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## COMMENT

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# Tread lightly along the new Silk Road

The headlines from the Middle East understandably focus on the war in Iraq, the nuclear ambitions of Iran and the Palestinian peace process. But 50 years from now, historians may say that one of the region's most important stories was a profound economic shift: the development of strong ties between the Middle East and the rest of Asia.

A dramatic rise in the flows of goods, capital and people between the oil-rich Gulf and the fast-developing nations of Asia began around the dawn of the new century that may go on to reshape the world economy. We first explored this prospect in these pages last summer (*The need for reform along the new Silk Road, July 4 2006*). Since then traffic along what we called "the new Silk Road" – the reincarnation of what had been the world's dominant trade route during the Middle Ages – has reached a new level of intensity.

The volume of trade between the six members of the Gulf Cooperation Council and east Asia roughly quadrupled between 1995 and 2005. Bilateral trade between those regions' two largest nations – China and Saudi Arabia – increased 30 per cent between 2005 and 2006 alone. Total cross-border capital flows between the council and the rest of Asia may climb from an annual \$15bn today to \$300bn by 2020.

Asia's huge and growing appetite for oil remains the principal driver. Imports of Gulf oil by Asian nations (including China and India) are projected

to rise at 3.7 per cent annually until 2030, accounting for almost half of the world's increased demand for oil. By 2030, China will buy more than half of its oil from the Gulf.

There has also been a significant rise in the pace, scale and scope of inter-regional investments. Alongside huge petro-projects – such as the historic agreement that China's Sinopec recently struck with Iran to invest as much as \$100bn to secure long-term supplies of oil and gas – there has been a flurry of big non-oil deals in recent months. Etisalat, the United Arab Emirates' partially state-owned telecommunications group, paid \$2.6bn for a 26 per cent stake in Pakistan Telecommunications; and Egypt's Orascom bought 19 per cent of Hong Kong's Hutchison Telecom for \$1.3bn.

UAE's property developers are placing sizeable bets. Damac Holding is building a \$2.7bn residential, office and leisure complex in Tianjin, China. Emaar Properties – one of the world's largest property developers, based in Dubai – is investing even more to develop entire townships as well as hotels in Pakistan and India.

A host of other indicators – from the new buzzword, "Chime" (denoting the "China, India, Middle East" trade zone), to a more than six-fold increase in direct flights between the Gulf states and China (from seven a week in 2000 to 48 flights a week in 2006) – point in the same upward direction.

Most important, there is no shortage of optimism in

the region. "We want to go global by going east, not west," declared Mohamed Ali Alabbar, chairman of Emaar. "The west has got ageing populations and ageing economies. The east is where the true glamour lies." In recent interviews with McKinsey, more than 20 top Asian and Arab business leaders echoed that outlook.

In spite of the enthusiasm, there are many challenges to overcome. Several senior executives from the Gulf confessed they feel more comfortable doing business with India than with China, largely for bureaucratic and cultural reasons.

'There is no shortage of optimism about Asia in the Gulf but, in spite of the enthusiasm, there are many challenges to overcome'

There is also a language gap and a shortage of interpreters.

To ensure the new Silk Road meets its potential, politicians need to keep striking bilateral trade accords, such as November's deal between China and Pakistan. Final agreement on a regional free trade accord between the Gulf states and Asian nations, expected this year, is critical. So too are reforms to improve financial transparency and corporate governance.

Creating new government-backed investment agencies – modelled on the US Overseas Private Investment Corporation

– would multiply private investment flows. China and India should also press ahead with plans to channel a portion of their big foreign currency reserves into new government investment agencies that would operate on market principles, along the lines of Singapore's Temasek.

If current trends hold up – and if existing potholes are filled in – the new Silk Road should soon emerge as a formidable corridor for global commerce. Between 2005 and 2020, for example, McKinsey estimates that trade flows between the Middle East and China could soar from \$59bn to between \$350bn and \$500bn in real terms, at least a six-fold increase. Moreover, India seems likely to double its gross domestic product by about 2020.

Growth of this magnitude will fulfil today's vision of a vast, prosperous commercial region. Along with business opportunities, it will present increasingly complex geopolitical challenges to the US and Europe, which have long dominated the trade and investment flowing to and from the Middle East. Yet if business and government leaders take constructive action now, they will ensure that the development of the new Silk Road will make both headlines and history.

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