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UAE: a new place in new world trade?

The United Arab Emirates (UAE) has the second largest and the most diversified economy in the Gulf Cooperation Council (GCC). Thanks to authorities' efforts to diversity exports over the last three decades, the share of the oil sector in GDP and in overall exports declined to 30% and 16% respectively in 2016 (compared with 43% and 76% in 2001). The country has become a regional hub for trade and logistics. This encouragement of new industries has helped the federation to increase its comparative advantage in sectors such as metals, minerals and plastics while also maintaining its competitiveness in oil sector.

In order to promote economic integration and widen trade ties, the UAE has signed various agreements with many countries in economic, trade, investment, and technical fields. The strategic location of the country allows it to play a central role in re-exporting goods from different countries around the world towards Arab nations. Re-exports account nearly 60% of total exports.

In addition, the UAE has been prioritising improving trade ties with China for years as the latter is one of the principal payers of the federation energy products. In 2013, China announced the Belt and Road Initiative (BRI), which is an initiative that aims to connect Asia, Africa, and Europe. The initiative has significant benefits for the UAE in terms of boosting commerce and investments, as well as accessing wider markets, especially regarding the construction, metals, trade, logistics and hydrocarbon sectors.

Despite these significant strides, the UAE is only halfway through its trade diversification process: emerging sectors remain commodity-related ones and the diversification has not yet affected manufacturing ones at this stage. Therefore, to a large extent, they do not enable UAE companies to implement a production process located across different countries. The integration of the UAE in global value chains is therefore not in sight yet.

Continuous efforts for economic diversification: rising importance of non-oil sectors

The UAE economy is one of the most diversified within the GCC. A member of the World Trade Organisation (WTO) since 1996[2], the country is benefitting from continuous efforts of trade diversification from its government authorities. Although oil and natural gas extraction became the most important sectors of the UAE sector since their discovery in the 1950s, authorities' commitment to diversifying exports has allowed the development of other sectors, such as wholesale and retail trade, real estate, finance, and tourism. The share of the oil sector in GDP declined to 30% as of 2016, compared to 43% in 2001. During the same period, the share of the construction sector in GDP passed to 9% from 6.5%, transportation to 6.6% from 4%, and financial activities to 6.4% from 3.9%.

1 - The Gulf Cooperation Council is comprised of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE.
2 - Other GCC members who have joined the WTO are Saudi Arabia (joined 2005), Qatar (1996), Oman (2000), Kuwait (1995), and Bahrain (1995).

The economic diversification has been also reflected in budget performance and exports (**Chart 1**). The share of oil revenues in total budget revenues has declined to 53% in 2017 compared with 67% in 2000. Exports of oil and oil products declined to 16% of total merchandise exports in 2016 compared with 76% in 2000. At that period, exports of plastics, wood and paper, precious stones, cement, transportation products and metals have increased. Civil aviation accounts for 12% of GDP and estimated to reach 32% by 2020 when it would contribute by USD 53 billion and 750,000 jobs to the federation's economy, according to the authorities' estimations. The country also benefits from being a port and logistic hub with 61% of cargo addressed to GCC states arrives through UAE seaports. Between 2000 and 2016, the share of stones[3] rose significantly to 14.6% from 1.6% while it also improved for plastics and transportation.

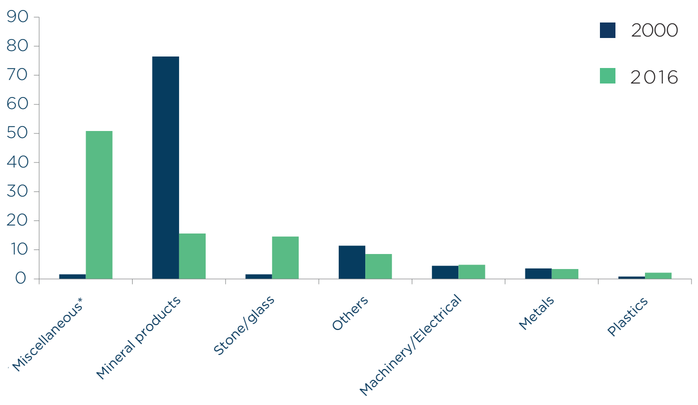
The diversification of exports has been due to the implementation of specific policy framework regarding regulations, investments, trade barriers and restrictions. The introduction of structural reforms and market-oriented regulations has allowed the expansion of the private sector. One of the pillars of this framework is based on the establishment of free trade zones. The UAE has over 35 free zones specialised in different sectors and in 2016 they accounted for USD 127 billion, nearly 57% of total trade with other countries. The UAE has implemented 63 bilateral investment treaties for the protection and promotion of bilateral investments and 100 double taxation avoidance agreements. The country's trade regime is open and its trade tariffs remain low: effectively applied tariffs (AHS)[5] in simple average terms stood at 4.03% as of 2015 lower than 4.76% in 2011. In comparison, they stand at 5.08% in Saudi Arabia, the largest economy in the region.

The UAE has yet to be integrated into international value chains

The advantage that each sector offers in terms of export diversification varies. The UAE has a higher degree of advantage in some of the non-oil exports compared with its GCC neighbours. The Revealed Comparative Advantage Index[6] (RCA, see **Chart 2**) of the World Bank, which is used to assess export diversification of countries, suggest the country was able to increase its advantage in sectors like metals, minerals, plastics and stones. Its comparative advantage continues in fuels though at a slower level. However, this improvement in comparative advantage does not seem to integrate the UAE in the global value chains (GVC) which means the manufacturing and assembling of a particular product in more than one country allowing the know-how transfer between the countries, as per the World Bank. Although the UAE has gradually increased its advantage in most of the products, the only ones with a score higher than 1 are fuels, metals, minerals, and stones. These products represent a very small part of the manufacturing sector, and do not enable UAE companies to implement a production process located across different countries. As a result, the integration of the UAE in GVC remains quite limited, despite the country's continuous efforts of economic and trade diversification.

Trading partners of the UAE have shown little changes during this period (**Chart 3**). It should be underlined that over the past years, exports have become more equally spread across the federation's clients: in 2006, the top five export partners represented 54% of the UAE's total exports, while in 2017 it represented 39%. The top ten exporters accounted for almost 65% in 2006, which fell to 58% in 2017.

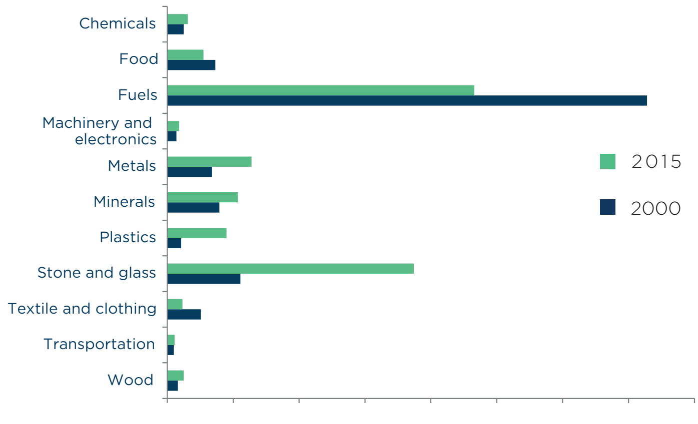
CHART 1
Breakdown of UAE's exports per sector



Miscellaneous includes "commodities not elsewhere specified" which jumped from USD 167 million in 2000 to nearly USD 150 billion in 2016.

Source: UN Comtrade statistics

CHART 2
Revealed Comparative Advantage Index of the UAE



Source: WITS, World Bank

3 - Stone and glass category includes stone, plaster, cement, asbestos, mica, etc articles, ceramic products, glass and glassware, pearls, precious stones, metals, coins, etc.
4 - The share of food products and wood remained flat around 1.5% and 0.5%, respectively. Machinery and electronics saw its share to inch up to 4.9% from 4.5%.
5 - The World Bank Group uses the concept of effectively applied tariff, which is defined as the lowest available tariff. If a preferential tariff exists, it will be used as the effectively applied tariff. Otherwise, the MFN applied tariff will be used. For more information, please consult: https://wits.worldbank.org/wits/wits/witshelp/Content/Data_Retrieval/P/Intro/C2.Types_of_Tariffs.htm
6 - The World Bank definition for RCA is as follows: "Measures of revealed comparative advantage (RCA) have been used to help assess a country's export potential. The RCA indicates whether a country is in the process of extending the products in which it has a trade potential, as opposed to situations in which the number of products that can be competitively exported is static. It can also provide useful information about potential trade prospects with new partners." If the index is higher than 1, it means there is a comparative advantage. If the RCA is less than unity, it means the country has a disadvantage in the sector or commodity.

CHART 3
UAE's main export partners (% of total exports)

2016		2017	
Japan	25.2	India	10.5
South Korea	10.3	Japan	9.4
Iran	7.1	Iran	9.1
India	6.0	China	5.5
Thailand	5.7	Switzerland	4.5
Singapore	3.3	South Korea	4.2
Pakistan	2.7	Singapore	4.0
China	2.2	Saudi Arabia	3.8
Saudi Arabia	1.5	Pakistan	3.4
Switzerland	0.4	Thailand	3.4

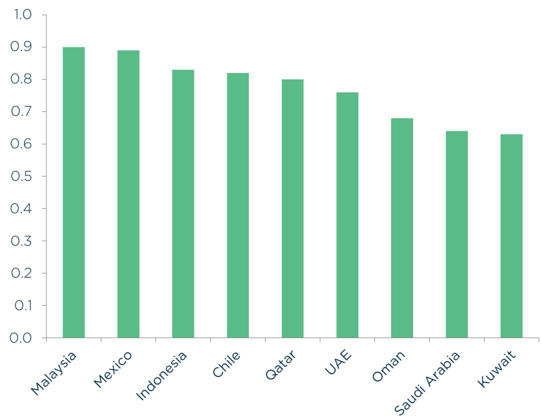
Source: IMF Department of Trade Statistics (DOTS)

In order to promote economic integration and widen trade ties, the UAE has signed various agreements with many countries in economic, trade, investment and technical fields. The country's strategic location allows it to play a central role in re-exporting goods coming from different countries around the world towards Arab nations. In addition, the UAE benefits from being a member of the GCC customs union, formed in 2003. The GCC countries is currently in talks to establish free trade zones with the European Union, Japan, China, India, Pakistan, Turkey, Australia, New Zealand, South Korea, and the Group of Mercosur (Brazil, Argentina, Uruguay and Paraguay).

Although UAE export quality has improved over the time (**Chart 4**), it still lags compared with some other commodity exporters, such as Malaysia and Mexico. Improvements in the quality of produced goods helps boost existing comparative advantages to increase productivity and export revenues[7]. Additionally, the country's exports of high technology goods remains very low compared with Chile, Indonesia, Mexico and Malaysia – each of which are recent examples of traditional commodity exporters who have successfully diversified their economy – although it remains slightly higher than its GCC neighbours[8]. The evolution of the export quality remains mostly concentrated in hydrocarbon-related goods, such as crude materials, chemicals and mineral fuels. For other products such as food, beverages, machinery and equipment, the quality evolution between 2000 and 2014 has declined.

Under these circumstances, the establishment of the Belt and Road Initiative (BRI) by China represents a whole new aspect for the UAE.

CHART 4
IMF Export Quality index:
(the higher the better; 1 = higher quality)



Source: IMF

Greater integration into the BRI – both a risk and an opportunity for the UAE?

The Belt & Road Initiative, often referred as a 21st century Silk Road, was announced by China in 2013. It is an initiative that aims to connect Asia, Africa and Europe. As of July 2018, more than 100 countries and international organizations are said to have signed Belt and Road cooperation documents with China, which widened the trade connections under the initiative to Latin America and the Caribbean, and the South Pacific region. The initiative, under which six economic corridors have been proposed[9], is expected to cost more than USD 1 trillion.

7 - Henn, C., Papageorgiou, C., & Spatafora, N., 2013, Export Quality in Developing Countries, IMF Working Paper 13/108
8 - UAE, Selected Issues, IMF, August 2016
9 - Six international economic co-operation corridors have been identified: New Eurasian Land Bridge, China – Mongolia – Russia, China – Central Asia – West Asia, China – Indochina Peninsula, China – Pakistan, Bangladesh – China – India – Myanmar. The Maritime Silk Road will connect China with Europe through the South China Sea and Indian Ocean and connect China with the South Pacific Ocean through the South China Sea. Source: HKTDC Research, http://china-trade-research.hktdc.com/business-news/article/The-Belt-and-Road-Initiative/The-Belt-and-Road-Initiative/obor/en/1/1X000000/1X0A36B7.htm

China aims to diversify its energy suppliers as much as it can. This has brought the country close to the Gulf States, which in turn have benefited from China's trade and investment flows. The value of bilateral trade between the UAE and China reached USD 52.7 billion in 2017, up 15% from a year earlier. Non-oil trade volume stood at USD 3.5 billion on the back of a slight increase of re-exports while imports reached USD 31.9 billion. The UAE's main exports to China are aluminium ingot, chemical fertiliser, petroleum, and polytene, while it imports mostly textile goods, apparel, metal products, machinery, and electronics. Within the BRI, the volume of non-oil trade between China and the UAE is expected to rise to USD 58 billion in 2018[10] as the initiative would give the federation the opportunity to enforce its regional hub position for exports and investments.

The UAE and China have implemented several mechanisms in order to sustain this cooperation, which is promoted via high level visits. Both countries have signed 13 agreements and memoranda of understanding that aim to strengthen strategic partnership and bilateral cooperation across several sectors. These include the construction of embassies and other buildings, the establishment of cultural centres, cooperation in energy, financial and agricultural domains, and e-commerce ties, among others. Such initiatives would allow the UAE to attract more investments from China, which is not currently ranked among the top 10 foreign direct investors of the federation. In 2017, the UAE attracted foreign direct investments (FDI) of over USD 10.3 billion, up from USD 9.6 billion in 2016. The country is also making efforts to attract more FDI from China, such as easing certain laws to improve the business environment, and providing training for free zones to local partners and stakeholders to promote investment.

However, a greater integration with China through the BRI would mean that the UAE could become more exposed to a slowdown in the Chinese economy – a real possibility due to a combination of several factors, such as the existence of overcapacities in Chinese economy, a credit bubble, and the imposition of tougher US tariffs against Chinese products. As a result, China's domestic demand and investments are likely to slow, which would have a knock-on impact on the UAE economy.

Furthermore, there are concerns about the BRI's geopolitical impacts. Many countries along the BRI routes are experiencing political tension. In an event of regional instability, the UAE's economy, just like others in the region, would suffer due to the deterioration in business sentiment. Additionally, any slowdown in the Chinese economy would weigh on UAE industry, starting with the oil sector, as slower growth in China would drag down the demand for the UAE oil and petrochemical products.

Last but not least, trade tensions between China and the United States could also indirectly affect the UAE. Additional restrictions on global trade flows would negatively impact the UAE's trade (13% of GDP) and logistics sectors (almost 8% of GDP). Although expectations for global merchandise trade volume growth have yet to be negatively affected (4.4% in 2018 as per the WTO), rising trade restrictions – coupled with other risks, such as higher inflation, geopolitical tensions, and tougher global financial conditions – could drag down world trade volume growth in 2019. Such a scenario would also negatively impact the UAE's transportation and trade sectors, as well as its exports and re-exports.

10 - AWAM, 2018. *UAE-China non-oil trade set to rise to US$58 bn in 2018: Al Mansouri tells UAE-China Economic Forum.* [Online] Available at: https://www.emirates247.com/business/uae-china-non-oil-trade-set-to-rise-to-us-58-bn-in-2018-al-mansouri-tells-uae-china-economic-forum-2018-07-21-1.671549 [Accessed 17 October 2018].

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