread restrictions on foreign direct investment imposed by Gulf countries also impact on the region's openness. All countries either prohibit or severely limit foreign investment in oil production, and many of the large industrial enterprises in the region are state-owned.[57] Although Iran has rescinded its prohibition on foreign investment,[58] cumbersome barriers to investment remain.[59]

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51 <http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm>
52 DFAT, *Submission No 9*, p 14.
53 DFAT, *Submission No 9*, p 15.
54 DFAT, *Submission No 9*, p 15.
55 DFAT, *Submission No 9*, p 15.
56 DFAT, *Submission No 9*, p 15.
57 DFAT, *Submission No 9*, p 15.
58 Embassy of the Islamic Republic of Iran, *Submissions 10 & 12*.
59 DFAT, *Submission No 9*, p 15.

3.48 Non-GCC foreign investors are limited to a maximum stake of 49 per cent in GCC-based companies, and foreign investors are generally unable to purchase real estate in Gulf countries. However, many Gulf countries have established free trade zones which offer various incentives, including a relaxation of many trade and investment restrictions.[60] The UAE is probably the most advanced in this regard.[61]

3.49 Another impediment to closer engagement with the region is relative unfamiliarity on the part of regional business people with what Australia can offer, compared with the United States, Asia and Europe.[62]

3.50 SMEC points out that Australians too have a limited understanding of the region. Just as Australians came over time to understand business practices in Asia, it too must also spend time and effort coming to terms to business practice in the Gulf.[63]

3.51 Austrade advised the committee that understanding the personal nature of business relationships, the importance of cultural mores of hospitality and courtesy, and religious and social practices, is vitally important to establishing effective business relationships in the region.[64]

Trade risk

3.52 EFIC assesses the Gulf States to be reasonably low risk in terms of whether they will serve their external debt. In EFIC words ‘except for Iran’s rating, [the Gulf States] are mid-to-low investment grade – neither speculative grade credits, nor gilt-edged Aaa / Aa credits’.[65]

3.53 These reasonably low ratings, which are compared to a range of other ratings in Table 3.8, mean EFIC are in principle ‘prepared to support Australian exporters and investors into all of these countries’.[66] Further, EFIC has more ‘capacity for exposure in each of the Gulf States than is currently being used.’[67]

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60 DFAT, *Submission No 9*, p 15.

61 Parliamentary Delegation to the Gulf States, *Meeting Notes.*

62 DFAT, *Submission No 9*, p 15.

63 SMEC, *Submission No 16*, p 4.

64 Austrade, *Submission No 8*, p 8.

65 EFIC, *Submission No 3*, p 3.

66 EFIC, *Submission No 3*, p 3.

67 EFIC, *Submission No 3*, p 4.

Table 3.8 Trade risk ratings

	EFIC rating	OECD rating	Moodys rating	Fitch rating	Standard & Poor rating
Bahrain	3	3	Baa1	A-	A-
Iran	5	4	C	B+	Not rated
Kuwait	3	2	A2	AA-	A+
Oman	3	3	Baa2	Not rated	Not rated
Qatar	3	3	A3	Not rated	A+
Saudi Arabia	3	3	Baa2	Not rated	A
UAE	3	2	A2	Not rated	Not rated

Source EFIC, Submission No 3, p 3.

Level of economic liberalism in the Gulf States

3.54 One final general indicator of interest is the Heritage Foundation's Economic Freedom index. Although it is not directly related to trade, the level of economic freedom in a country clearly has some indirect impact on trade.

3.55 Table 2.2 lists the degree of economic freedom in the Gulf States in terms of a range of criteria.

Table 3.9 Economic freedom in the Gulf States

	Bahrain	Iran	Kuwait	Oman	Qatar	Saudi Arabia	UAE	*Australia*	*Singapore*
Trade Policy	3.0	2.0	2.0	3.0	3.0	4.0	2.0	*2.0*	*1.0*
Fiscal Burden	1.8	3.6	1.5	1.5	3.1	2.0	2.0	*3.8*	*2.6*
Government Intervention	4.0	5.0	4.5	4.5	4.5	4.5	4.0	*2.0*	*3.5*
Monetary Policy	1.0	4.0	1.0	1.0	1.0	1.0	1.0	*2.0*	*1.0*
Foreign Investment	2.0	4.0	4.0	3.0	3.0	4.0	3.0	*2.0*	*1.0*
Banking and Finance	1.0	5.0	3.0	3.0	3.0	4.0	4.0	*1.0*	*2.0*
Wages and Prices	3.0	4.0	3.0	4.0	2.0	2.0	3.0	*2.0*	*2.0*
Property Rights	1.0	5.0	3.0	3.0	3.0	3.0	2.0	*1.0*	*1.0*
Regulation	2.0	5.0	3.0	3.0	4.0	3.0	3.0	*2.0*	*1.0*
Informal Market	2.0	5.0	2.0	2.0	2.0	3.0	2.0	*1.0*	*1.0*
Overall ranking	***20***	***148***	***48***	***54***	***60***	***74***	***42***	**11**	**2**

Source The Heritage Foundation[68]

3.56 The level of economic freedom in a country reflects to some degree the nature of the economy and what forces are driving it. Economic

68 <http://www.heritage.org/research/features/index/>

freedom, for example, has a strong relationship with economic growth.[69]

3.57 Bahrain and UAE are clearly the most liberal economies in the Gulf, with Kuwait, Oman and Qatar following. Saudi Arabia is somewhat less liberal and Iran is the least free economy in the region. Australia and Singapore have been included for comparative purposes.

69 Julio Cole, 'The contribution of economic freedom to world economic growth, 1980-99', *Cato Journal*, Vol 23, No 2 (Fall 2003).