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Oman's trade and opportunities of integration with the Asian economies☆

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ABSTRACT

This paper investigates the determinants of trade between Oman and its major Asian trading partners in order to gauge the impact of the process of trade liberalisation. The empirical findings based on the gravity model indicate that Oman's imports from Asia are strongly determined by Asian population, Asian per capita gross domestic product (GDP), real exchange rates, distance and Oman's per capita GDP. The results also provide strong evidence that Oman's oil exports to Asia are strongly and equally determined by Asia's and Oman's population. Our findings reveal that while distance is not a friction to Oman's oil exports, it has a weak regressive effect on non-oil exports. Our results also indicate a negative but statistically insignificant effect of trade liberalisation on non-oil exports. These findings certainly have policy implications in terms of Oman–Asia trade relationship and in particular the need for more policy intervention to liberalise the non-oil exports sector so as to facilitate its wider integration within Asia.

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1. Introduction

Oman is one of the Arab countries and a member state of the Gulf Co-operation Council (GCC) group of countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates) that has enjoyed a significant long-term partnership with several countries in Asia for many years. It has a historical record of trade and cultural exchange with countries like India and Pakistan and its overall relationship with these as well as other countries in Asia strengthened over-time as a result of increasing levels of trade, investment, temporary labour migration, tourism and outward remittances. In terms of trade, Oman matters significantly to a number of Asian countries including China, Japan, South Korea, India, Thailand, Singapore, Pakistan, and Malaysia. Large and fast growing Asian countries like China and India are playing an increasingly stronger role in terms of determining Oman's exports and imports. Asian countries have contributed positively to Oman's economic welfare in terms of supplying labour and providing raw materials. Investment and tourism services have also benefited Oman as well as Asia.

Oman's engagement with Asian countries is certainly a strong indicator of its desire to integrate with a region that offers many opportunities for its long-term economic well being. Hoekman and Sekkat (2010) have argued that economic integration in terms of trade in goods as well as services, labour and capital has been a key economic policy of Arab countries for several years. For example, Al-Khodiry and Puig (2012) note that greater economic and monetary integration has been a long-term objective of the GCC member states that dates back several years to the Economic Agreement of 1981. GCC member states established this agreement specifically aimed to pursue greater economic and monetary integration. Tas and Togay (2012) note that the GCC member countries are integrated at many levels with the establishment of a customs union in 2003. Although, the achievements towards greater economic and monetary integration varies from one GCC member state to another, there are signs that some progress has been made in some countries particularly in terms of greater economic integration (not monetary integration) within GCC member states in recent times.

Since mid 1990s, Oman has been implementing a development strategy mainly centring on liberalising its trade regime (World Bank, 2010). As part of its drive towards greater economic integration, Oman, nevertheless, took the bold step in joining the World Trade Organisation (WTO) in 2000 and this has added impetus in strengthening its already existing long-term economic partnership with Asia. A resulting outcome of Oman's membership to the WTO is that it has led the country on a faster path of liberalisation and this together with the vision of a broader domestic economic reform program initiated by His Majesty, Sultan Qaboos Bin Said; it has shown some progress in its policy of trade liberalisation and trade expansion.

Since 2003, Oman has been applying the Gulf Cooperation Council (GCC) common external tariff, which has two rates: 0 and 5% (WTO,

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2008). The country's simple average of the most favoured nation (MFN) applied tariff in 2008 was 5.5%, after having been cut from 7.7% in 2002 (World Bank, 2010). WTO (2008) notes that if preferences are taken into account, then Oman's trade regime is actually a bit more liberal, since its simple average of the applied tariff is 5.2%. According to the World Bank (2010), on the basis of its 13.2% MFN Tariff Trade Restrictive Index (TTRI), Oman's trade regime is more restrictive than that of an average high-income non-OECD (4.0%) or high-income (3.9%) country. A unique feature of Oman's trade policy is that agricultural products receive the highest protection, with a TTRI of 38%, compared to the average of 6.2% for non-agricultural products (WTO, 2008). Oman has a maximum MFN applied tariff, excluding alcohol and tobacco, of 100%, which it levied on pork and pork products (WTO, 2008). The simple average of the overall rest of the world tariff (including preferences) faced by the country's exports is 9.8% (World Bank, 2010). According to the Central Bank of Oman (2008), Oman mainly exports hydrocarbons, which traditionally do not face high tariffs, explaining the very low 1.1% weighted rest of the world tariff (including preferences). A review of Oman's trade law and practices in post-2000 has also given it an opportunity to engage in trade partnerships such as the Pan Arab Free Trade Area (in which all six States of the GCC take part) as well as trade agreement negotiations with large Asian economies such as China, Australia and New Zealand. Oman's free trade agreement (FTA) with the United States came into effect on January 1, 2009. The country also gained better access to markets as a member of the GCC which signed an FTA with Singapore in December 2008 and another one with the European Free Trade Association (EFTA) in June 2009.

Sadik and Bolbol (2001) noted that most Arab countries since 1985 worked at restructuring their economies to allow markets and private sector to have more leverage in allocating resources. Sadik and Bolbol (2003) in their study on Arab external investments argued that the diversification of the economic structure, financial development, political liberalisation and a leading role of the private sector could attract home return of Arab capital as well as foreign capital. Oman has been no exception as far as the liberalisation and diversification of its economy is concerned as it took steps to liberalise its trading environment with a significant decline in its applied tariff rates in the last decade (discussed in Section 2).

Recent statistics indicate that Oman is moving towards a more competitive economy. For example, according to Schwab (2012), the editor of "*The Global Competitive Report*" of the World Economic Forum, Oman's global competitive rankings improved from 41 in 2009–2010 to 32 in 2012–2013 among the 144 countries assessed. Oman has gradually been improving its business environment and in particular allowing more private sector participation in the real economy as well as more private and foreign investment incentives and activities, all essential foundations that would allow easier process of trade integration. For example, in its "Doing Business Report 2012," the World Bank (2012) notes that in terms of *ease of doing business*, Oman ranked 49 among the 183 countries in 2011 compared to 51 among the 155 countries in 2006. Improved business environment has allowed Oman an opportunity to develop its sectors other than the production of petroleum and petroleum products. The discussion in Section 2 provides evidence that, Oman trades more vigorously with several countries now than a decade ago thus positively indicating that the aim for a greater integration with other economies is still a live part of its long-term economic integration policy.

Asian countries on the other hand have been expanding their trade reach in light of the global financial crisis. It is now well known that the global financial and economic crisis seriously undermined economic growth for the United States and the European Union countries. For example, Ziesemer (2010) showed that the credit crisis of the OECD countries had a negative impact on growth of the world economy. In his recent study, Celik (2012) finds evidence of contagion during US sub-prime crisis for most of the developed and emerging countries while Haidar (2012) shows theoretically how a currency crisis can transmit through the trade sector channel of the economy. In their study, Aloui et al. (2012) argued that as a result of the recent international financial crisis, sparked off by the U.S. sub-prime crisis, economic growth in emerging markets (several of which are Oman's trading partners) out-performed growth in the developed economies.

In view of the recent developments as a result of the financial crisis as noted above, the business sectors of the major developed and emerging economies appear to be increasingly leaning towards regional or bilateral free trade agreements (United Nations, 2010) in order to increase trade. According to Brooks and Ferrarini (2011), bilateral and regional co-operation initiatives involving Asian economies have proliferated in the last two decades. The global financial crisis compelled several Asian economies to look within the region for trade, finance and investment opportunities. Large Asian economies such as China and India have been aggressively engaging into regional trade agreements. Sen (2006) argued that following the regional financial crisis of 1997–1998, there has been an ongoing phenomenon of proliferation of bilateral and regional trading agreements in the Asia-Pacific region. For example, China has economic integration agreements with other countries in Asia as well as non-Asian countries (Snyder, 2009). India, one of the other large Asian economies has also engaged into more comprehensive regional trading agreements with its neighbouring economies including some of the major Organization for Economic Cooperation and Development (OECD) economies (Seshadri, 2009).

For Oman, the growth in its exports will depend on sustainable demand of the markets particularly in Asian region. Given, the economic downturn in the United States of America and the European countries, the likelihood of Oman securing these markets for its non-oil exports in the short to medium term is bleak. Given Oman's process of current trade negotiations with countries in Asia including Australia and New Zealand and in order to improve the pace of trade integration into the international trading system, it is worthy for Oman to focus on the Asian market that is likely to provide a much viable long-term market opportunities for its non-oil exports as Asian countries are typically larger markets. For Oman, Asia also offers much investment and business opportunities and will continue as a source country for much of its labour requirements as it has been in the past. The signs of Oman's focus on Asian markets have started to emerge. It signed a FTA with Singapore in 2008 (World Bank, 2010) and is in the process of discussing possible trade agreements with Australia, New Zealand and China (WTO, 2008).

In view of the reform of the domestic economic environment, there is a strong likelihood of a faster growth in Oman which is certainly likely to further strengthen and expand its trade with Asia and other countries in the region. Given Oman's geographical proximity to Asia and its ongoing initiative to be more closely integrated within the Asian trading environment as well as Asia's vast market opportunities, this study attempts to identify the determinants of the level of trade between Oman and its Asian trading partners. This study is important in terms of gauging the future potentials of Oman's trade with Asia and its long-term aim of regional integration thus allowing the government to formulate more targeted foreign trade policies with greater strength and meaning. To our knowledge, this is the first empirical study examining Oman's trade with Asia and in doing so it adopts a gravity model framework in which time-series cross-country data for the period 1991 to 2009 are used as part of the empirical analysis to determine trade flows. This study makes a new contribution to the research involving Oman's trade with Asia with the view of assessing the potentials of greater trade integration. The rest of the paper is structured as follows. The next section discusses some aspects of trade with Asia. Section 3 discusses the literature and outlines the analytical framework. Section 4 presents the empirical findings and a discussion of the results. Section 5 concludes.

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