

# **Proposal for Strengthening Strategic Relations with the Gulf Countries in the Middle East**

## **Urgent Need to Resume Japan-GCC FTA Negotiations**

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As Japan faces high energy prices and supply concerns, strengthening strategic relations with the Gulf countries in the Middle East, which are major producers of crude oil and natural gas, is now an urgent matter. So far, Japan has made efforts to deepen cooperative relations with the Gulf countries in the Middle East. It drafted and revised the Japan-Saudi Vision 2030<sup>1</sup> to serve as the compass of the bilateral strategic partnership with Saudi Arabia and launched the Japan-UAE Comprehensive Strategic Partnership Initiative (CSPI).<sup>2</sup> However, in light of the present situation, it must further strengthen efforts in addition to steadily promoting the existing initiatives.

More than 15 years ago, Japan started negotiations for a free trade agreement (FTA) in September 2006 with the Gulf Cooperation Council (GCC) consisting of Saudi Arabia, the UAE, Bahrain, Oman, Qatar, and Kuwait. However, the talks were suspended shortly after<sup>3</sup> and have remained so for more than 10 years. While the GCC's FTA negotiations with China, the ROK (Republic of Korea), India, Australia, the EU, and others were also put on hold at about the same time, its positive stance on concluding FTAs in recent years<sup>4</sup> has prompted various countries and regions to initiate or reopen negotiations.<sup>5</sup>

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<sup>1</sup> Japan and Saudi Arabia agreed on this framework in 2016 as the compass for their new cooperative relationship in the future. The two countries will embark on cooperation in broad-ranging areas, including energy, quality infrastructure, investment and finance, and capacity building, and aim at synergy between Saudi Arabia's "Saudi Vision 2030" for breaking away from dependence on oil and job creation and "Japan's growth strategy."

<sup>2</sup> Intergovernmental initiative formulated at the Japan-UAE summit in April 2018 for the further development of the bilateral strategic relationship in wide-ranging areas, including economics, culture, education, the environment, and defense.

<sup>3</sup> Negotiations were discontinued after the second round of official talks in January 2007 and the fourth round of unofficial interim negotiations in March 2009.

<sup>4</sup> The closing statement of the GCC summit (in January 2021) mentioned FTA negotiations going forward, citing China, India, Pakistan, Australia, New Zealand, and the UK as negotiating partners. (No mention of Japan.)

<sup>5</sup> China reopened negotiations at one point in 2016, and Foreign Minister Wang Yi and the

Keidanren submitted in September 2005 a proposal entitled “Call for Early Launch of Negotiations for Japan-GCC Economic Partnership Agreement.” In October 2009, it also issued its “Requests for the Japan-GCC Free Trade Agreement,” strongly demanding the early conclusion of a Japan-GCC FTA. If Japan does not take action in the current situation, it may not only lag in competitiveness behind other countries and regions that are making steady progress, but the very survival of Japan as a country may also be threatened. Therefore, following our proposal September 2022,<sup>6</sup> we are strongly urging the government to resume negotiations for a Japan-GCC FTA and conclude it as soon as possible.

## **I. Importance of Strengthening Strategic Relations with the GCC Countries**

### **1. Securing Stable Energy Supply**

The GCC countries supply over 90% of Japan’s crude oil needs and some 20% of its natural gas needs. They are of vital importance for Japan’s energy security. China, India, the ROK, and other countries have rapidly expanded their crude oil and natural gas imports from the Middle East countries in recent years to meet their growing demand for energy. In addition, the European countries, which used to rely heavily on Russia for natural gas, are now expanding procurement from the Middle East<sup>7</sup> after Russia’s invasion of Ukraine in order to diversify their suppliers. Furthermore, building supply chains for the manufacture of hydrogen and ammonia in connection with the global issue of reducing greenhouse gas emissions and achieving carbon neutrality has become an urgent task. There is great expectation on the crude

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GCC Secretary General declared their intent for the early conclusion of FTA negotiations in January 2022. Former ROK President Moon Jae-in visited Saudi Arabia in January 2022, reaching an agreement with the GCC Secretary General to resume talks. Subsequently, negotiations reopened in March 2022. India also resumed negotiations in November 2022, while Australia and others are coordinating to resume negotiations.

<sup>6</sup> “Toward the Reconstruction of the Free and Open International Economic Order—Japan’s Role and Strategy in Trade and Investment” (September 13, 2022)

<sup>7</sup> The European countries are strengthening cooperation with the GCC countries in order to break away from energy dependence on Russia. Germany exchanged a document with Qatar (in May 2022) on strengthening energy relations, including the import of LNG. The Czech Republic also signed an economic cooperation agreement with Qatar (in October 2022) for LNG interchange.

oil and natural gas abundantly available in the GCC countries for use as raw materials in this endeavor.

As the global scramble for crude oil and natural gas intensifies, there is concern about a situation in which Japan may lose out to other countries in procurement, thus seriously impacting the people's livelihood and economic activities. Therefore, strengthening ties with the GCC countries is of great urgency. It is necessary to put in place systemic infrastructure that will guarantee stable mid- and long-term supply of resources and energy.

## **2. Expansion of Exports and Investment**

The GCC area is Japan's fourth largest trading partner in the world. It is not only an important source of oil and gas, the stable supply of which is of critical importance; this area is also the second largest customer of Japan's auto exports after the U.S., as well as an importer of numerous Japanese products, such as steel products, auto parts, motors, construction and mining equipment, and beverages. The GCC countries constitute an extremely important market for Japan's industrial sector. With their great purchasing power backed by oil income and the expected expansion of the consumer market thanks to population increase—particularly increase in young people—they will continue to be a promising destination for Japan's exports and investment.

## **3. Contribution to Economic Growth and Solution of Social Problems**

The GCC countries are aiming at breaking away from overdependence on fossil fuels, diversifying industry, and achieving carbon neutrality. Efforts are being made under the states' leadership, and this has generated enormous demand for infrastructure. Japan needs to capture such demand without fail and to support economic growth in the GCC countries and contribute to solving their social problems through the construction of quality infrastructure, including in the energy, urban development, transportation, logistics, water, and digital sectors, which Japan excels at.

On the other hand, the present situation is such that Japanese companies are already at a disadvantage in the fierce price competition with foreign companies in recent years. They also need to import high quality materials and equipment from Japan in many cases. If the conclusion of an FTA is delayed and imposition of tariff on these imports continues, this will have a serious negative impact on infrastructure contracts.

## **II. Improvement of Business Environment in the GCC Countries through the Conclusion of FTA**

From the above, considering the importance of the GCC countries for Japan, we strongly demand that the Japan-GCC FTA negotiations be reopened promptly to conclude an agreement embodying the following points at the earliest time.

During this process, along with negotiations with the GCC, Japan should also pursue bilateral talks with the UAE, which is actively negotiating for bilateral FTAs with the ROK, India, and other countries.

### **1. Liberalization and Facilitation of Trade in Goods**

At present, the GCC countries impose a 5% uniform tariff on imports from other countries, with certain exceptions. Since Japanese companies are facing fierce competition with foreign companies, if the GCC goes ahead to conclude FTAs with third countries and reduce or abolish their tariff, Japanese companies will be absolutely disadvantaged in their access to markets in the GCC countries even if it is only a matter of 5% or less. Virtual elimination of tariff should be implemented in all trade areas, including automobiles and auto parts, steel products, transport machinery, construction and mining equipment, and beverages.

At the same time, it is necessary to promote the acceleration, simplification,<sup>8</sup>

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<sup>8</sup> The following are necessary: abolition or digitization of health certificates, country of

and digitization of customs procedures in order to facilitate trade.

## 2. Liberalization of the Investment and Service Sectors

In order to ensure that Japanese companies can engage in business activities freely in the GCC countries, (1) areas where Japan can give full play to its advantage, such as the petrochemical, power, environment, and water sectors, as well as a wide range of other sectors should be included in liberalization; (2) regulations such as restrictions on foreign capital, including rules on setting up local subsidiaries,<sup>9</sup> and excessive obligation to hire local employees<sup>10</sup> should be relaxed or abolished; and (3) other local regulations that impede the activities of foreign investors should be abolished. In addition to concluding a Japan-GCC FTA focused on liberalization,<sup>11</sup> ISDS (investor-state dispute settlement) provisions, a ban on performance requirements, fair and equitable treatment, freedom to make remittances, compensation for expropriation, and such other comprehensive provisions should be included in the agreement's chapter on investment.

In February 2021, Saudi Arabia announced its policy for inviting foreign investment, setting such conditions as disqualifying multinational companies with no regional headquarters (RHQ) in the country from participating in bids for projects by the government and related organizations from 2024. As of now, government projects covered by this provision and details of the new system remain unclear, giving rise to great confusion. This policy should be rescinded, and the government procurement market should be opened.

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origin certificates, and invoice endorsements (GCC countries), relaxation of procedures on the Saber platform (Saudi Arabia), relaxation of third country invoices (Qatar), abolition of the system of appending consular authentication to trade documents (Kuwait), abolition of pre-shipment merchandise inspection certificates by third parties (Kuwait), abolition of radiation-free certificates (Kuwait and Qatar), and so forth.

<sup>9</sup> The GCC countries impose restrictions on foreign capital in specific sectors or in many sectors with some exceptions. It is necessary to relax the ratio of foreign capital and investment requirements or even abolish restrictions on foreign investment per se.

<sup>10</sup> Saudi Arabia, the UAE, Oman, and other countries require the hiring of local employees according to the line of business and company size. Ratio of local employees should be lowered, wage regulations should be relaxed, or the system itself should be abolished.

<sup>11</sup> At present, Japan's investment agreement with Kuwait is the only one with the GCC countries that prioritizes liberalization. The Japan-Saudi Arabia and Japan-UAE agreements that are not liberalization-type and the agreements with Qatar and Bahrain under negotiation need to be liberalization-focused.

### **3. Facilitation of Human Mobility**

With the policy requiring the hiring of local employees and the spread of the COVID pandemic, there have been many cases of restrictions on the issuance of working and residence visas to foreigners. Since there are many plant and infrastructure projects in the GCC countries requiring specialized skills, there have been cases in which restrictions on human mobility hinder the execution of projects. Requirements for working and residence visas should be relaxed, application procedures simplified, and working visa exemptions implemented.

### **4. Liberalization and Facilitation of e-Commerce**

Certain GCC countries require data localization.<sup>12</sup> Amid the advancement of digitization of economic activities, free transfer of data between the GCC countries and Japan should be ensured and data localization requirements should be banned through the conclusion of an FTA.

### **5. Building the Legal Foundation**

There have been cases of legal system instability in the GCC countries regarding taxation,<sup>13</sup> customs clearance, and setting up local subsidiaries, such as ambiguous requirements, strict and complicated procedures, lack of consistency and transparency, and arbitrary system changes, that seriously affect business activities. Explicit regulations, sufficient advance notification when legal systems are newly established or revised, fair and transparent system management, fast processing of permits and licenses,<sup>14</sup> and other improvements are necessary.

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<sup>12</sup> Saudi Arabia and Oman prohibit the transfer of data outside the country. The UAE, Bahrain, and others also impose certain restrictions.

<sup>13</sup> There have been cases in the GCC countries where taxation systems and their application change suddenly and where penalty taxes are imposed without any clear legal basis.

<sup>14</sup> Raising retail prices in the GCC countries needs to be approved by the government, but processing of applications takes over six months. Furthermore, price increases are limited to a maximum of 5%. It is necessary to speed up approval of retail price changes.

## 6. Strengthening Cooperation in the Environmental and Energy Sectors

In order to strengthen Japan's energy security, provisions on stable supply of oil and natural gas exports to Japan, such as full consideration for the execution of existing contracts if export restrictions are being applied, advance notification and consultation on the introduction of export restrictions, and accommodation for emergencies, should be included.<sup>15</sup>

Provisions on cooperation toward achieving carbon neutrality, similar to those being discussed in the ROK's FTA negotiations with the UAE, should also be considered in order to deepen cooperation with the GCC countries in the environmental and energy sectors and capture their enormous demand for relevant infrastructure.

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<sup>15</sup> For example, the Japan-Indonesia and Japan-Brunei Economic Partnership Agreements stipulate that in order to ensure stable supply of energy and mining resources, advance notification and consultation must take place before new restrictions are introduced and full consideration must be given to existing contracts when applying such restrictions. There are also provisions on ensuring transparency in export approval procedures; cooperation in policy support, human resources development, technical support, and so forth in order to strengthen relations in the energy sector; setting up energy subcommittees and such other frameworks for dialogue, etc.