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BUILDING THE NEW SILK ROAD

Why the Gulf should pivot towards the East.

OVER THE PAST THIRTY YEARS global economic geography has radically shifted towards the East, with the centre now lying just East of Mumbai. In a belated recognition of the shift in global economic power, if not yet political power, the Obama administration announced in 2013 a 'pivot to East Asia', with the aims of growing security, political and economic ties with the region's countries and of 'containing China'.

The GCC countries should undertake a similar strategic pivot of their political, economic and financial policies towards Asia and the East, with the aim of embracing China, not 'containing' it. The Gulf region needs to develop its bilateral and multilateral relations with Asia and China, building on existing trade and investment relations. The policy focus should be to revive and build a "New Silk Road" that passes south of the old Silk Road. This "New Silk Road" represents the global demand and supply chains emerging from China whose tendrils are growing into Asia, Africa, the Middle East and Latin America.

The tectonic shift in global economic and financial geography undermines the inherited web of alliances, institutions and treaties forged in the aftermath of World War II. The global financial crisis that shattered the American financial empire in 2008 accelerated the Asia and eastward shift. Gulf policymakers need to awaken to this new economic reality and forge new alliances and partnerships to become an integral part of and builder of the New Silk Road.

Within the coming decade, China already the world's second largest economy, will surpass the US economy in size. Driven by demographics, structural change towards an increasingly market-based economy, export-driven and building human capital, investment in infrastructure, new technology absorption and productivity convergence, China will, by 2030, have an economy about the same size as the US and EU combined.

By 2060 the so-called currently emerging economies will represent over 60 per cent of the global economy. This transformation of the global economy reflects itself in changing patterns of production, trade, investment and capital markets. Already in 2013, with a total of $4.16 trillon in combined exports and imports China became the world's biggest trading nation. Indeed, China's share of global trade went from three per cent at the start of 2000, when it entered the WTO, to reach over 10 per cent in 2013. This share will grow over the coming decade, although at a less rapid pace.

"The global financial crisis that shattered the American financial empire in 2008 accelerated the Asia and eastward shift. Gulf policymakers need to awaken to this new economic reality and forge new alliances."

MOVING FROM ENERGY TO THE NEW SILK ROAD

Given their energy natural resources, the Middle East countries are strategic trade and investment partners for an energy-hungry and deficient China. Energy has been the main driving force in the development of the China-GCC economic relationship, but the future is likely to be fundamentally different as both China and the GCC diversify their economies and Chines goods, products and services gradually displace their Western counterparts and Geely, Cherry, Great Wall and Lifan become household names and drive out GM, Chevrolet, Fiat, Opel and Peugeot. For the foreseeable future we will be dancing to a Chinese tune.

BRIDGE BETWEEN ASIA AND AFRICA

Given its location at the mouth of the Gulf, international connectivity, growing linkages to Africa and the quality and efficiency of its infrastructure, the UAE is now the logistics hub for China: some 70 per cent of Chinese exports are re-exported via the UAE to the other GCC countries, India, Iran, East and North Africa.

In addition to trade flows, China-GCC investment flows have been on the rise as GCC economies remove restrictions to foreign investment and increase the diversification of their economies.

Africa is now a key recipient of Chinese FDI, which is leading to a transformation of African economies and their international connectedness. The UAE with its central geographic position midway between Africa and China, its superior transport infrastructure, logistics and connectivity, has become China's gateway into Africa.

Dubai, one of the most open cities in the region, is already home to over 150,000 Chinese residents; with some 3,000 Chinese companies registered in the emirate, up from just 18 in 2005. After China and the UAE eased bilateral visa regulations in September 2009 and the UAE obtained "approved destination status", the number of annual Chinese travellers pouring into the Gulf state mushroomed to over 300,000.

FOUR PILLARS TO 'PIVOT EAST'

The symbiotic energy relationship between China and the Gulf represents the past. The future should be based on more solid, less 'liquid', building blocks. There are four.

One, **prioritise negotiations of the China-GCC Free Trade Agreement** which have been treading water since July 2004. The stakes are high: China is now the main trade partner of the GCC. The policy framework should be put in place to remove barriers to trade (including services), allow market access and investment and facilitate the multilateral rights of company establishment and joint ventures. The China-GCC FTA should also ease cooperation between state-owned and government-related enterprises that are dominant in both China and the GCC countries.

Similarly, cooperation and joint investment between the SWFs of the two parties would lead to wiser investment in financing economic development in Asia, the Middle East, Africa and other emerging markets where the real returns are more promising.

Two, **the GCC banking and financial system should be integrated into the emerging 'Redback Zone'** where payments, capital markets and banking and financial assets and transactions will be based on the Renminbi as an international currency. It is economically inefficient to use dollars and euros to finance GCC-China trade and investment links. There is no economic or financial reason why the oil and gas exports of the GCC to China should not be denominated and payment settled in RMB. This would lower transaction costs and diminish risks.

For the GCC countries the RMB will be the currency and means of payment underlying the New Silk Road.

Three, **establish a Renewable Energy (RE) and nanotech partnership between the GCC and Asia/China.** China has emerged as the world's clean energy and clean tech powerhouse. The UAE and GCC need to develop an industrial partnership with China to jointly undertake R&D in RE, water resource management and build solar power technology and energy capacity. Given its geographic and climatic comparative advantage, the GCC can become the global solar powerhouse building on Chinese technology and knowhow. Indeed the GCC countries can become major exporters of solar power energy and technologies. This will enable a new export production sector to emerge and, more importantly, create new job opportunities. Similarly, nanomaterials are largely carbon and hydrocarbon based, offering great potential for the GCC countries to use their plentiful resources to invest in nanotechnology and become producers and exporters of nanomaterials and technology.

Four, **the GCC and China should establish a security framework agreement to protect their joint interests.** The Gulf and the Middle East is a region of conflicts, tensions and vulnerabilities that have been exacerbated by the Arab Firestorm. These tensions reflect, among other factors, competition and conflict for the rich energy resources of a region that contains 48.4 per cent of the world's oil and some 43 per cent of its natural gas.

As the US retrenches, "pivots east" and redeploys its military assets, China and the GCC will need to ensure that no security vacuum emerges to threaten their strategic interests and the growing New Silk Road. Over the coming decades China will grow its 'soft power' but will also build its military and strategic assets as befits a super-power. Given its high dependence on the energy resources of the Gulf China will seek to insure its energy security, while the GCC will want to protect its energy reserves and associated infrastructure. The outlines of a future alliance are in the making.

PIVOTING EAST IN A NEW MULTI-POLAR WORLD

A new multi-polar world has emerged over the past thirty years that has shattered the post World War II paradigm and structure and the near hegemony of the US whose economic, financial and military power is waning. Over this same period the GCC countries have grown their economies based on an energy market dominated by Europe and the US and to a lesser extent Japan. That world is no longer.

The new world order requires a re-assessment of strategy and policies and a pivot to the East by the GCC countries, to be integrated into the New Silk Road. There is much to look forward to in this brave new world. GB

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