

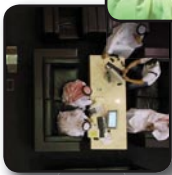
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Growing Protectionism Threatens Middle East's World Trade



Contagious Effect of the US Subprime Crisis on the Gulf Countries



Framework for a Renewable Energy Transition in the GCC



Saudi Mediation in Afghanistan



Implications of Iran's Nuclear Program



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Cover picture. Taliban Fighters in Wardak Province, Afghanistan.

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Growing Protectionism Threatens Middle East's World Trade

Dr. Samir Pradhan

Falling World Trade and Growing Protectionism

Trade is one of the important channels spreading the contagion of the current economic recession. The countries of the Middle East, which are characteristically overdependent on international trade for their overall economic growth and development, are therefore bound to be affected. The most significant aspect of the current slowdown in world trade is the syn-chronized nature of the decline in exports and imports of major developed and developing economies since September 2008 (WTO, 2009). Importantly, the impact of the global economic slowdown is clearly evident in the trade of bulk commodities which has been hit by plunging commodity prices and the crunch in trade financing. As a result, the Middle Eastern economies, being primary exporters of commodities, have been negatively affected by the global

demand destruction for commodities, especially oil and petrochemicals. Besides, the surge in protectionist tendencies as counteractive measures against the ongoing economic crisis further compounds the problems for the Middle Eastern countries that are also equally dependent on imports. It may be premature to draw broader conclusions at the moment, but looking at the recent trade restrictive measures implemented by countries across the globe as seen from the comprehensive coverage by the Global Trade Alert Initiative (GTA), it is quite clear that the Middle East region has been very negatively affected. The major objective of this article is to delineate the current trajectory of Middle East's world trade in the grip of global recession and to analyze the impact of foreign trade measures implemented globally on the commercial interests of

the Middle East through the perusal of various qualitative indicators extracted from the GTA database. Against this background, the next section overviews the reorientation or strategic regional shift of Middle East's world trade. The succeeding section evaluates the impact of foreign trade measures on the Middle Eastern countries. With a brief summary, the last section puts forward a few plausible policy conclusions.

Reorientation of Middle East's Trade

The Middle East is an interesting case study in any analysis of the impact of trade policy measures implemented during the current global economic crisis. Indeed, the Middle Eastern countries are highly open economies with a total average trade-to-GDP ratio of 105.2 in 2008. Both exports and imports of goods and services constitute a highly significant portion of each country's GDP, signifying the importance of international trade for the Middle Eastern economies (See Table 1). The peculiar factor endowment of the Middle East which is rich in oil and poor in water makes international trade an indispensable factor in the growth and economic development of the region and simultaneously makes these countries of the region highly vulnerable

Table 1: Trade Indices as a Percentage of GDP, 2005-2007

Country	Total Trade (X+M)			Exports (X)			Imports (M)		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Bahrain	20.02	28.06	25.23	73.52	65.06	61.25	53.51	47.73	54.1
Egypt	-4.03	-3.60	-2.36	34.25	34.13	33.38	38.27	37.73	37.73
Jordan	-41.43	-37.44	-37.7	52.61	54.56	57.75	94.0	92.00	91.53
Kuwait	35.72	32.96	23.04	63.99	67.88	59.90	28.28	25.12	25.62
Lebanon	-14.66	-12.49	-12.5	61.03	63.45	66.86	75.69	75.93	79.11
Oman	27.09	28.4	24.67	63.02	62.14	63.12	35.93	37.51	39.87
Qatar	..	..	..	..	..	..	..	..	..
Saudi Arabia	33.004	32.69	31.1	59.38	62.61	64.2	26.37	29.92	34.16
Syria	1.46	3.86	-73.36	40.82	39.42	37.8	39.36	35.56	35.01
UAE	..	..	..	..	..	..	..	..	..
Yemen	4.96	0.44	-1.26	40.52	41.27	38.98	35.56	40.83	39.86

Note: Two dots (..) indicate that data are not available or are not separately reported.
Source: The World Bank, Worldwide Trade Indicators (WTI) database (2008)

1 In the Middle East, the focus countries covered in this report are the six members of the Gulf Cooperation Council (GCC) namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE); Iraq; Iran; Yemen; Jordan; Lebanon and Syria.

2 Trade-GDP Ratio is estimated as an economy's total trade of goods and commercial services (exports + imports, balance of payments basis) divided by GDP, on the basis of data for the three latest years available. GDP is measured in nominal terms and with market exchange rate.

to the cyclical pattern of world trade movements.

Of late, a clear shift is taking place in the geographic direction of the Middle East's world trade in consonance with the changing economic strength of countries in the region. While in the past, highly populous, more diversified non-oil exporting countries like Egypt used to be the major economic powers, of late, the GCC has emerged as the most important economic center of the region – accounting for nearly 60 percent of the total GDP of the Middle

Eastern countries have been most affected. Similar negative trends are also likely to emerge in Europe – another major trading partner of the Middle Eastern countries. In particular, non-oil exporting countries are highly dependent on the European market. Sluggish economic activity in European countries therefore will have an impact on the exports of these countries. However, looking from the perspective of the major oil exporting countries' (GCC's) trade with Asia, a different picture emerges. While on the one hand, exports of oil and petrochemicals

The peculiar factor endowment of the Middle East – which is rich in oil and poor in water – makes international trade an indispensable factor in the growth and economic development of the region and simultaneously makes the countries of the region highly vulnerable to the cyclical pattern of world trade movements

Table 2: Direction of Middle East Exports, 2005-2007,(%)

	2005				2006				2007			
	Asia	European Union*	North America	Others	Asia	European Union*	North America	Others	Asia	European Union*	North America	Others
Oil-exporting countries		14.3	11	20.1		17.2	15.6	9.6		3.9	1.2	23.6
Non-oil exporting countries		48.6	6.2	16		45.8	6.2	18.7		50	3.2	20
Middle East		18.2	10.5	19.6		21.5	14.2	10.9		28.5	2.3	21.6

Note: * EU-15; Oil-exporting countries include: Algeria, Bahrain, Kuwait, Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, Sudan and the United Arab Emirates. Non-oil exporting countries include: Comoros, Egypt, Jordan, Lebanon, Mauritania, Morocco, Syrian Arab Republic, Tunisia and Yemen.
Source: Calculation based on the UN-Comtrade database.

East region. The GCC countries are even more closely integrated in the globalization process than the rest of the region.

The drop in world trade due to the economic crisis has affected the Middle Eastern countries. As evident from the trends in Table 2, Middle East exports to North America which accounted for 10.5 percent and 14.2 percent of its total exports in the years 2005 and 2006 respectively, declined to 2.3 percent in 2007. The US is an important export destination for Middle Eastern countries. In 2006, the US accounted for 19 percent of the total exports of Egypt and Saudi Arabia and 15.6 percent of Jordan's total exports. Thus it is natural that with recession taking its toll in the US, these Middle

to the developed world has declined due to low demand and negative oil prices, the Asian region being the largest export destination continues to be an important trade partner, even though there is a moderate decline in exports to Asia.

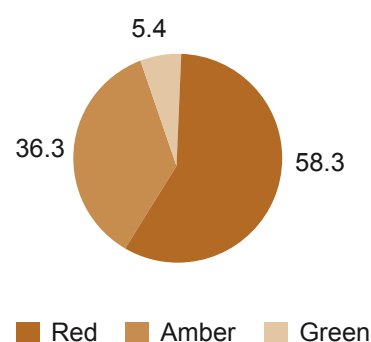
Impact of Foreign State Measures on Middle Eastern Commercial Interests

As of September 11, 2009, a total number of 240 state measures affecting Middle Eastern countries have been identified in the GTA database, out of which 146 measures affect the GCC countries. It is important to note that discriminatory measures (marked red and amber) comprise an overwhelming 95 percent of total measures against the Middle Eastern countries while

trade liberalizing measures account for the remaining 5 percent. In other words, while Middle Eastern countries are faced with 204 trade discriminatory measures implemented or about to be implemented by countries across the world, trade liberalizing measures affecting the region number only 36. This implies that the Middle Eastern countries, being substantially open economies, will face the brunt of increasing protectionism across the world, and their world trade will be considerably affected due to restrictive measures undertaken by the rest of the world during the crisis, which would further negatively affect growth and economic development in the region.

As evident from Table 3, the UAE is faced with highest number of discriminatory trade measures followed by Saudi Arabia, Iran, Oman, Jordan, Kuwait, Syria, Lebanon, Bahrain,

Figure 1. All Measures Affecting Middle East Countries (%)



Source: Calculated from the GTA Database as of September 11, 2009 1.30 pm.

Table 3: Post-Crisis Trade Measures Affecting Middle Eastern Countries

	Green	Amber	Red	Total
Bahrain	1	6	7	14
Kuwait	1	7	8	16
Oman	1	9	14	24
Qatar	2	6	6	14
Saudi Arabia	2	17	17	36
United Arab Emirates (UAE)	1	18	23	42
GCC Total	8	63	75	146
Iran	3	11	13	27
Iraq	1	0	3	4
Yemen	0	0	11	11
Jordan	1	6	15	22
Lebanon	0	4	10	14
Syria	0	3	13	16
Middle East Total	13	87	140	240

Source: Calculated from the GTA Database as of September 11, 2009

Qatar and Iraq. Moreover, the nature of discriminatory measures confirms the increasing protectionism across the world, which could considerably hinder Middle East's world trade in the near future (see Table 4). Apart from trade distorting measures such as export restrictions, export subsidy, tariff measures, non-tariff barriers, technical barriers, trade defense measures; Middle Eastern countries also face negative investment measures undertaken in the rest of the world. However, these restrictive measures are not implemented directly against Middle Eastern countries, but are a result of growing protectionist measures against the economic crisis.

While Middle Eastern countries in general and GCC in particular confront an increasingly discriminatory trade environment in the aftermath of the global economic recession, they are not undertaking substantial counteractive measures pertaining to international trade. This is evident from the trends of measures identified in the GTA database. As of September 11, 2009, Middle Eastern countries have implemented or are about to implement only 15 measures, out of which 12 are trade discriminatory measures and the remaining are trade liberalizing measures (see Table 5). Importantly,

these discriminatory measures are highly transitory in nature and were undertaken solely on the basis of health concerns and therefore would have marginal localized impact on global trade.

Thus, Middle Eastern countries in general and GCC in particular would face daunting challenges in their international trade during the current

global economic recession. By virtue of being highly trade dependent economies, future economic growth of the region will no doubt be affected by these negative trends. Since the success of any trade policy crucially hinges on its actual contribution towards improving market access for domestically produced products and services and its ability to minimize the consequences of openness, trade liberalization and globalization on the domestic market, Middle Eastern countries need to reorient their trade strategy to address the increasing proliferation of trade discriminatory measures across the globe. This in turn makes it imperative for the Middle Eastern countries to enable appropriate policy regimes at the national as well as at the regional level. In this regard, the GCC countries should take the lead in projecting a collective front at the various multilateral fora like the G-20 and WTO, urging better surveillance and monitoring and ensuring an enabling multilateral trade regime. Moreover, the GCC countries should also intensify economic integration at

Table 4: Nature of Discriminatory Measures against Middle East

Measure Type	Number of Measures
Bail out / state aid measure	40
Consumption subsidy	2
Export subsidy	27
Export taxes or restriction	29
Import ban	4
Intellectual property protection	1
Investment measure	12
Local content requirement	5
Non tariff barrier (not otherwise specified)	10
Other service sector measure	5
Public procurement	5
Sanitary and Phytosanitary Measure	10
State trading enterprise	3
Tariff measure	25
Technical Barrier to Trade	5
Trade Defence measure (AD, CVD, safeguard)	11
Trade finance	10
Total Discriminatory Measures	204

Source: Calculated from the GTA Database as of September 11, 2009

Table 5: Post-Crisis Trade Measures implemented by Middle Eastern Countries

	Green	Amber	Red	Total
Bahrain	0	0	0	0
Kuwait	1	0	1	2
Oman	0	0	0	0
Qatar	0	0	0	0
Saudi Arabia	1	1	4	6
UAE	0	1	1	2
Gulf Cooperation Council	2	2	6	10
Iran	0	0	0	0
Iraq	0	0	1	1
Yemen	0	0	0	0
Jordan	1	0	1	2
Lebanon	0	0	1	1
Syria	0	0	1	1
Middle East	3	2	10	15

Source: Calculated from the GTA Database as of September 11, 2009

Traders at the Kuwaiti Stock Exchange



Table 6: Nature of Discriminatory Measures implemented by Middle East Countries

Measure type	Number of Measures
Bail out / state aid measure	1
Import ban	3
Sanitary and Phytosanitary Measure	5
State trading enterprise	1
Trade finance	1

Source: Calculated from the GTA Database as of September 11, 2009

the broader regional level in the Middle East, which could result in greater bargaining power at the global level. While trade diplomacy in the region is still in its infancy, multilateral bodies

such as WTO also need to enhance capacity building in the region.

Concluding Remarks

Unlike other regional economies,

The increasing spate of trade distortionary measures undertaken by economies across the world to counter economic recession would negatively affect the Middle Eastern countries in general and the GCC in particular ...

the Middle East has huge stakes in the multilateral trade regime. The increasing spate of trade distortionary measures undertaken by economies across the world in response to economic recession would negatively affect the Middle Eastern countries in general and the GCC in particular and thereby become an obstacle to future economic growth. While paradoxically the industrial economies are increasingly tempted to fall back on the good old protectionist practices, the Middle East region, especially the GCC, continues to tread the path of trade liberalization even in the face of severe global economic recession. As analyzed from the GTA indicators, the trends of trade-related measures taken by the Middle Eastern countries vis-à-vis rest of the world during the ongoing economic crisis is less trade distortionary in comparison to the measures taken by the rest of the world negatively affecting the Middle East. While recent attempts may be a move 'back to fundamentals,' trade-related policy making has been relatively weak in the Middle East region during the ongoing financial crisis. This policy deficit is due to insufficient awareness and lack of trade-related capacity building in the region. Therefore, policy makers in the region should address these concerns at the earliest. Dr. Samir Pradhan is a Senior Researcher for the Economics Program at the Gulf Research Center.

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Contagious Effect of the US Subprime Crisis on the Gulf Countries

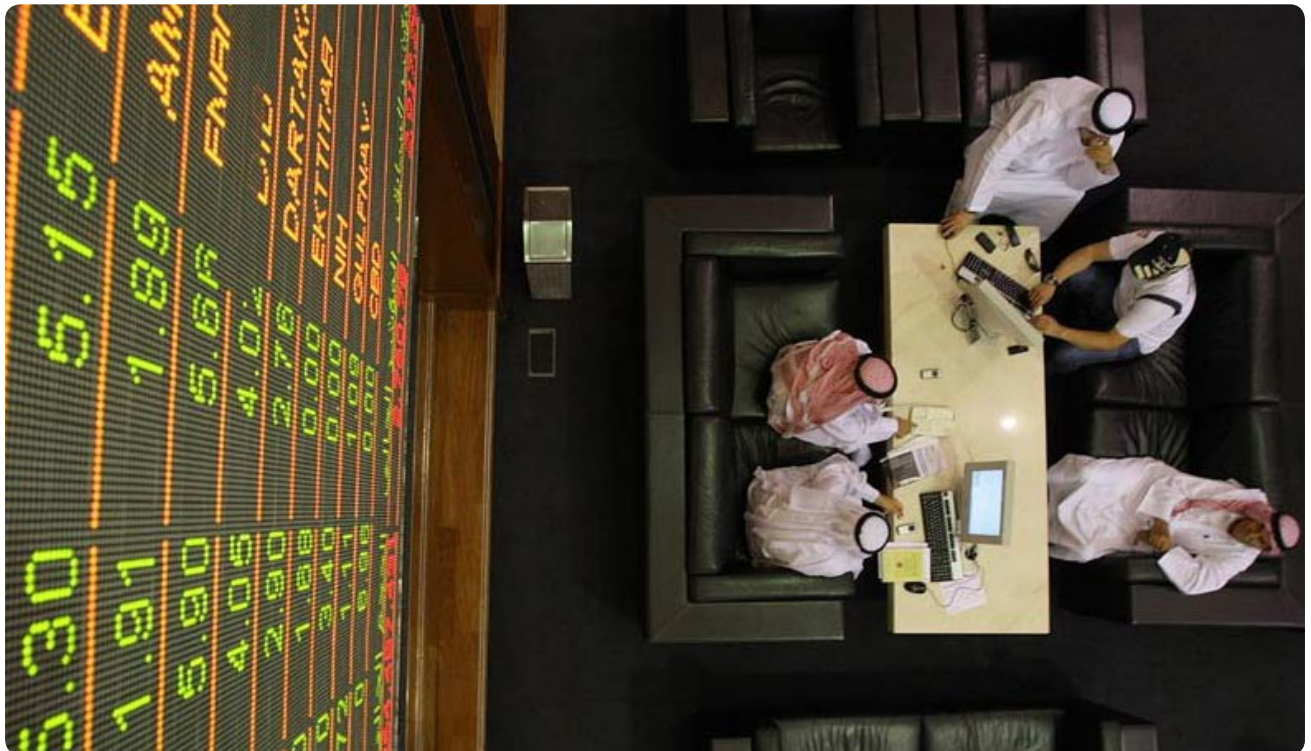
Sana Khelifi

Since the 1990s, there have been a series of financial crises, one after another. Concrete examples include: The Tequila effect of 1994 which shook several Latin American markets; the Asian flu of 1997 which generated a speculative attack in Indonesian, Korean, Malaysian and Thai markets though most of the emerging markets and even some developed markets were affected; the Russian Cold of 1997 which gave rise to a sequence of stock and bond crashes, and unduly influenced the international financial market though on a smaller scale as compared to the global market capitalization¹ and recently the US subprime mortgage crisis which has

turned out to be far more than merely a subprime crisis and could be called a financial tsunami. Each crisis spreads around like a contagious disease, sometimes without any apparent fundamental explanation. In other words, a financial crisis whatever its deep tremendous effect, could have a sudden universal impact; what harms the economy of one country, can, indeed, harm the economies of many other countries in turn. Hence, one may conclude that no matter the extent of the financial crisis and the way it is structured, and no matter where it is located, financial crises are contagious by all means. This phenomenon known as “financial contagion” has caught

the attention of many researchers and analysts. Forbes and Rigobon (2001) define contagion in fact as a significant increase in cross market linkages after a shock to one country or a group of countries. In fact, this concept presents several operational advantages.² It is useful for those institutional investors who are engaged in international diversification strategies³ which become ineffective with the presence of contagion; as well as for the new macroeconomic policies and monetary authorities planning to bail out the markets affected by foreign crises. Certainly, the recent subprime crisis will provide an unparalleled contemporary laboratory for testing such a phenomenon. This crisis which

Traders at the Dubai International Financial Center (DIFC)



1 Robert Boston, "Contagion without borders", Canadian Investment Review 2003.

2 Forbes, K. and Rigobon, R. (2001), "Measuring Contagion: Conceptual and Empirical Issues", Kluwer Academic Publishers, pp. 45-46.

3 As a reflection, the portfolio diversification would minimize the risk when the underlying assets are less linked.

originated in very specific and relatively small segments of mature and emerging financial markets has spread across the borders, from sector to sector, from country to country to devastate the entire financial system.

Yet, many commentators believed that emerging economies would continue their recent growth despite the downturn in Europe and United States and we tended to hear that Gulf economies would be immune in the ongoing financial turmoil. This was the idea of the called 'decoupling' thesis.⁴ In addition, according to a Standard & Poors survey, Gulf exposure to subprime instruments is limited. However, after the bankruptcy of Lehman Brothers, the fourth largest American investment bank in mid-September 2008, it has become clear that no part in the world will be immune from the crisis. In the present paper, we investigate the contagious effect of the subprime crisis on the Gulf countries theoretically by identifying the potential channels that could move the US subprime crisis to Gulf countries and empirically by gauging the change in dependence structure between the Gulf and US stock market from the pre-crisis period to crisis period based on the Forbes and Rigobon definition to detect the financial contagion.

Transmission Mechanisms of the Subprime Crisis

Certainly, understanding the bridge of channels between the US and the GCC economies will be fundamental to gauge the subprime crisis' spillover effect on the Gulf. These channels can be classified into two: Fundamental based contagion and pure contagion.

Fundamental-based Contagion

Securitization

Securitization, as a financial channel,

has strongly contributed in the domino effect of the subprime, starting from borrowers' defaults of payment and foreclosures, to affect all of the subprime players: the subprime originator who sold the mortgage to the special purpose vehicle (SPV) with all legal rights to collect the regular payment cash of the loan, and the SPV which transformed the mortgage loan into securities to sell it to investors by giving them regular interest in return. An investor in fact could be: banks, hedge funds or

they offer. Abu Dhabi Investment Authority (ADIA) and Kuwait Investment Authority (KIA) have lost more than 40 percent according to December 2008 estimates while Saudi Arabia Monetary Agency (SAMA), being a conservative fund, has lost 12 percent.⁶ However, the exposure of Gulf banks to subprime related instruments is limited. Thus far, only a limited number of GCC banks have officially declared their exposure. Losses published are around \$3.7 billion thus far which is limited compared to other banks.

Figure 1: Gulf Stock Market Crashes



Source: SABB

SWFs, pension funds or insurance companies. The delinquencies of the borrowers generated a decline in cash flows which were given to the investors. Therefore, a vicious circle of losses was spawned: losses on MBS & CDOs, waves of corporate defaults, and a drying up of capital.⁵ The local real estate market in the GCC began to collapse sharply in June 2008 and the credit default swaps rose sharply too, due to the rise in bond defaults. Sovereign wealth funds also have sustained heavy losses since they had heavily acquired mortgage backed Securities (MBSs) for the high yield

Trade Channel

Generally, trade channel is manifested in financial contagion when crisis in one country affects other countries' trade balance. Contagion based on this channel passes through the devaluation which leads, as a direct effect, to the deterioration of the trade balance of major trading partners due to the drop in exports to countries in crisis and as an indirect effect, dropping of the competitive devaluation. As the world's largest exporter as well as producer of oil, GCC oil accounts for more than 80 percent of governments' revenues⁷.

4 Mohammed, Al Maraj, "Impact of the Current Global Financial Crisis on Bahrain's Economy," at the BCCI Seminar, Manama, November 18, 2008.

5 Roubini (2008), Twelve steps to a financial disaster, P1-P6

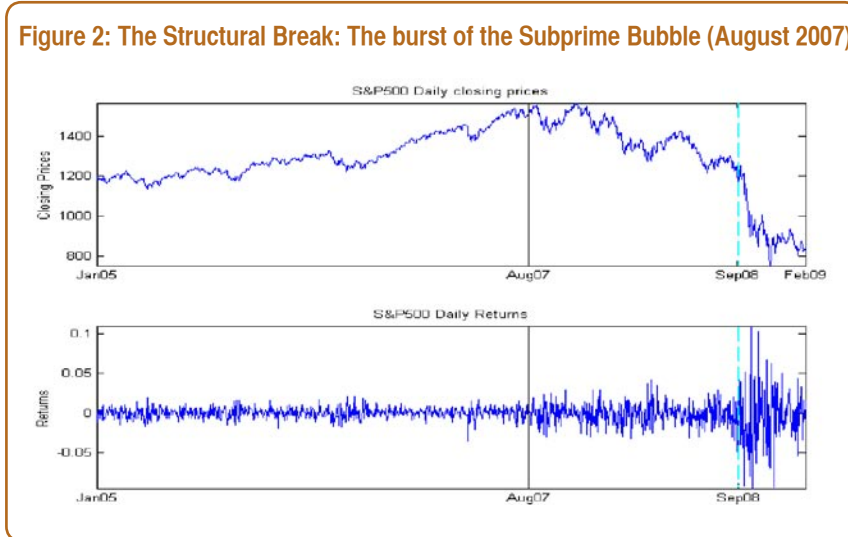
6 Brad Setser and Rachel Ziemba, GCC Sovereign Wealth Funds Reversal of fortune, working paper, Center for Geoeconomic studies, January 2009.

But, the current slowdown has shrunk the exports and imports of petroleum due to the fall in world oil demand. It is estimated to have dropped by 1.57

in principle healthy, pushing them into the bad equilibrium. Namely, the subprime crisis has generated a confidence crisis which was

crisis had become global which has engendered a pure contagion⁹. The consequent fear and the skepticism changed the investor expectation toward a negative outlook. Investor expectations are important because they are self-fulfilling prophecies that keep on driving financial markets. Gulf investors, like their counterparts elsewhere, look for safe havens for their capital; they were shifting away from volatile equity markets. Massive outflows accompanied by the liquidation of assets have generated liquidity shocks that sharply affected the GCC financial markets. Therefore, akin to other international investors, GCC investors with different classes: Banks, Corporates, Hedge funds, multinationals were forced to re-allocate their portfolios and liquidate their assets at the same time to cut losses. GCC stock markets reacted as shown in the figure below. All indices fell over 40 percent. The Dubai index (DFM) plunged by 73 percent from the beginning of 2008

Figure 2: The Structural Break: The burst of the Subprime Bubble (August 2007)



million barrels per day, according to OPEC in 2009. And fuelled by the depreciation of the US dollar, GCC current account surpluses are expected to decline by 68 percent in 2009.⁸

evident first in the credit market and then prompted endogenous liquidity shocks because of the herding behavior of investors. All forms of credit vehicles in general,

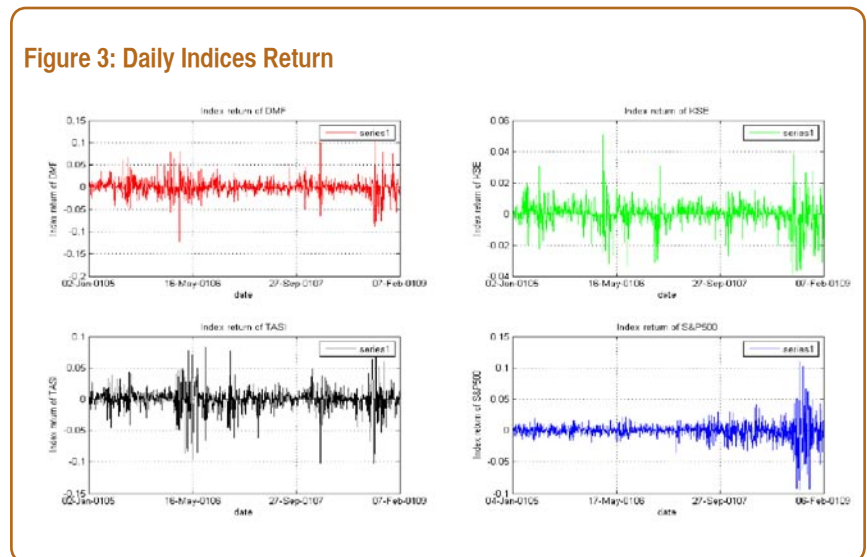
Fundamental-Based Contagion: Common Aggregate Shock

The subprime crisis was accompanied by several common shocks that greatly affected the US and simultaneously affected other countries. These include the hike of the Fed interest rate, the rising of spreads and finance costs accompanied with loans defaults and CDS hike. Besides, given the GCC currency pegs to the US dollar, the Gulf States faced gigantic losses. The decline in oil prices also constitutes a cruel shock on economy in general and GCC states in particular as they are highly dependent on oil.

Pure contagion

Pure contagion refers to the shifting of investor sentiments from a country's crisis to other countries, which are

Figure 3: Daily Indices Return



and subprime in particular, became suspicious in their eyes lest they contain credit risk. A backlash against financial assets was spawned and investors started feeling that the US

to March of 2009 while the Saudi equity index (TASI) was down about 57 percent. Even the highly buoyant Qatar market was down 50 percent. The magnitude of this rally

7 According to government authorities
 8 Estimation of the United Nations Economic & Social Commission for Western Asia UN-ESCWA
 9 Some economists believe that the cause of the current economic turmoil is the psychological contagion and the investors' herd behavior. Prof. Robert Shiller was the main analyst of the Subprime psychology. He has argued that the failure to anticipate the risks and the irrational exuberance in expecting profits have caused the Subprime crisis

remains highly dependent on non-fundamental factors such as return of foreign investors and on investor sentiment and confidence (Figure 1). Theoretically, The US subprime crisis appears to be contagious to GCC market, despite the limited fundamental impact revealed by Gulf countries.

Empirical evidence of financial contagion of the subprime crisis on Gulf Countries

Using daily return indices issued from the US stock market and three other GCC markets: S&P500, DFMG market, KSE and the TASI index of the Saudi stock market extended from the January 1, 2005 to February 5, 2009, we gauge statistically the change in dependence structure between the US and the Gulf markets from the pre-crisis to crisis period by copula modeling,¹⁰ referring to the definition augmented by the Forbes and Rigobon definition. Namely, a significant increase in dependence between the Gulf and American indices after the burst of the subprime bubble relative to the period before that can be interpreted by the presence of contagion.

Results¹¹

August 1, 2007 has been chosen as the structural break date separating the pre-crisis period and the crisis period based on the fundamental event (burst of the Subprime bubble) and the empirical perception shown below (Figure 2).

Primary analysis displays an increase in dependence between the Gulf stock market and the US market after the subprime structural break. However, this dependence seems greater up to September 2008 following the Lehman Brothers event.

We note that there is also a Gulf crash in the second quarter of 2006.

It corresponds to market corrections due to an overvaluation of stocks that time. It is clear that the first crash of Gulf market in 2006 did not have an effect on the US market while the US subprime crisis had a large effect on the Gulf market (Figure 3).

The estimation results for the dependence structure modeling based on the copula approach exhibits statistical significant increase of copula parameters which imply the shifting in dependence from the calm period to the crisis period which started from August 2007.¹² In fact,

Table 2: Estimated Copula Parameters of the American Index and Gulf Indices (in %)

	S&P500		
	Whole Period	Pre-crisis	Crisis
DMF	2.57	-3.70	7.72
KSE	3.79	0.44	7.72
TASI	5.05	-1.19	12.85

contagion signs, as described in the Forbes & Rigobon (2001) definition, were pronounced in all studied indices: DFM index for the Dubai market, TASI index for the Saudi Arabia Market and KSE for Kuwait. Statistical significance, however, is stronger in the case of the US and Saudi Arabia markets. Namely, co-movements between the analyzed markets have become more noticeable after the bursting of the mortgage bubble.

Conclusion

This study tests for financial contagion of the US subprime crisis to Gulf economies both theoretically and empirically. Theoretically, it investigates the possible connections that could move the subprime crisis to the Gulf market, by identifying the potential

No matter the extent of the financial crisis and the way it is structured, and no matter where it is located, financial crises are contagious by all means

channels between the US and GCC countries. Fundamental channels consist of securitization, oil trade and some other common shocks like the Fed interest rate and the depreciation of US dollar while psychological channels are based on the herding behavior due to the shift in investor sentiment because of their sensitivity to signs of economic weakness.

Empirically, Gaussian Copula has been used to model the change in dependence structure from the pre-crisis to the crisis period. Results show significant level of contagion in Kuwait, Dubai stock markets and Saudi stock market. However, the latter displays the strongest contagion level. Contagion signs should be taken into consideration by the portfolio managers though the diversification strategies become futile with the presence of contagion. Our results could be also handy for Gulf central banks who decide for a bailout. Indeed they are consistent though the Saudi government adopted the biggest bailout relative to other GCC countries.

However, the evaluation of the fundamental-based contagion has been strained by the lack of transparency in Gulf markets. For instance, only few institutions have published their write-downs. Besides, the discontinuity of the series has complicated the empirical adequation tests¹³.

Sana Khelifi worked as a Researcher in the Economics Program, Gulf Research Center.

¹⁰ Copula is a statistical approach used to join or couple multivariate distribution functions to their one-dimensional marginal distribution functions. It is used here to model the dependence structure among markets.

¹¹ The results are based on the Matlab (v 7.0) Programming Tool.

¹² T-student and Gaussian copula functions have been selected as the Univariate marginal function and the joint function, respectively for all the indices under investigation as per the Maximum likelihood estimation.

¹³ Series are discontinued by holidays: Many saints' days in the US as well Eid holidays and some special local events in the Gulf.

Framework for a Renewable Energy Transition in the GCC: Finding the Right Paradigms

Imen Jeridi Bachelierie

The noise made by the numerous announcements on initiatives related to renewable energies makes it difficult to focus on what conditions are required to translate these initiatives into embedded technologies. This focus is particularly essential in the context of emerging economies and among them those most heavily dependent on traditional energy sources as their main source of GDP – the GCC countries.

Governments around the world are striving to develop Renewable Energy Sources (RES) as a way of reducing their dependence on traditional (conventional) forms of energy. The gradual depletion of fossil fuels, recurrent shortages and surges in their prices as well as environmental impact of their use are stimulating economic, political and social responses to diversify energy sources, reduce government dependence on the world's leading oil-producing countries and eventually answer local or international sustainability challenges.

All of these facts are spurring the adoption of RES in many countries and continuously driving technological innovation focused on their local development and effective use. This is helping governments to craft strategies that enable a gradual transition to transform their local energy markets, creating new industries, jobs, products and organizational processes around the paradigm of indigenous energy.

Reflecting the growth of the wind electric industry in Europe, the European Wind Energy Association reports that as of 2008 a total of 65,933 MW of installed wind energy capacity was operating in the European Union (EU) and EU-candidate countries. This capacity is roughly 2.6 times the US total.¹ More generally, RES in Norway, Latvia and Sweden represent 45 percent, 36 percent and 28 percent in their total energy mix, respectively.

Embedment of RES Technology in Germany

The history of RES development in Germany is by all accounts most instructive.² RES technologies have deployed rapidly in Germany since 1990 largely as a result of energy

policies adopted by the German government and the European Union. RES deployment targets coupled with incentives such as government subsidies to renewable electricity producers have propelled the rapid growth of wind and solar thermal power, and, increasingly, to broader deployment of biomass and photovoltaic systems. For example, installed wind capacity has grown by more than 2,000 percent since 1990, biomass by more than 500 percent, and solar photovoltaic installations by more than 15,000 percent.

RES electricity generating capacity grew exponentially following the adoption of the Renewable Energy Supply Act in December 1990, and even more rapidly following the

Solar tower 'beam down' is a demonstration project built by Masdar in partnership with Cosmo Oil of Japan and the Tokyo Institute of Technology



¹ Germany has the largest installed capacity at 23,903 MW, or 94.9 percent of the American total. Spain ranks number two in Europe at 16,740 MW, or 66.5 percent of the American total. Wind Energy Association in <http://www.fuelalternative.com.ua/content/sview/en/id,26377/>

² This section is largely based on Paul Runci, "Renewable Energy Policy in Germany: an Overview and Assessment" January 2005 in <http://www.globalchange.umd.edu/energytrends/germany/1/>

Renewable Energy Feed Law, which came into force in April 2000. These policy measures have been part of a broader long-term German energy strategy to reduce greenhouse gas emissions and other environmental impacts of energy use. In 2002 alone, avoided emissions resulting from deployed RES technologies for electric power production were almost 36 million tons CO₂ equivalent or 10 percent of total electricity-related CO₂ emissions.³

The impressive rise of RES took place in Germany despite the fact that the 1990 baseline for RES technologies was very low, but market-based policies have been effective in moving existing technologies into the market. Increasingly, governments in Germany have shifted their attention from basic and applied research programs since the early 1990s and devoted more resources to deployment incentive programs. This application-oriented approach has resulted in the embedment of RES technology in Germany with a rapid growth of renewable energy industries and commercial deployment of many existing renewable energy technologies.

Furthermore, this accelerated deployment has paralleled a sharp decline in investment in energy research and development (R&D) by the German government. In some cases, the adoption of deployment policies has entailed a largely implicit tradeoff with funding for energy R&D. For example, funding for wind and solar R&D programs has remained constant or experienced small declines, while deployment funding in both areas has increased sharply.

In particular, the decline in support for solar photovoltaic and biomass R&D provides a counterpoint to the host of other policy measures adopted to spur the adoption of these technologies.

Despite the fact that German government has invested more than 3.5 billion Euros in RES R&D between 1990 and 2005, the greater emphasis on technology deployment activities is the key success factor of Germany's RES program.

The GCC Context

What can be learned from the German case that could be useful to the GCC countries? A good starting point would be to explore RES background initiatives in the region, especially past R&D programs in Saudi Arabia.

In addition to the globally shared worries for energy supply and, increasingly, pressing environmental concerns, the GCC countries are facing their own set of challenges. Aridity of the region, population growth and rapidly growing demand for energy and electricity in particular, high energy intensity, and inefficient use of supply are putting added pressure on the region's reserves of fossil fuels as well as increasing the burden of government finances.⁴

Yet, despite all these factors, as well as past interest and large funds allocated to RES research programs since the 1970s, there is plenty of scope for the socio-economic exploitation of the region's renewable energy potential.⁵ Indeed, interest in developing renewable energy sources in the region had been expressed in some GCC countries as early as the mid-

1970s, but the quasi-inexistent impact of the region's past RES experience

Governments are crafting strategies that enable a gradual transition to transform their local energy markets, creating new industries, jobs, products and organizational processes around the paradigm of indigenous energy

on its energy markets is particularly perplexing. This past experience could be useful, though, to better evaluate the present interest and investments in RES shown by some institutions in the Gulf now.

R&D programs and demonstration projects were implemented in the Gulf and these helped in the conduct of techno-economic feasibility studies and technology assessments. Most of these programs involved cooperation with international research institutions and industries and triggered further local R&D conducted in King Abdulaziz City for Science and Technology (KACST) and other universities in Saudi Arabia, the Kuwait Institute for Scientific Research (KISR), or the University of Bahrain (UOB) to name but a few.⁶

Applications were focused on grid connected solar electricity generation as well as decentralized usage for remote areas, solar (PV and thermal) energy powered water desalination plants of different scales, solar cooling and heating, and solar production of

3 Landmark legislation such as the 1991 Energy Feed Law and 2000 Renewable Energy Law have had an accelerating effect on the deployment of renewable energy technologies since 1990. Ibid.

4 The World Bank Regional Energy Brief for MENA in <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/EXTMNAREGTOPENERGY/menuPK:585818~pagePK:51065911~piPK:51065915~theSitePK:585807,00.html>

5 GCC countries have high direct solar radiation levels: average solar radiation in the Arabian Peninsula is 2,200 KWh/m²/year. These irradiation levels (>250 W/m²) are very favorable for the use of Concentrated Solar Power (CSP) technologies.

6 In particular, in Saudi Arabia, the Solar Energy Research American Saudi (SOLERAS) was established in 1975 with the US and was directed towards demonstration projects on solar PV electricity generation and water desalination. The Hydrogen from Solar Energy (HYSOLAR) program was contracted with Germany and concentrated on the efficiency of PV plants and how solar-based production of hydrogen could be improved. For more details, a full report on RES capacities and stakeholders of the GCC countries is being finalized by the Gulf Research Center (GRC).

hydrogen as an energy carrier. Wind energy technologies were also explored and the utilization of hybrid wind diesel electricity production systems to replace oil-produced power proved to be attractive for many applications. Solar radiation and wind energy assessments have also helped GCC institutions gain valuable experience in the fields of instrumentation, calibration, data collection, and monitoring and analysis. Similarly, some progress was also made in the use of solar energy equipment through testing the adequacy of early photovoltaic or solar thermal dish equipment under local climate conditions. A solar village project in the north-west of Riyadh is the most prominent example of such experiments. The total cost of this project amounted to \$100 million.

For Saudi Arabia, developing an industrial solar seawater desalination system was one of the main interests in a cooperation program with the US. A pilot plant was constructed in the

organizations were involved, and the total project cost amounted to \$35.3 million. However, the system was neither economically nor technically viable. The Yanbu plant was shut down in 1989 and the technology tested there has never established itself as a commercial desalination technique.

It is estimated that from the mid-1970s to the mid-1990s, at least \$200 million was invested in international joint R&D programs to develop RES in Saudi Arabia. These were mainly basic research projects implemented in cooperation with the US and Germany.⁷ Have these programs triggered joint promotion by Saudi scientists and industries of any RES technical innovation or created a solid technological niche? The answer is no.

On the contrary, these programs focused on researching and testing novel concepts that generally need an existing science, technology

simply were not - and still are not - available in the region. Therefore, it does not come as a surprise that these R&D efforts produced no local patents or major scientific results. The operation, maintenance and performance (OM&P) activities may have provided new concepts, manufacturing solutions or helped design new commercial equipment, but these benefits remained limited to the primary technology providers and/or international industries involved in their installation and integration,⁸ emphasizing the technological limitations of such activities in the Saudi context.

In general, the scientific knowledge gained in some Saudi - and similarly in other GCC⁹ - laboratories has not been transferred to the local industrial sector. Such a transfer would have initiated the local private sector's participation in the development, manufacturing and utilization of solar or wind technology devices.

Germany based Waldpolenz Solar Park, is the world's largest thin-film photovoltaic (PV) power system. The 40 MW solar power system is using state-of-the-art thin film technology and supplying about 40,000 MWh of electricity per year



coastal region of Yanbu in the mid-1980s to test and demonstrate the world's first and largest solar powered seawater desalination. Various

and innovation (STI) eco-system and a long-term research policy to generate products adapted to local needs and constraints. Such systems

Unfortunately, the above mentioned R&D programs played no role in spurring the development of RES in the region. They did not serve to

⁷ HYSOLAR, from 1986 -1995, focused on hydrogen and fuel cell R&D. Scientists of the ERI-KACST have gained professional experience in this field. In Germany, it is only in recent years that such R&D has experienced sharp funding increases. Global intensive R&D is still needed in these areas to bring technologies closer to commercial viability and broad market deployment.

⁸ Like the Chicago Bridge and Iron Company, Salah H. Alawagi "Evaluation of Solar Energy Research and Its Application in Saudi Arabia" in *Renewable & Sustainable Energy Reviews*, 5 (2001) 59-77.

⁹ Scientific research on RES funded by KISR since the 1980s expanded to more than 140 research projects, totaling around \$50 million and involving more than 70 researchers, engineers and technicians. Researchers from the University of Bahrain have conducted several studies in the area of solar and wind energy sources and they encourage the use of these sources of energy in electricity generation and water desalination as an alternative source to fossil fuels. Since the 1990s, RES potential assessments and water desalination projects using renewable sources (demonstration scale) have been conducted in Bahrain by faculty members from different departments in UoB.

establish a local technological base nor were they economically and politically sustained to encourage widespread adoption and gain a footing within a socio-technical system, thus transforming the indigenous energy market, introducing new skills and creating jobs for the local population. There was thus no embedment of RES technologies, in spite of these early investments, interest and huge geographical potential of the GCC countries.¹⁰

The absence of national strategies to develop RES reflects the lack of socio-economic perspective behind the early R&D programs of the Gulf. This contributed to the existing constraints for RES potential deployment. Indeed, the absence of national goals and legal frameworks for the promotion of RES (policy legislation issues), non-availability of subsidies/agreements for RES electricity generation and investments (cost issues), lack of dissemination and utilization of knowledge gained within the laboratories, low awareness, information and relevant market skills (market technology issues) are all real barriers to triggering a RES market transition in the GCC.¹¹

In recent years, surging fossil fuel prices and awareness of climate change threats have renewed global interest in renewable energy technologies. But how can we guarantee that the renewed interest of the Gulf countries in RES translates into proper technology transfer this time?

In particular, the GCC's booming economies are faced with mounting energy requirements because of their fast growing populations and increasing per capita consumption of electricity. Together with industrialization and the vital need for

energy intensive water desalination, this combination of needs and growth effects are posing serious sustainability challenges to GCC resources. Power generation is predominantly oil and gas based in all the GCC countries and this is evidently straining fossil fuel reserves, shortening their duration and contributing further to the CO₂ footprints of the GCC that are already record high. Evidently, such consumption patterns need to be addressed by local governments in terms of energy security, availability of power generation capacity, sustainability of the socio-economic development and reduction of the environmental footprints.

To mitigate the impact of climate change resulting from burning fossil fuels, and for a more profitable utilization of the latter, alternative sources for electricity production will probably be pursued. Nuclear energy – as a technologically viable solution to electricity generation – is a competitor to RES as alternative energy to reduce carbon emissions. This alternative though poses problems of waste management, safety and security, which RES do not. In addition, uranium supplies are limited.

However, as has been argued in a previous section, isolated R&D activities do not represent the most rapid or economically viable solution to harness the region's potential for the development of RES. Past R&D efforts to build new RES know-how in the GCC countries bore no fruit, as this process had not been embedded in the GCC economies. As has been further described earlier, adoption of the deployment policies approach, with a protracted reduction in R&D expenditure, gained Germany its RES leadership position.¹²

This suggests that deployment of existing RES technologies in the near term, along with any learning-by-doing

In recent years, surging fossil fuel prices and awareness of climate change threats have renewed GCC interest in renewable energy technologies. But how can we guarantee that such interest translates into proper technology transfer to the Gulf countries?

and induced industrial innovation from this deployment, is a real opportunity for RES know-how to be embedded in a socio-technical system. Such a process is indeed capable of transforming the indigenous energy market.

RES costs are steadily declining due to the evolution of various technologies, and it is time that sufficient budgets are allocated to their deployment in the region should leaders wish to intensify the role of RES in the region's energy mix. In fact, diverse stakeholders including governments, industries, R&D centers, and consumers can form a network both to actively advance RES deployment and make this process a real opportunity for technology transfer to the region. For this to happen, strategies should consider a comprehensive approach and look at aspects such as utilization, regulations, finances, R&D and manufacturing as essential parameters of renewable energy development in the region. Moreover, policies should be more deliberately introduced at different levels of the society to persuade individuals and

¹⁰ The total infrastructure installed through these R&D efforts did not exceed 2 MW of solar electricity-generation capacity for demonstration purposes.

¹¹ Doukas, Patliziari and Psarras, "Enhancing Renewable Energy in the Arab States of the Gulf: Constraints & Efforts" in Energy Policy 34 (2006) 3719-3726.

¹² Government expenditures for renewable energy market conditioning and deployment incentives exceeded total government energy R&D expenditures by more than 200 percent in 2002. See Paul Runci "Renewable Energy Policy in Germany: an Overview and Assessment," January 2005 in <http://www.globalchange.umd.edu/energytrends/germany/1/>

organizations to support the practices of acquiring technical RES know-how and training people into relevant skills, and make sure that technologies and qualifications are adapted to local needs.

One has recently witnessed the implementation of high profile RES projects, both from the public and private sectors in the Gulf. Notably, some GCC institutions are funding basic research targeting next generation technologies, for later deployment, or investing in RES deployment activities in foreign energy markets. The expectations of such projects are high among investors, industries, researchers and end-users. However, from the perspective of what has been discussed, project

leaders need to reflect and apply key concepts to their RES activities:

- 1) Are they based on the concept of indigenous energy to develop local markets and answer their needs?
- 2) Are they based on the deployment of existings technologies vs R&D of future technical know-how?
- 3) Are they designed to be embedded into the local economy?

To help in the reflection, it would be beneficial to meditate on this thought:

The acquisition of technical ideas appears to be essentially social, intellectual, cultural, and educational, while having a strong and direct link with industrial products and their economic markets. When technical

Deployment of existing Renewable Energy technologies in the near term, along with induced industrial innovation from this deployment, is a real opportunity for relevant know-how to be embedded in socio-technical systems of the GCC countries

ideas - or technology - keep an abstract dimension for a society, it will always have the shape of imported objects, designs, or models.¹³

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Saudi Mediation in Afghanistan

Nicole Stracke

The Indian Prime Minister's visit to Riyadh in February 2010 mainly focused on strengthening the future economic cooperation with Saudi Arabia. It is also possible that Prime Minister Manmohan Singh is seeking support from the Saudi leadership to put pressure on the Pakistan military and security institutions to deal more effectively with terrorist groups based in Pakistan which threaten India.

The Indian request followed a similar call for Saudi involvement made by the US and the Afghan government earlier this year. During the London conference in January, the Saudis had made guarded promises to support mediation but only if Taliban cut their ties with Al Qaeda.

Following the conference, Hamid Karzai, the Afghan President, visited the Kingdom to ask for Saudi involvement in negotiations with the Taliban but failed to get a positive answer. The absence of a positive reaction from the Saudi side made Mrs. Clinton discuss the mediation issue with Saudi leaders behind closed doors, removing it from the public meeting agenda during her recent visit to the Kingdom.

The question at this stage is whether the Saudis are willing and able to play a mediatory role between the Afghan government and the US on one side and the Taliban on the other. The perception in Saudi ruling circles is that the chances of successful mediation are very limited and, therefore accepting a mediatory role on US-Afghan request would mean taking on a risky, thankless and, possibly, an unrewarding endeavor.

A basic requirement for successful mediation is the official and explicit agreement of all parties involved. In this case, we have the US and Afghan governments making private and public demands for Saudi mediation, but there have been no encouraging signals from the Taliban – neither from the so-called moderates nor from hardliners such as Mullah Omar. So far it looks like the Taliban is united in not giving any positive response to calls for Saudi involvement in mediation.

In fact, Saudi Arabia and the Taliban share an unhappy history. Despite the fact that Saudi Arabia was one of only three states that recognized the Taliban regime, its relations with the Taliban leadership rapidly deteriorated in the mid-1990s. Saudi-Taliban relations witnessed a major shift after the US embassy bombings

in Kenya and Tanzania in 1998, when Saudi Arabia demanded that the Taliban should stop providing a safe haven to Osama bin Laden and the al-Qaeda organization. The Kingdom demanded that the Taliban leadership hand over Bin Laden to the Saudi authorities as was accused of terrorist crimes committed both inside and outside the Kingdom. The Taliban refusal to do so led to rapid deterioration in relations. Since then, relations between the two sides have been governed by perceptible mistrust with the Taliban leadership accusing the Kingdom of supporting the US invasion of Afghanistan after the 9/11 attacks. The Saudis feel they have no leverage to influence the Taliban group under Mullah Omar's leadership or persuade them to make concessions.

At the same time, the Saudi government

King Abdullah with Indian Prime Minister Manmohan Singh



finds it difficult to trust the US government and President Karzai. The Saudis are not ruling out the possibility that even if they initiate the mediation process, they may not be in control and, in fact, may be unable to determine the outcome of such mediation. The Saudis have been observing the US diplomatic shortcomings in dealing with the Israeli-Palestinian conflict and the Iranian nuclear file; they believe that the US is not able to stand by its commitments and promises and therefore, at this stage, prefer to refrain from any direct involvement that is based on closer cooperation with the US and the US-friendly Karzai government.

The Taliban have set clear conditions for any negotiations. They do not recognize President Karzai as a partner and insist on talking directly and exclusively to the “occupiers;” they also demand the withdrawal of all foreign forces from Afghanistan to allow the re-establishment of the Taliban state. These conditions are not acceptable to President Karzai or the US, and Saudi mediation is not likely to change the Taliban demands.

At the same time, official involvement in Afghanistan is currently not a top priority for Saudi Arabia. The Saudis are much more concerned about security challenges in Yemen, the development of the Iranian nuclear program, the security situation in Iraq and the Arab-Israeli peace process. For the Saudis, the US shift in priorities from Iraq to Afghanistan is a matter of concern and, at this stage, they feel no obligation to invest in mediation efforts.

The US could certainly promise the Saudis a more active role in dealing with the Palestinian issue and Iran in return for Saudi acceptance of a mediatory role in the Afghan situation. However, even if the Saudis are convinced that their involvement in Afghanistan could be rewarded by the US taking greater effort to resolve issues of concern to Saudi Arabia, the

current absence of a positive response from the Taliban makes successful mediation impossible.

As long as the Taliban think that their war against US is winnable, and as long as they think that they can achieve all objectives by military means, it will be difficult to bring them to the negotiating table or to get any concessions from them. The new military offensive in Helmand and other provinces under Taliban control could well be the decisive factor in determining whether the Taliban will respond positively to any mediation

The question at this stage is whether the Saudis are willing and able to play a mediatory role between the Afghan government and the US on one side and the Taliban on the other

initiative, external and internal.

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Implications of Iran's Nuclear Program: A View from the Arab Gulf Region*

Dr. Christian Koch

When it comes to the Iranian nuclear program, the GCC states find themselves between a rock and a hard place. On the one hand, while the Arab Gulf States have voiced their support for a civilian program in Iran, they have been clear that they oppose any military application that might develop out of Tehran's pursuit of nuclear technology. The GCC states – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates – are of the view that Iran as a military nuclear power would pose a direct threat to their internal as well as external security. On the other hand, these states have also stated clearly that they do not want to see a military confrontation develop out of the current stand-off as this contains equally damaging consequences for their security. Yet, given the GCC's own limited mechanisms to bring about an Iranian change of mind and to ensure that Tehran comes out clearly and verifiably with its peaceful stated

intentions, the Arab Gulf finds itself at the mercy of decisions made elsewhere – in Washington, Paris, Moscow and Beijing.

A Ruptured Relationship

The above dilemma stems from the fact that the Iran-GCC relationship is defined by deep mistrust about the intentions and motivations of the other. While Iran wants to keep the issue of Gulf security within the region so that it can better play its dominating and powerful role in the Gulf, the Arab Gulf states seek to more or less internationalize regional security in an effort to bring about as broad a commitment as possible from external states to Gulf stability. In its efforts to suggest alternatives to the current Gulf security stalemate, Iran repeatedly asks for the withdrawal of all foreign forces from the region as a prerequisite. The GCC states meanwhile seek such foreign protection to compensate for

their own deficit in self-defense capability and because they do not want to be thrown under any sort of Iranian mantle.

Without a doubt, there is the clear perception among Arab Gulf policy-makers that Iran remains acutely oblivious to the security concerns of the GCC states, and that it solely seeks to measure up to the United States even seeing itself in the same league as Washington. Viewed from Riyadh, Abu Dhabi or Doha, Iran does not appear to have a serious policy towards the GCC which takes into account in any way the security perceptions of the Arab Gulf. The result is an Iranian approach to its neighbors that in essence borders on contempt and is framed within suggestions of superiority. Iran, in fact, displays a high degree of arrogance that does nothing more than perpetuate existing perceptions. This was highlighted recently when Iranian

Iran's nuclear facility at Natanz



* This text is based on a talk delivered at the 18th Annual Arab-US Policymakers Conference of the National Council on US-Arab Relations held in Washington, D.C., October 15-16, 2009. It has also been posted on the blog www.raceforiran.org

President Mahmoud Ahmadinejad referred to the GCC states as “those little nations of the Gulf.”

There are numerous examples that display this Iranian attitude:

- The regular carrying out of offensive military maneuvers and exercises in Gulf waters. These exercises are not as much meant to scare off the United States as much as they are a clear attempt to intimidate Arab Gulf countries.
- The carrying out of missile launches and tests which have the same impact as military exercises. Not only does Iran repeatedly state that the GCC states are within easy range of these missiles but Tehran has in fact threatened to launch those missiles against US military installations in the region in the event of US attacks on Iranian nuclear installations. These bases are, of course, located on the territories of the GCC states.
- Iran has on numerous occasions threatened to intervene in the internal affairs of the GCC states including stating that cells exist within these countries that can be called upon to carry out subversive activities or indicating that thousands of suicide bombers stand ready to carry out missions in the Gulf if necessary.
- Iran regularly threatens to shut down the Strait of Hormuz through which almost one third of the world's oil supply flows daily. This is in fact a direct threat to close the lifeline of the Gulf.
- Iran makes territorial claims on the GCC states including repeated claims on the island state of Bahrain and it continues to occupy the three islands claimed by the UAE in the Gulf near the Strait of Hormuz. On Bahrain, it was only in February 2009 that an Iranian Parliamentarian claimed that if Bahrainis were to vote in a referendum, they would choose to be part of Iran. There have also been calls of Bahrain as Iran's 14th governorate. On the island issue,

Iran has refused to engage in a substantive dialogue with the UAE including having the issue referred to the International Court of Justice (ICJ). What is particularly offensive for the UAE is that Iran regularly refers to the territorial dispute as a “misunderstanding” implying that the UAE authorities are simply not sophisticated enough to understand the matter.

- In the same vein, Iran has repeatedly questioned the legitimacy of the Arab Gulf states and their system of rule as most recently demonstrated by the Iranian Deputy Foreign Minister Manouchehr Mohammadi in 2008 when he stated that the Arab Gulf monarchies would soon be swept aside.
- Finally, there are instances of Iranian interference in other parts of the Middle East, for example, in Iraq, Yemen, Lebanon, and the Palestinian territories. In none of these places is Iran seen as playing a positive role towards conflict resolution but rather as a spoiler intent on keeping developments unbalanced so that Tehran can control the situation through deniable allies.

Equally relevant is the fact that Iran has missed numerous opportunities offered by the GCC states to build a more constructive regional relationship. The presence of President Ahmadinejad at the GCC summit meeting in Doha at the end of 2007 was one of those chances. The invitation for the Iranian president was issued in the spirit of a gesture to show that the GCC states continue to place the emphasis on dialogue and that opportunities exist to resolve the conflict over the Iranian nuclear program. But instead, the Iranian President's speech before summit delegates was notable not for what he said but for what he did not say. No word on the intentions of the Iranian nuclear program and thus no words of reassurance for the Arab Gulf leadership, no mention of Iranian policy in Iraq and possibly

Iranian efforts to help stabilize the situation there, and certainly no word on the issue of the three UAE islands. Instead, Ahmadinejad put forward ideas that were simply regurgitations of past proposals and therefore utterly

The Iran-GCC relationship is defined by deep mistrust about the intentions and motivations of the other

failed to offer confidence about Iranian intentions. His reference to “our closeness and our common historic, social and cultural background” as the foundation for closer relations proved wholly insufficient. His continuous reference to the Persian Gulf at a summit of Arab Gulf States was perceived as a particular and unnecessary affront.

What Iran just does not seem to comprehend is that a little assurance can go a long way as far as the GCC states are concerned. There is already a broad consensus in the region that Iran, given its size and power, has a natural leading role to play when it comes to security issues. But with that role comes the responsibility to act and behave in a manner that promotes confidence and ensures greater regional stability. For the moment, Iran only pursues policies in the opposite direction.

It is in this context that Arab Gulf perceptions about the Iranian nuclear program must be seen. What is clear to GCC policy officials is that a potential Iranian nuclear program will not constitute a direct threat to the existence of the United States or even Israel (given Israel's second strike capability and the fact that any Iranian program is certain to be a crude program with a limited number of devices at the outset). Rather, a nuclear weapon will provide Tehran an additional cover for it to institutionalize its interference and meddling in its

immediate neighborhood. In those instances where Iran might be exposed or caught regarding such a policy, it would then simply thumb its nose and challenge anyone to do something about it.

In general, as far as the GCC states are concerned, no one is asking Tehran at the moment for a favor. The fact remains that Iran is a signatory to the Non-Proliferation Treaty (NPT) and has certain obligations under its treaty provisions. Yet, Iran has violated those provisions and there are three legally binding UN Security Council Resolutions which demand that Iran stop its current enrichment activities. Those violations have in fact been acknowledged by all the permanent members of the UN Security Council including Russia and China. For the GCC states, if Iran is not forced to abide by its international treaty obligations, then what are their overall

Furthermore, there is a strategic dilemma that presents itself. Given the very real defense vulnerability of the Arab Gulf States in terms of limited self-defense and deterrence capabilities coupled to the absence of any trust regarding Iranian intentions, there is a growing recognition within the GCC leadership that it would be completely irresponsible to mortgage one's future security by either relying on the United States to do the right thing or depend on Iran to come to its senses ultimately and become a good neighbor. Neither is it acceptable to just sit and wait until the day when the reality of an Iranian program becomes clear alongside Iranian nuclear hegemony.

As such, there is no option but for the GCC states to react. The first steps have already been taken with the announcement by the GCC, both collectively and individually, that they

The GCC states have three choices: do nothing, seek protection or develop their own capability

given that possible US scenarios for protecting the GCC states would be insufficient. Can the Arab Gulf rely on a US defense or even a nuclear umbrella? Would this even be approved in the US Congress? Would such an umbrella be domestically acceptable in the GCC states since it would mean even greater reliance on the US? If a situation were to develop whereby Iran launches a nuclear missile on the Arab Gulf side, would such an umbrella even be useful given that retaliation by the United States would not undo the damage done by a nuclear warhead landing in a GCC capital? Or what would be the consequences if one day the United States and Iran bury their hatchet with the implicit agreement on Iran resuming its position as policeman of the Gulf? In terms of all of these questions, protection is thus not really protection. It is also not an alternative to current efforts to prevent Iran from becoming nuclear. To say otherwise is to put the cart before the horse. The bottom line here is that Iran is the key to nuclear non-proliferation in the Gulf and wider Middle East. While the GCC states would accept a US umbrella as a temporary measure, it would simply be a cover until a state like Saudi Arabia can develop its own capability.

In terms of the above considerations, the GCC states have three choices: do nothing, seek protection or develop their own capability. The first means trusting Iran while the second is insufficient. The only viable alternative is therefore to move towards an indigenous capability. There is, of course, no doubt that the outcome of such a strategy remains uncertain, but to ignore strategic realities would be irresponsible and an abdication of national interests.

Iranian President Mahmoud Ahmadinejad at a power plant in Iran



value? Israel, India and Pakistan are in a different category in this case as they never signed the NPT. The success/failure in making Iran abide by its obligations is seen as a litmus test for the way forward. Certainly, if Iran is allowed to get away with it, there will be a strong sentiment in the GCC states not to abide by those standards either. For the GCC, the priority is thus to see Iran stick to its original commitments.

are pursuing the path towards civilian nuclear power technology. While there are logical arguments that can be made from an energy point of view for pursuing this option, there should be no doubt that Iran is in fact the cause for such decision. But to take this one step forward, given current Iranian intransigence, the GCC states also have to maintain their option to pursue military nuclear programs of their own

So what is to be done? It should be clear that the focus has to be on preventing an Iranian nuclear program and ensuring Tehran's fulfillment of its commitments and international obligations. As the GCC states cannot stop Iran on their own, they require the support of the international community to ensure Iranian compliance. At the same time, there need to be renewed efforts at coming up with creative solutions. One idea would be the revival of the Saudi initiative of creating an international consortium for nuclear fuel. A second would be the proposal put forth by the Gulf Research Center at the end of 2004 for the creation of a Gulf Weapons of Mass Destruction Free Zone (GWMDZFZ) as a precursor to a wider Middle East WMD Free Zone. But given that it is unlikely that the current government in Tehran will engage seriously on any of these proposals, there is also the need for a broader and more effective public diplomacy effort that enlarges the debate within Iran about the utility of pursuing a nuclear program. If change is to come about in the Iranian position, it has to come from within. Inflammatory rhetoric should in this context be avoided as this only gives the embattled government of President Ahmadinejad unintended legitimacy which it can then utilize against its internal as well as external enemies. Here, further steps should also be taken to bring about a joint approach from the GCC within a multilateral context to highlight to Tehran both the opportunities and the potential consequences of a failure to resolve the nuclear issue.

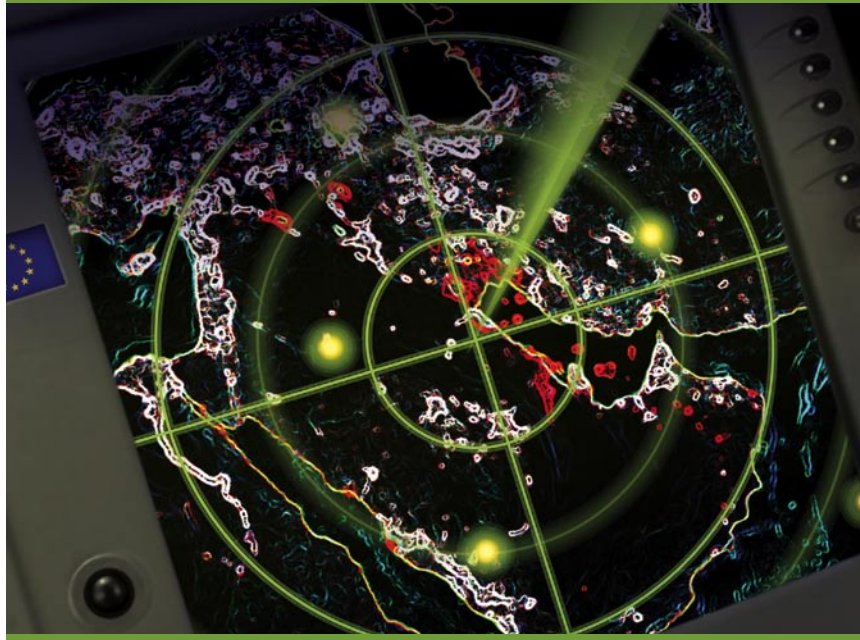
In the end, there are clear options available for Iran to pursue and take advantage of. Unfortunately, Iran has a history of wrong timing and there is a sense that this will be the case once again this time around.

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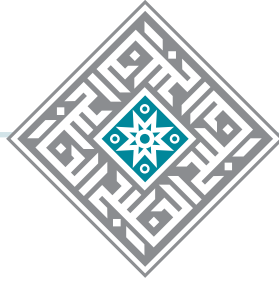


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Knowledge for All

EU-GCC Relations and Security Issues **Broadening the Horizon**



The relationship between the member states of the European Union (EU) and those of the Gulf Cooperation Council (GCC) is multifaceted and has over the years taken on a number of different dimensions. With security issues such as those related to terrorism, the US-led invasion of Iraq and its aftermath, and concern over a potential Iranian nuclear program coming to the forefront, ties between the EU and the GCC have taken on a security component that up to this stage remains largely undefined and understudied. The collection of papers included in this volume highlight many of the different salient issues playing a role on the security front and put forward perspectives under which this new dimension in relations can be better understood. This includes an attempt to move from the currently still vague and largely theoretical notions of GCC-EU security cooperation into more policy-applicable and relevant approaches that build on past European experiences. *EU-GCC Relations and Security Issues* extends empirical insight into various aspects of the European approach to the region from a security-based perspective, provides a comparative context into which it becomes possible to frame a more solid base for understanding European policy in the region, and through the use of case examples illustrates how the present cooperation can be expanded and improved upon.



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Based in Dubai, UAE, the Gulf Research Center (GRC) began its activity in 2000 as a privately-funded, non-partisan think tank, education provider and consultancy specializing in the Gulf region. The GRC produces recognized research from a Gulf perspective, redressing the current imbalance in Gulf area studies, where regional opinions and interests are underrepresented.

The GRC believes that the Gulf Cooperation Council has transcended the initial reasons for its establishment, to become a fundamental right of its citizens in the development of the region. The GRC seeks to further this belief by being an institution of distinction and innovative research that advances different aspects of development to ultimately benefit the people of the region.

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