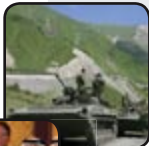


Gulf Monitor



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Neutrality Is Not an Option:
The GCC States and the Georgian Crisis



The UN and the GCC



The Islamabad Attack and Al-Qaeda
Involvement



The Impact of the US Financial Crisis
on the GCC Countries



The G20 and the GCC Agenda

November 2008, Vol. 2, No. 6



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Published by

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Cover picture. Russian soldiers monitoring a check point near Nadarbazevi. (Image courtesy of AFP)

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Neutrality Is Not an Option: The GCC States Need to Take a Clear Position on the Georgian Crisis

Abdulaziz Sager

The crisis over Georgia should give the GCC states a reason to be concerned. Far from being confined to its immediate neighborhood, the crisis between Russia, Georgia and the international community has broader and emerging geopolitical implications as well. One immediate area of concern is Iran's continued march toward a military nuclear capability and the role of Russia in this equation. This has direct consequences for the security of the entire Gulf region. As a result, the Arab Gulf states cannot afford to stay quiet in the current discussions and they must make their concerns known and state their policy positions clearly. A strategy of not taking sides, maintaining strict neutrality, and avoiding a clear position in fact can have counterproductive results.

Overall, relations between the GCC states and Russia have improved in the last few years with trade volumes increasing six-fold since 2000 and with former President Putin's visit to Saudi Arabia and Qatar in February 2007 outlining numerous areas of additional cooperation. To be sure, there are concrete interests at play when it comes to GCC-Russian relations. These concern counter-terrorism efforts, the role of the Muslim community within the Russian republics, the possible sale of military equipment to the Gulf region, cooperation on energy issues and finally, Iran's nuclear program, which has the potential to upset the regional strategic balance in a fundamental manner.

In all of these areas, concrete cooperation is possible but only if Russia displays a stabilizing attitude towards the broader region. With its actions in the Georgia crisis, the fact is that Russia has not only jeopardized the expansion of the north-south economic corridor from the Gulf to Russia but its military campaign has also had a direct negative impact on Gulf investment in the Caucasus. For example, the Georgian port of Poti, which is majority-owned by UAE's Ras al-Khaimah Investment

Authority, sustained heavy damage in the Russian air raids. Such action is certainly not the right signal as far as the region is concerned.

In light of such events, it is necessary for the GCC to take a clear position and make sure that Russia understands the possible consequences of its actions also for GCC-Russian ties. Three concrete steps can be taken. First, the GCC should come out clearly in support of the efforts of the European

A convoy of Russian troops makes its way through the mountains toward the armed conflict between Georgian troops and separatist South Ossetian troops on August 9, 2008



Union (EU) to resolve the crisis diplomatically and to work out a solution that serves as the foundation for a broader European security order. Europe is the chief interlocutor between Moscow and Tbilisi, and the EU is the only institution available at present that can not only serve as a basis to restore confidence but, more importantly, prevent the crisis from deteriorating further and beyond its immediate neighborhood. The deployment of 200 ceasefire monitors in the buffer zones around South Ossetia and Abkhazia, ahead of an expected Russian troop withdrawal by October 10, is a step in the right direction toward de-escalation and the GCC should support it.

Second, the GCC states have to make it clear to Russia what is expected of it. As far as Iran is concerned, it has to be conveyed to Moscow that this in no time to use the Iran card



as a bargaining chip in its broader confrontation with the United States. Given that Iran is in direct violation of three UN Security Council resolutions to freeze its uranium enrichment activities, it remains in the interest of the international community to see that Iran does not attain a nuclear capability while at the same time ensuring that the current stand-off is resolved peacefully. The report released by the International Atomic Energy Agency (IAEA) on September 15 once again underlined that the agency is not able “to provide credible assurance about the absence of undeclared nuclear material and activities in Iran.” In this light, Iran cannot be allowed to reap the indirect benefits of this crisis by being allowed to use Russian obstructionism to stave off further action against the Islamic Republic in case it fails to fulfill its obligations to the Security Council.

In this context, Russia needs to underscore that there exists no linkage between Iran’s nuclear activities and the Georgia crisis. Furthermore, the GCC states should demand of Moscow the assurances that any item delivered to Iran as part of the work on the Bushehr reactor is strictly limited to civilian applications only. Better yet, Russia should not provide any nuclear assistance to Iran at all. In addition, Russia should also not allow the sale of the Russian S-300 anti-air defense system to Iran to proceed as this would most certainly be a wrong signal at a wrong time.

Third, the GCC states should strengthen their relations with NATO through the Istanbul Cooperation Initiative (ICI). As far as Gulf security is concerned, Russia is no alternative and certainly not a replacement for the US in the region. While the US military role in the region does come with its own problems and complications, it does remain an integral part of assuring

the independence and sovereignty of the GCC states in a dangerous and unpredictable neighborhood. Here, NATO is a viable alternative that can assist the region with the stability it requires while at the same time

Far from being confined to its immediate neighborhood, the crisis between Russia, Georgia and the international community has broader and emerging geopolitical implications as well. One immediate area of concern is Iran’s continued march toward a military nuclear capability and the role of Russia in this equation

tempering the more objectionable unilateral tendencies of the US. Moreover, ICI is the right platform to enhance regional cooperation and coordination. Consequently, it is time for the GCC to send a strong signal to NATO of their desire to see cooperation under ICI deepened and expanded, including seeing Saudi Arabia and Oman signing up to the initiative. The GCC states should also make it clear that they support NATO’s position with regard to the situation in Georgia.

While one can understand the case for neutrality as some have called for in the GCC, such a stand is not the right one to take at this time when key security and strategic issues are at stake. If the GCC states want to play an active role in shaping the regional security environment, their position must be clear and straightforward. The crisis as it relates to Georgia and Russia provides them the opportunity to play such a role.

Abdulaziz Sager is Chairman of the Gulf Research Center

The UN and the GCC: Common Goals towards a Common Future

Kareem Mahjoub

This year's national general assembly of the United Nations not only highlighted the important role of the GCC as a regional bloc, but also showcased the transformation that the Gulf States have had on the international community. While the opening statements of UN member states are often overlooked in the General Assembly, it can provide one with an idea of the thoughts, values, goals and concerns of member states. During this year's meeting, the opening statements of the GCC in particular served as a benchmark for how the Gulf States view current developments in international affairs

and what kind of role they see themselves playing.

In their opening statements, the GCC States highlighted common themes that not only reflect their domestic achievements and concerns, but also focused on the global issues that the international community needs to address. For the United Arab Emirates, Bahrain and Kuwait, particular emphasis was placed on the domestic reforms being implemented in education as well as the expansion of the representation of women in government. The UAE, for example, recently appointed two

female ambassadors, the first in the country's history, along with the federation's first female judge. It is as His Highness Shaikh Abdullah Bin Zayed mentioned, "the enhancement of their role and participation in the labor market".¹ The UAE further pointed to its efforts in attempting to improve the rights of workers and establish regulatory bodies to monitor and maintain their safety and well-being. What remains to be seen of course is how viable such reform is in the Gulf and whether tangible results will be made. Nevertheless, the fact that domestic issues represented a part of the statements can be seen

In preparation for the upcoming 28th GCC leaders summit, Bahrain's Finance Minister Ahmad bin Khalifa, former European Union Trade Commissioner Peter Mandelson, Emirati Minister of State for Financial Affairs and Industry Mohammed bin Kherbash and Qatari Finance, Economy and Trade Minister Yussef Hussein Kamal arrive for a meeting of Gulf Cooperation Council (GCC) finance ministers in Doha, 02 December 2007.



¹ H.H Shaikh Abdullah bin Zayed Al Nahyan, Minister of Foreign Affairs in the UAE, before the general debate of the 63rd session of the United Nations General Assembly: New York, September 27, 2008

as a growing confidence within these states about their internal development and achievement. In the past such issues would have been largely ignored. Thus, by underlining their readiness and willingness to talk about what is still considered sensitive territory, the GCC states sent a strong signal that this time around they are ready to engage in substantive discussions in which they can defend their own ground.

In the same context, the Millennium Development Goals (MDGs) was an issue that nearly all the Gulf states were keen to address. The progress towards meeting these goals is seen by all GCC states as an important move towards securing global development. While a country like Kuwait is proud to state they had realized all their development goals, the UAE, Bahrain as well as Kuwait expressed their concern that the MDGs would not be met by the 2015 deadline.

In line with the need for meeting the MDGs, the GCC states also expressed a common desire for assisting countries in need. Foreign aid was mentioned amongst several nations as a key priority. Saudi Arabia announced that it had recently allocated \$500 million dollars for the World Food Program, along with writing off more than \$6 billion of its loans to least developed countries. The kingdom also said it had extended more than \$90 billion worth of loans to countries in need. The UAE informed the assembly that it had sent over 2 million tons of wheat to Yemen, Syria and Egypt along with the establishment of numerous institutions focused on providing aid and support in the developing world. Kuwait too donated almost \$250 million in the Kuwait Fund for Arab Economic Development, which provides grants and loans to developing countries. What this

underlined is that while maintaining a focus on regional as well as global developments, the Gulf as a region is equally keen to support the development and acceleration of progress to its neighboring countries. Arguably more could be donated, but it this has to be seen a step in the right direction especially in light of the financial crisis that is leaving deep impact in many of the industrialized Western countries.

In addition to concern over development, security issues featured heavily in all of the GCC addresses to the Assembly. Qatar in particular based its whole speech on the theme of peace, using as examples previous agreements of Britain and France in 1904, and the United States and the Soviet Union in 1971 as examples of the needed diplomacy to resolve present world problems. At the heart of the debate is the fact that the Gulf region itself faces pressing security challenges. Nuclear proliferation is a concern for many. While the idea of establishing nuclear power programs has been articulated by several GCC states, the issue of nuclear proliferation is an item of high concern. In this context, the UAE emphasized the importance of the Middle East and the Gulf becoming a free zone for weapons of mass destruction with particular emphasis placed on Iran's nuclear program, a notable concern for all of the GCC members. It was mentioned that Iran's actions could have dangerous consequences for the region which is why many of the nations have called on the United Nations and the IAEA to monitor and control this issue.

While the Iranian nuclear issue dominates the Gulf region in terms of security, other matters in the Middle East were also brought to the forefront, most notably as can be expected

with regard to the Palestinian-Israeli conflict. Saudi Foreign Minister Saud al-Faisal stated that he believed the conflict "overshadowed all other issues in the Middle Eastern region, creating a climate conducive to

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the development of extremism and the spread of terrorism."² And while the GCC condemned the continued settlement operations of Israel, along with its closure of crossing points and erection of checkpoints, a protest that is not new amongst the Gulf States, it is noticeable that the GCC states have engaged in a number of diplomatic activities aimed at providing a level of stability to the region. For example, Qatar has involved itself on a variety of fronts, and by mediating over the crisis in Lebanon, it has gained praise from other GCC members and the United Nations. Saudi Arabia has also worked towards improving the politics of the Middle East by attempting to resolve the Palestinian political turmoil between Hamas and Fatah and re-launched its own Arab Peace initiative. Moreover, under the initiative of King Abdulaziz, the kingdom launched an inter-faith dialogue summit in Madrid followed by a larger UN-sponsored inter-faith conference at the UN in November 2008 that has sought to promote

dialogue in addition to improving the image of Islam around the world. It is steps like these which highlight the common goals of the GCC to improve the future of the region.

It should also be mentioned, the variety of other topics that were covered in the speeches. For one, issues related to the environment and food security were raised by many of the GCC ministers with the Gulf countries stressing the importance of creating and investing in sustainable energy and combating climate change. The Gulf has begun to realize the challenges ahead and have slowly begun to take measures to combat this. Bahrain maintained the importance of the issue of climate change and advocated the importance of the creation of a successor to the Kyoto protocol. Saudi Arabia announced a donation of \$300 million for the establishment of a fund for research on the environment and climate change. The UAE, with its rising population and strains on its infrastructure also announced its intentions with Shaikh Abdullah bin Zayed announcing several strategic programs including the launch of the Masdar Initiative, a sustainable development project which is destined to become the first carbon-free city in the world. Technologies such as solar energy and desalination of water were also mentioned as having the potential to become mainstream in the region. Such debate is critical especially in light that a recent survey showcased that the UAE is the worst in the world for its per capita environmental footprint with Kuwait as another of the top ten worst offenders.³ In this regard, the UAE already has plans in progress to introduce effective public transportation and reduce car emissions.

On a second front, the GCC states also concentrated on the need for further reform within the United Nations system. Bahrain, the UAE and Kuwait used their opening statements as an opportunity to highlight their concerns regarding this issue with Bahrain remarking on the need to “reform renew and reinvigorate our international organization and its organs, to be more responsive to the needs of a new world.”⁴ While Bahrain gave a general overview of the need to change the United Nations as a whole, other countries focused on the need to reform the United Nations Security Council. The UAE called for a “fair representation on the United Nations Security Council and an enlargement of that body”⁵ while Kuwait also called for improvements in the work methods including increased transparency and an increase in its membership.⁶ Such calls are explanatory from the point of view that an enlarged Security Council would allow for better representation of the international community and provide a more balanced approach to global issues, particularly those of the Middle East.

Finally, the GCC states also used their presence at the General Assembly to hold a series of bilateral meeting and advance their interests through personal interactions. Of particular note is the regular meeting that takes place between GCC and the EU during this time which have by now become a regular annual event. During this year’s meeting, GCC foreign ministers and their European counterparts focused on such pertinent issues as as Palestine, developments in Iraq, Iran’s nuclear ambitions as well as the overall status of relations and how existing ties can be improved upon. From the EU side, Javier Solana and the EU Commissioner for External

Relations, Benita-Ferrero Waldner, attended. While unfortunately no new progress was made regarding the highly anticipated FTA between the regional blocs, the coming together nevertheless symbolized that the EU is committed towards maintaining positive relations with the GCC and that there are efforts underway to strengthen the bonds between the two blocs. The GCC states once again underlined their determination to build relations with Europe rather than relying solely on reaching across the Atlantic to their traditional security partners, the United States.

The addresses of United Nations member states are a requirement of all members in the General Assembly. Essentially they are merely a formality, a tradition of sorts, in which all member states can address the international community. What is important to grasp however, is what can be implied from such statements. The Gulf states through their statements have expressed their desire to contribute to development, their fears over nuclear proliferation and the damaging effects of the Israeli-Palestinian crisis. Aspirations for domestic reform were acknowledged and attempted, while also realizing that the need to work towards climate change is paramount to the region and the international community. While the GCC has a long way to go in many of the topics mentioned, the speeches do highlight common goals that have an influence on the rest of the international community. The desire to improve the status of the region and resolve its key issues highlights the growing role that the GCC is prepared to play.

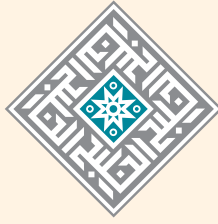
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³ “UAE tops league of wasteful countries”, *The National* October 29, 2008. <http://www.thenational.ae/article/20081029/NATIONAL/229065952>

⁴ H.E Shaikh Khalid Bin Ahmed Bin Mohammed Al-Khalifa, statement before the 63rd Session of the United Nations General Assembly September 27, 2008.

⁵ H.H Shaikh Abdullah bin Zayed Al Nahyan, Minister of Foreign Affairs in the UAE, before the general debate of the 63rd session of the United Nations General Assembly: New York September 27, 2008

⁶ His Highness Shaikh Nasser Al Mohammed Al Ahmed Al Sabah, Prime Minister of the State Of Kuwait, before the 63rd regular session of the United Nations General Assembly September 25, 2008



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The “Gulf and Africa: Developing a New Strategic Partnership” forum will bring together key leaders from business, academia, government and media to outline the main challenges facing more constructive relations between the key regions of Africa and the Gulf. The purpose of this event is to cover a wide range of issues enabling the proposition of policy recommendations that will ensure closer ties.

Upping the Ante: The Islamabad Attack and Al-Qaeda Involvement

Faryal Leghari

On Saturday, September 20, 2008, Islamabad witnessed one of the most horrific suicide attacks in Pakistan's history, which targeted the Marriott hotel less than two kilometers away from the Parliament, the Presidency and the Prime minister's house. As an explosives-laden truck detonated at the barricade set up at the hotel's entrance, it caused a powerful explosion that left 56 dead and 250 injured, among them many foreign nationals including Libyans, Saudis, Turks, British, Germans, Danes and Americans. The Czech ambassador and two US Marines were among those killed.

While it has faced other major attacks in the past, this attack marked a new chapter in terrorism aimed at Pakistan.

More importantly, this attack was planned to coincide with President Zardari's first parliamentary address. There is strong reason to believe that the hotel was a secondary target and that the original target was the Parliament where the top political and military leadership had gathered for the address. Due to two crucial security checkpoints and the high alert in force near the Parliament, the attacker instead decided to zero in on the hotel that was considered a high-value target catering as it did to the political, diplomatic and the civilian elite.

The message that the attack intended to deliver was directed at the United States, the government and the public. It resonated loud and clear and echoed

the anger building up over the spate of air strikes and the ground operation (on September 3) of US forces at Angoor Ada inside Pakistan. In retrospect, this attack should not have come as a surprise because militants from FATA had repeatedly warned of reprisals. The surprise element of this attack was in its planning and operation.

If we look at the history of terrorist acts, we find that the September 20 attack heralds a new stage in the quality of operations. The operation and planning of the attack pointed to an obvious al-Qaeda involvement. It was highly organized, carefully planned and based on pre-inspection of the target.

People stand next to the crater left by a bomb blast next to the Marriott Hotel in Islamabad on September 22, 2008.



The hotel, a high-value target that had been attacked before, was highly protected. The fact that despite this, the terrorist groups were very successful in achieving their objectives reflects that there was detailed planning of the many stages that are typically employed in carrying out a terrorist operation. These include target selection, pre-inspection and monitoring – that in cases involving high value targets such as this could take up to six months – the study of the penetration point for the attacker, the vehicle and the kind of explosives that are used, as well as the timing. These are all crucial factors in the success of a terrorist operation.

In this case, the operation was highly successful principally due to its intensity and the result it achieved. It is believed that nearly 600 kg of high grade plastic explosives may have been used in combination with TNT and aluminum powder in a military style bomb that caused a crater 25 feet deep and 50 feet wide besides considerable damage to surrounding buildings as well.

The attack struck an ominous note, for the confrontation between security and terrorist groups has reached a stage where one can judge that the terrorists are gaining an upper hand. They have shown a greater degree of flexibility, adaptability and persistence in carrying out operations against specified targets. This was apparent in the case of Benazir Bhutto's assassination in December 2007 as she was also targeted a month and a half prior to her death.

As for Al-Qaeda involvement, it is believed to be indirect though the attack seems to bear its fingerprints in the planning and operational aspects. There is no doubt that Al-Qaeda has been directly responsible for the overall improvement in the attacks and operations in Pakistan including the use of sophisticated methods and explosives.

The Arabic language news channel Al-Arabiya said that a group by the name of *Fidayeen e-Islam* had taken responsibility for the attack and demanded the closure of US and NATO military bases in the region and an end to US attacks in Pakistan's tribal areas. The group's intention was to target the US Marines and NATO officials staying at the hotel.¹ The Marriott attack was obviously a message to the government to desist from implementing US diktat and to cease military operations in FATA. The Interior Ministry initially held the Taliban responsible for the attack and claimed that there was an obvious link to them and the Al-Qaeda. Intelligence sources, however, have pointed to the possible involvement of Harkat ul Jihad Islami (HUJI) operatives; the organization was allegedly responsible for similar high-impact suicide attacks in Lahore on the FIA building and the Naval War College. HUJI leader Qari Saifullah, who had links with Al-Qaeda, had been arrested for possible links to Bhutto's assassination only to be released later on the pretext of there not being enough evidence in this regard. It is rumored that his release was a bid to halt the wave of suicide attacks unleashed by his organization following his arrest. Saifullah was arrested and extradited from Dubai in December 2004 on charges of plotting the twin suicide attacks on President Musharraf in December 2003 but was released in 2005 when a case filed in the Supreme Court challenged his detention on the basis of there not being enough evidence.

Even more than former president Musharraf, the current political regime is viewed by even that section of the Pakistani public considered "moderates" as one that is susceptible to ceding to American interests. It is perhaps to distance the military from such a perception that General Kayani,

In retrospect, this attack should not have come as a surprise because militants from FATA had repeatedly warned of reprisals. The surprise element of this attack was in its planning and operation

the Chief of Armed Forces, took a stand and vowed to retaliate with force against further transgressions, besides reiterating that there would be zero tolerance of US strikes in Pakistani territory.

The current escalation of the security crisis, along with the tension marking US-Pakistan relations and the reigning confusion as far as policy making is concerned, has worsened the situation. The government is yet to define and commit to a firm stand in support of national interest and needs to take immediate action by insisting on a complete stop to any strikes by foreign forces on its soil. The fight against terrorism is likely to be a long drawn out one and will need resolve, commitment and perseverance. What is important at this point is to prevent the moderates from turning towards extremism that threatens to engulf larger sections of the population with the continuing buildup of an impotent rage and feeling of helplessness as more civilians are killed in continuing air strikes. Without succumbing to either the militants' challenge to the state, or accepting the aggressive US policies that are being implemented at present to somehow redress the international forces' eroding control in Afghanistan, Pakistan needs to strike a balance and fight terrorism that is and has been its own war for a while.

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¹ <http://in.reuters.com/article/domesticNews/idINLM3375020080922v>

million by the end of this year,³ while Bahrain's Gulf International Bank was downgraded by Moody's because of its holdings of US mortgage-backed securities. The bank had to make provisions for \$966 million and raise additional capital.⁴ Although S&P deems overall Gulf subprime exposure as limited, it reckons that banks may be concealing related losses and more might surface going ahead. Among others, Qatar Insurance Company has also been associated with possible subprime losses.⁵ No GCC bank has thus far quantified any exposure to the bankruptcy of Lehman Brothers, and several GCC central bank officials have denied that any significant exposure could exist. Given the magnitude of Lehman's collapse, such exposure may very well surface over time and could exist in the form of bank bonds, derivative trades where Lehman has acted as counterparty (e.g. credit default swaps), or structured investment products that were guaranteed by the failed US investment bank.

Altogether the hitherto announced subprime exposure of GCC banks of about \$2.7 billion seems to be small compared to more than \$500 billion in Europe and the US. Part of this may be attributable to a lack of transparency with more exposure likely to surface over time; on the other hand, anecdotal evidence suggests that GCC banks have been relatively conservative compared to their American and European peers. In many cases, the investment criteria of banks did not allow the purchase of non-investment grade bonds or complicated structured products and an occasional lack of sophistication may have proven to be beneficial for some banks, now that such products are literally discredited.

However, the majority of assets in the region are not managed by banks but by Sovereign Wealth Funds (SWFs) like Abu Dhabi Investment Authority (ADIA) or Kuwait Investment Authority (KIA). The SWFs invest in a broader range of securities, but public data about the size and composition of their assets is not available, and one has to rely on estimates. As they are sophisticated investors with a considerable equity component of 40 percent and more, according to estimates, their exposure to the current market turmoil must have been considerable. They probably have also invested more in riskier debt structures like CDOs than the region's banks. Unlike banks, they do not have to act when the values of these assets decrease on a market to market basis; in case these assets do not default, they have the luxury of holding them until maturity or until the storm has hopefully passed. Still, unlike 2007, the losses of 2008 must have hurt the region's SWFs to a considerable extent, although they have diversified portfolios and have enjoyed continuous inflows because of relatively high oil prices. Larger overseas investments of GCC companies, like Emaar's \$1.05 billion investment in John Laing Homes, the second largest privately held home builder in the US, or SABIC's \$11.6 billion purchase of GE Plastics, have not been faring too well and will affect the foreign asset position of the GCC countries negatively for the time being.

The Indirect Financial Effect: Rising Costs of Finance and Tight Liquidity

While the direct subprime exposure of GCC banks has been limited thus far, the real problem for the GCC

banks lies in the indirect exposure to increased costs of funding amidst maturity mismatches and credit exposure to local consumer, project and real estate financing.

With inflation in double digit territory and interest rates in the lower single digits, massively negative real interest rates in the GCC countries do not constitute a compelling incentive to save. At the same time, a lot of funds that were speculating on revaluations of local GCC currencies have been withdrawn in the wake of the recent strengthening of the dollar

With inflation in double digit territory and interest rates in the lower single digits, massively negative real interest rates in the GCC countries do not constitute a compelling incentive to save. At the same time, a lot of funds that were speculating on revaluations of local GCC currencies have been withdrawn in the wake of the recent strengthening of the dollar. Thus, GCC banks need to turn increasingly to the capital markets to refinance themselves. But here the cost of credit has risen tremendously as the following chart shows; spreads for corporate bonds in the GCC have risen from around 145 a year ago to over 500 basis points above LIBOR and the EIBOR, the Emirates interbanking rate, has approximately doubled from June to beginning October 2008.

3 "Gulf Banks Make Provisions for Further Subprime Losses," MEED, June 6, 2008, available at: http://www.meed.com/news/2008/06/gulf_banks_make_provisions_for_further_subprime_losses.html.

4 "Gulf Bank Raises \$1bn to Cover Subprime Writed"

5 Matthew Martin, "Gulf Counts"

6 "Dubai's CDS Widen amid Concern over \$22B Refinancing," Zawya Dow Jones, October 12, 2008.

A major reason for this distressed scenario is the deterioration of Dubai-related credit that constitutes a large part of the GCC bond market universe, as the emirate borrowed extensively to finance its development projects and Dubai Inc. companies were among the most prominent issuers in the GCC. Credit default swaps for Dubai corporations and banks trade considerably higher than their GCC peers. Dubai will need to refinance \$6 billion of debt in 2008 and another \$16 billion in 2009, according to JP Morgan.⁶ The CDS market clearly shows increased

capitalizations than their GCC peers, are reluctant to extend their commitments as they face liquidity constraints in their established markets at home. Postponements, modifications and drawdowns of loans have become a widespread occurrence.⁸ According to Reuters, the Middle East has borrowed 16.5 percent less in the third quarter of 2008 (down to \$91 billion from \$109 billion a year ago), a trend that is likely to continue in the fourth quarter.⁹ Overall, \$15 billion of foreign currency debt (loans and bonds) have to be repaid in the GCC

Mitigation Efforts

While GCC central banks had been preoccupied with runaway credit growth and inflation during the first half of 2008, they have now started to react to the liquidity crunch by monetary easing and other stabilizing efforts. The UAE was the first GCC country whose government announced guarantees for bank deposits thus echoing similar measures in the US and Europe, and the UAE central bank has tried to alleviate liquidity bottlenecks by providing an additional Dh50 billion short-term facility to banks. Initially this has done little to ease tight liquidity in UAE markets and the EIBOR has continued to rise. The terms offered were deemed too expensive, and against the backdrop of deteriorating international markets, skepticism persisted. This led to an additional injection of Dh70 billion on October 15, which was well received by local equity markets.

The Kuwaiti central bank chose a more active approach than its UAE peer by cutting its benchmark discount rate from 5.75 percent to 4.5 percent on September 29, followed by active liquidity injection which has led to declining interbank lending rates since October 5. In Saudi Arabia, SAMA cut its repo rate to 5.5 percent for the first time since 2007 and reduced reserve requirements from 13 percent to 10 percent on October 12. As SAMA has resisted rate cuts since September 2007 when the Fed started easing, there is room to maneuver for further rate cuts.

Generally, it seems that GCC central banks are increasingly following an accommodative stance

GCC Corporates (GCC): Spread above LIBOR, HSBC/ DIFX GBCI Index



concern about debt funding of local projects and the real estate market. As a vast amount of long-term projects have been financed with short-term funds, this maturity mismatch puts additional pressures in current tight capital markets.⁷

The syndicated loan market in the GCC is now severely disrupted, according to senior banking sources. International banks, which are a dominant force in the local project finance market as they have larger

in 2008 and \$35 billion in 2009, plus \$6.9 billion in local currency. Half of the outstanding debt will come from the UAE alone.¹⁰ Among those debts will be \$6.5 billion bond issues, which will need to be refinanced, such as the ones of Emirates Bank and Mashreqbank. The conditions that these issuers are facing have worsened considerably with spreads on GCC corporate bonds now much higher than the 80 basis points and over Libor and less that prevailed during 2006 and early 2007.¹¹

7 Also see Andrew England and Simeon Kerr, "Gulf Markets Suffer Heavy Losses," *Financial Times*, October 6, 2008, <http://www.ft.com/cms/s/0/ad4ad756-93d5-11dd-b277-0000779fd18c.html>.

8 "Gulf Syndicated Loan Market Severely Disrupted: Bankers," *Reuters*, October 2, 2008.

9 Christopher Mangham, "Large Lending Deals to the Gulf Dry Up," *The National*, October 2, 2008. <http://www.thenational.ae/article/20081002/BUSINESS/920528081/1049/BUSINESS>.

10 Merrill Lynch, GCC Quarterly, Research Note, October 9, 2008

11 "Gulf Firms Face \$6.5 Billion Refinancing," *MEED*, October 10, 2008.

While the direct subprime exposure of GCC banks has been limited thus far, the real problem for the GCC banks lies in the indirect exposure to increased costs of funding amidst maturity mismatches and credit exposure to local consumer, project and real estate financing.

at the expense of anti-inflationary considerations. However, they have acted unilaterally thus far and have not found a common policy like the European Union. If interbanking rates start to differ considerably due to different policies and their differing reception in each country, the more successful a country is in bringing down rates the more likely it is that it will attract borrowers from neighboring countries. Authorities will need to address this, otherwise

they may be tempted to impose some kind of capital controls to make sure that the accommodative measures they are undertaking will benefit their own economies and not evaporate via open capital markets.

Additionally, the sovereign wealth funds of the region have started to help out cash-strapped banks and corporations. The Kuwait Investment Authority (KIA) announced in September that it was considering investing within the country to prop up local capital markets, but no detailed figures about possible investment targets or troubled asset exposure of Kuwait banks were given. The announcement suggested some sense of urgency and estimates about the possible investment volume were as high as \$15 billion.¹² In an unprecedented move, the Qatar Investment Authority (QIA) set aside funds of \$5.3 billion on October 13 in order to buy up 10-20 percent stakes of the local Qatari

banks. Beside the liquidity easing measures of central banks and purchases of bank and company shares by SWFs, direct placement of SWF funds with local commercial banks to shore up their deposits could be a distinct possibility. It remains to be seen whether other GCC SWFs will follow the example of the KIA and QIA and whether they will play the white knight for a badly-shaken GCC banking scene should things aggravate further. Moody's assumes that Abu Dhabi would help out Dubai companies with equity if a systemic bail-out was needed.¹³ Bank mergers could also be a distinct possibility: National Bank of Dubai and Emirates Bank merged in 2007, and a merger is now also being contemplated for Abu Dhabi Commercial Bank and Abu Dhabi National Bank.

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Cranes are erected at the Dubai Marina, where scores of skyscrapers and towers are under construction



¹² Kuna, "Kuwait Investment Authority Announces Local Investment Increase," September 15, 2008, <http://www.zawya.com/marketing.cfm?zp&p=/Story.cfm/sidKUN0064080915130031/KIA%20Says%20It%20Will%20Increase%20Investments%20In%20Kuwait%20Market?cc>. Also see, Zainab Fattah, "Persian Gulf Shares Rebound on Fed's Bailout Plan; Emaar Climbs," Bloomberg

¹³ Moody's, "Demystifyin

The G20 and the GCC Agenda: The Need for an Economic and Political Agenda for the GCC States

Abdulaziz Sager

When the world's powers gather together during the month of November in the United States to begin a series of meetings to discuss the global financial crisis, the Gulf Cooperation Council states (GCC - Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) will be an important component of the discussion. While Saudi Arabia will be an active direct participant, the other GCC states will be keen listeners. To be sure, these states are impacted by the financial crisis just as much as other countries despite having large financial reserves based on their position as the world's most significant oil producers. In fact, the GCC states are likely to face a certain degree of pressure for an anticipated constructive role they will be expected to play. For example, US President Bush has already been suggesting that he is looking forward to the involvement of the Kingdom of Saudi Arabia in the summit. Similarly, British Prime Minister Gordon Brown has called for the Gulf States to contribute to a new fund facility being created within the International Monetary Fund.

In this context, it is important to remember that the GCC states have traditionally played a stabilizing role whether in terms of financial markets through their investment decisions or by maintaining price equilibrium and stable supplies to the world's energy markets. This position will not change. However, it is important that the discussions on the current financial crisis not be limited to the present economic agenda only but that the meeting also considers the

broader political context in which this crisis is occurring and being handled. For the GCC countries this is an important item on the overall agenda and it will be necessary for other participating countries, including the United States, to comprehend that solely seeing the position of the GCC states in economic terms is no longer sufficient.

The reason for a broader agenda is that the current global financial crisis

cannot and should not be seen in isolation. It is indeed the culmination and manifestation of a series of interrelated unresolved problems, which have led to accumulated tensions in the international political, security and economic system, tensions that are causing deep fractures in the system itself. One way to compare the situation is to relate it to how earthquakes occur. Here, tectonic plates are constantly in movement, getting closer or farther

President George W. Bush (R) walks hand-in-hand with Saudi King Abdullah at the G20 Summit at the National Building Museum on November 15, 2008 in Washington



from each other. Such movements create growing stress at the points of juncture between plates, stress which must be released either through multiple smaller adjustments (small earthquakes) or through a major, sometimes catastrophic event.

Today, we are witnessing a major earthquake whose epicenter is in the United States and in the financial system, but its origins are not exclusively in either of the two. The global system has accumulated stress in many of the plates that constitute it. This includes the following, not necessarily exhaustive, list:

- The international trade plate has seen rapid progress towards globalization, with shifting production of material goods from the traditional industrial countries to new emerging countries,



creating greater and greater trade imbalances with growing problems for employment in the industrial countries and the progressive disappearance of industry. These trends are not sustainable, in the sense that if one extrapolates them into the future, one comes to a vision which is paradoxical and clearly unacceptable. So, something must be done: not necessarily a complete reversal of liberalization, but surely a less ideological implementation of free trade, with exceptions and a degree of state re-involvement in the economy. Signs of that are already evident.

- The international energy system is characterized by a huge imbalance in the level of per capita energy consumption between the US and the rest of the industrial countries; between the industrial countries and the emerging countries; between even the emerging countries and the poorer countries, including almost the whole of Africa, where billions of people do not have access to commercial energy at all. Available reserves of fossil fuel together with environmental considerations clearly tell us that the current pattern of energy consumption in the industrial (and the GCC) countries is unsustainable. Something must change very radically if one wishes to be able to envision an acceptable scenario of the future.

- The international security system has been characterized by the unchallenged and unchallengeable supremacy of a single superpower, but whose immense military might has proven totally ineffective to achieve the objectives that matter. The US has not been able to win the war either in Iraq or in Afghanistan and has found its hands tied with regard to Iran. As a result, the US is looking like a useless superpower – it has the might to destroy the world but cannot impose its will unilaterally. This is an untenable position in the long run. The non-proliferation file

will probably be one on which things must change quite rapidly. Faced with the resurgence of interest in nuclear energy and the impossibility of keeping nuclear ambitions in check

Today, we are witnessing a major earthquake whose epicenter is in the United States and in the financial system, but its origins are not exclusively in either of the two. The global system has accumulated stress in many of the plates that constitute it.

in Iran or North Korea or elsewhere, the nuclear powers will either have to admit defeat or finally accept a substantial reduction in their nuclear arsenals. A complete rethinking of the US military strategy in the coming months and years is one aspect that can be anticipated.

- The international financial system is the easiest to understand just now. For years, the system has been based on deregulation and the massive encouragement of indebtedness for US consumers and enterprises, paralleled by growing government debt and trade deficit – all based on the thinking that this was the rest of the world's problem, not the US's. The rest of the world was expected to be forever happy to buy US assets – and it has been by and large, except that the system within the US itself at some point collapsed. It is very interesting that the crisis originated out of the mortgage market, not out of a global crisis of confidence in the US economy or the US dollar. That the US financial posture was untenable has been evident for years – but the IMF and everybody else hoped for a soft landing. Instead, the soft landing has turned into a crash with the result

The GCC states have traditionally played a stabilizing role whether in terms of financial markets through their investment decisions or by maintaining price equilibrium and stable supplies to the world's energy markets

that the international financial system will have to obviously be established on new bases.

All of the above only substantiates the claim that one cannot simply tackle the financial crisis without at the same time also addressing some of the political issues. For the GCC states, this means that they must concentrate on a few key points:

- Get from the United States a clear commitment that they will support regional integration – within the GCC and with the rest of the Arab countries. The US has been systematically sniping at the GCC and this must stop. In line with the

above, the GCC states should seek a commitment to honestly work towards a regional security system that is based on progressively building mutual trust rather than on the military presence of the US in the region.

- Get assurances that the trade system will be redesigned in a way that is not contrary to the interests of the GCC countries. This means a combination of openness to international trade with tolerance of state intervention which is geared to achieving developmental objectives. While this is very difficult to articulate in practice, the general idea is clear.
- Get assurances that a major effort will be made to put the non-proliferation train back on track, which includes negotiating a substantial cut in the arsenal of the nuclear powers and putting pressure on all countries to become parties to the NPT.
- Get assurances that the new international financial system will not tolerate systematic imbalances, not even in the US, and that

international investment will be free within well understood rules. There should be no discrimination against Sovereign Wealth Funds (SWFs).

- Ask for US support for the four key diplomatic initiatives of Saudi Arabia with respect to regional crises:
 - King Abdullah's peace plan to solve the Israeli-Palestinian conflict,
 - his diplomatic initiative to start a dialogue between the Afghan government and the Taliban,
 - the Saudi position towards a united Iraq in which all components share in power, and
 - the engagement of Iran in a regional context.

All of the above are essential points and they represent a comprehensive framework that the GCC states should pursue as the discussion about resolving the present global financial crisis proceeds. Isolated and single point solutions will not work and it is time to adopt a broader approach.

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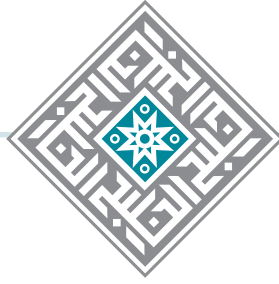
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Gulf Research Center

Knowledge for All

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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