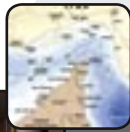


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Where is the UAE Islands Dispute Heading?



Japan-Iran 'Strategic Partnership' from a Broader Perspective



Oil Prices Flare Up: Market Fundamentals versus Speculative Activities

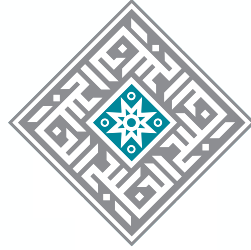


Turkey and the GCC States: A New Era of Bilateral Economic Relations



Climate Change Brings Water Troubles to a Boil

September 2008, Vol. 2, No. 5



Gulf Research Center
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Cover picture. A grab taken from the Yemeni television shows burnt cars outside the US embassy following an attack in the capital Sanaa on September 17, 2008. (Image courtesy of AFP)

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Where is the UAE Islands Dispute Heading?

Nicole Stracke

Iran's decision to open two new offices for maritime rescue and ship registration on the occupied island of Abu Musa in August 2008 sparked immediate criticism from the UAE government, the GCC states and in the wider Arab world. Abu Dhabi called it a clear "contravention of the 1971 Memorandum of Understanding with Iran" and sent a formal protest to the UN Secretary-General. The GCC states expressed their support for the UAE and issued a statement condemning the Iranian action, demanding the removal of its "illegal installations" and urging Iran to respect UAE's sovereignty. During a press interview, the GCC secretary general even went a step further and drew parallels between the Israeli behavior in occupied Arab lands and the Iranian conduct over the UAE islands.

The Iranian action may have come as a surprise to many observers who had expected Tehran to lie low at a time when it was faced with international pressure over the true nature of its nuclear program and over the legitimacy of the program in view of UN Security Council resolutions. One would have also thought that Iran would refrain from provoking its Gulf and Arab neighbors as it is in need of regional support. However, a second look shows that for Iran, the decision to establish administrative offices in Abu Musa is a calculated risk and probably, from the Iranian leadership's view, one that is worthwhile taking.

Earlier, the UAE restated its position on the question of the islands, this time publicly and more critically. In a speech by UAE State Minister for Federal National Council Affairs and Minister of State for Foreign Affairs Dr. Anwar Gargash delivered in Tehran before the meeting of the Non-Aligned Movement last June, the UAE minister firmly called on Iran to adhere to the basic principles of non-alignment which required a peaceful settlement of disputes, urging Tehran to respond positively to the UAE's "peaceful initiatives" and settle the UAE-Iran islands dispute through direct bilateral negotiations or by agreeing to refer the case to the International Court of Justice. This was a surprisingly outspoken statement from the traditionally cautious UAE. The fact that it was delivered in Iran and before an international gathering was significant and unquestionably displeased the Iranian leadership. The Iranian reaction came indirectly; without referring to the UAE Minister's statement, the Iranian government officials intensified their propaganda reiterating the claim that the islands are Iranian and there is no need for negotiations or ICJ intervention.

In fact, Tehran did not even recognize the dispute, calling it simply a "misunderstanding."

The decision to open new administrative offices at Abu Musa is a continuation of the Iranian policy of gradual and systematic colonization that has been in play since the late 1970s. This policy



has manifested itself in the form of a number of unilateral decisions taken by the Iranian leadership in clear violation of the 1971 MoU. The Iranian action aims to change the status quo of the islands. Iran calculates that once it lays down the foundation for its authority and control and changes the demographic set up of the islands, it will be able to change the reality on the ground and strengthen the Iranian bargaining position when the time comes to negotiate the issue of sovereignty over the islands. Changing the demographic set-up and expanding control is a common tactic employed by most occupying powers, as Israel has done over the years when it built new settlements on Palestinian land in the occupied West bank.

Moreover, by establishing the offices, the current Iranian government has tried to reinforce its credibility among hardliners. A hardline attitude on the issue of the islands is likely to enhance the government's popularity at home, as different Iranian governments have worked hard to convince the people that the islands are an integral part of the state's territory. Tehran also aims to prove to both its domestic and regional audience that it is able to stand up to regional and international pressure.

In dealing with the islands issue the UAE faces a major dilemma. On the one hand, the UAE cannot consider the military option as a means to reclaim its sovereign right over its occupied islands; the UAE government

has always emphasized the need to settle this dispute diplomatically. On the other hand, the UAE is unable to generate the required diplomatic pressure to force the Iranian government to seriously consider the settlement of this dispute by political or legal means. Iran is taking full advantage of this situation and gradually increasing its illegal presence on and control over the islands. Iran is well aware of the fact that the GCC states lack a united strategy towards the islands issue. The GCC states, no doubt, have been issuing strong statements condemning Iran's moves, however, there has been no action beyond rhetoric.

Iran's violation of the 1971 Memorandum of Understanding, its current threats to close the Strait of Hormuz thus interfering with the freedom of navigation in

The decision to open new administrative offices at Abu Musa is a continuation of the Iranian policy of gradual and systematic colonization that has been in play since the late 1970s. Iran calculates that once it lays down the foundation for its authority and control and changes the demographic set up of the islands, it will be able to change the reality on the ground and strengthen the Iranian bargaining position when the time comes to negotiate the issue of sovereignty over the islands

the Gulf waters, or the recent Iranian hints about its ability to destabilize the Gulf states and intervene in their internal affairs – should all give reason for the regional states to counter Iran. Yet, the UAE as well as other GCC states have no mechanism in place to counter Iranian defiance or its aggressive behavior. Ironically, Iran is still expecting the UAE to continuously follow its moderate policy and avoid a direct confrontation, and with good reason. Tehran understands that the UAE separates inconvenient issues such as the islands dispute from other parts of its foreign policy. Tehran assumes that sustaining a healthy business and economic relationship with Iran is one of the key elements of UAE foreign policy, and that the UAE will not jeopardize its business relations with Iran over the islands issue and will refrain from a direct confrontation. The recent developments in the islands issue only reflect the present Iranian government policy, and we may expect more of this belligerent behavior in the near future.

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Japan-Iran ‘Strategic Partnership’ from a Broader Perspective

Sachi Sakanashi

Japan had been under the “protection” of the United States since the end of the Second World War. The Article 9 of the “pacifist constitution” that Japan adopted after the war, which was drafted by the US occupation officials, forbids Japan to have a military or fight a war.¹ Attempts to amend Article 9 have not only received a strongly negative reaction from countries like China or Korea, which once suffered from Japan’s militarism, but they have been fiercely criticized inside Japan itself, where a majority of the people still support the constitution as a “fruit” of the bitter war experience.

What Japan can do in terms of security within the existing constitutional framework is, therefore, quite limited, while the United States has long urged Japan to “play a bigger role in the sphere of security,” especially since the end of the Cold War. However, it is also true that Japan today is trying hard to more actively engage in the security arrangement that surrounds it, not only by following US expectations, but also by developing a policy approach that represents Japanese interests more directly. Announcing the will to establish “strategic partnership” with Middle Eastern states should be understood in such a context. For Japan, simply the formal announcement of its determination to be more actively engaged is an important step that will promote the articulation of its interests, which could only be pursued on condition that they are beneficial not only to Japan but also to the Middle Eastern states, including Iran.

‘Strategic Partnership’ and Japan’s Middle East Policy

‘Strategic partnership’ is one of the key terms in contemporary Japanese diplomacy in the Middle Eastern region. Discussions about how to build strategic partnerships gathered momentum during the visit of Prime Minister Shinzo Abe to five Middle Eastern countries, namely Saudi Arabia, UAE, Kuwait, Qatar, and Egypt, in the spring of 2007.² Given that Japan heavily

depends on the Middle East for its oil supply, Japan has looked into items it can provide to the Middle East, such as high-level technologies or know-how on human resources development, which can then form a part of the social infrastructure, and could as a result form a broader basis for solid development as well as security in the long run.

It is important to note that Japan’s emphasis on “strategic partnership” is an outcome of the trial and errors that

Japanese Defense Forces officers salute local tribes leaders as they prepare to leave the town of Samawa, Iraq, 8 July 2006.



¹ The□

² See, for example, Masayuki Yamauchi, “Building a Strategi□□ May 24, 2007.

went along with the discussion on a “new world order” after the Cold War and, more specifically, after the 1990-91 Gulf crisis. At the time of the crisis, Japan was severely criticized for being passive and deciding too late to support the coalition forces. Japan’s \$13 billion contribution to the liberation of Kuwait was criticized by the US for not only being “too little, too late,” but also for “just sending money and not troops.”³ As such, Japan, which had been dependent on the US for its security for such a long time during the Cold War, was unsure what was meant by the United States when it stated that Japan was required to “take responsibility” as a growing economic power.

The need to make a decision “on its own” has been strongly felt by the Japanese government officials since then. The main question was what Japan should do in order to actively



engage in maintaining peace in the international arena within the existing constitutional framework. Although there were some who would argue that Japan should become a “normal country that can fight a war,” the Constitutional restriction does not allow Japan to do so. “Strategic partnership” was a term that was chosen within such a context. For Japan, “strategic partnership” means a mutually interdependent relationship based on demand for essential resources such as oil on the one hand and high-level technologies on the other.

US Pressure and Japan’s Decision

To what degree a change in Japanese policies has occurred was made evident by the fact that Japan actually sent troops to Samawah in southern Iraq in December 2003 as part of the coalition led by the US. Although Article 9 of the Constitution forbids Japan to have a military, Japan has maintained Self Defense Forces since the 1950s, with the interpretation that the Constitution does not ban Japan from defending itself. In this context, it was the Ground Self Defense Forces (GSDF) that were sent to Samawah with the rationale that they were dispatched not for the purpose of combat but for a humanitarian mission in the reconstruction process as authorized by the United Nations.

The attempt of the Japanese government to expand the scope of the activities of the SDF started soon after the 1991 Gulf crisis. After being criticized for “not sending troops,” the Japanese government made a decision to dispatch the SDF overseas for the first time since its establishment. As a result, the SDF were sent to the Gulf region to conduct a mine-sweeping operation from June to September 1991. The following year, in 1992, the government enacted a law to make

possible the dispatch of the SDF overseas to join the Peacekeeping Operations mandated by the United Nations.

After the September 11 incident, Prime Minister Junichiro Koizumi made a quick decision to send the SDF to the Indian Ocean in order to provide logistical and intelligence support for the North Atlantic Treaty Organization’s (NATO) operations in Afghanistan, based on a legislation of specified duration, the “Antiterrorism Special Measures Law.” This was ultimately followed by the dispatch of the Ground SDF to Samawah, which, it was claimed, was not in contradiction with the Article 9 of the Constitution, for “Samawah was not a combat zone” and the SDF’s activities would be simply “humanitarian.”

Whether the argument was convincing or not, what was evident was that the amount of discussion made regarding the dispatch of SDF to Iraq was far from enough, as the interpretation of the Article 9 in its application remained as ambiguous as ever. The fact that the “Antiterrorism Special Measures Law,” which authorized the MSDF operation in the Indian Ocean, could not gather enough support to be extended and thus expired in November 2007 shows that the opinions regarding the desirable role that Japan and the SDF should play in today’s world still deeply divide Japanese politicians. The Air SDF transport unit based in Kuwait that covers Baghdad and northern areas today may also have to leave once the UN mandate expires in December 2008.

US Pressure on Iran and Japan

While Japan’s relations with the Article 9 of the Constitution have always been ambiguous, its attitude towards Iran, which did not necessarily figure in any discussions on the SDF or Article

³ See, for example, “Japan’s Late Aid Only Enhances ‘Too Little, Too Late’ Image,” *The Washington Times*, March 12, 1991, and “Japan Weary of Bashing by US, Europe,” *Chicago Tribune*, June 11, 1991.

9, has been clearer. Regarding Iran, it is important to understand that US pressure on Japan to restrict its dealing with the regime in Tehran is not related to any inherent Japanese “military” capability. Instead, the facts are that Iran is the third biggest exporter of oil to Japan and both countries have maintained a close relationship even after the 1979 Revolution, during the same time that ties between the US and Iran completely disintegrated.

Within the context of the Japanese-Iranian relationship, it has to be recognized, of course, that Japan’s options vis-à-vis influencing Iranian policies are very limited. Although many had expected that the then President Khatami’s visit to Japan in October 2000 would open a “new chapter in Japan-Iran relations,” as was stated by the then Foreign Minister Yohei Kono on the occasion,⁴ the Azadegan oil field development contract, which was one of the outcomes of Mr. Khatami’s visit to Japan, had to be modified significantly once the pressure against Iran with regard to its nuclear activities got severe. Japan’s interests in oil-rich Iran, which can only be materialized on mutually beneficial terms, likely would never materialize due to the political environment that surrounds Iran today.

Furthermore, Japan is not included in the P5+1 negotiations with Iran, which consists of the permanent UN Security Council members plus Germany. Nevertheless, they are not the only negotiators with Tehran, especially when isolation is the last thing that today’s Iran would hope for in the international community. Iran is trying to involve as many countries as possible in the negotiation process, and Japan still believes that it has its own role to play as a country that has good relations both with Iran and the United States. Japan has attempted

to engage Iran in its own way in order to find a way out from the impasse of the Iranian nuclear issue, for the US accusations against Iran sometimes seem quite one-sided even to Japan.

As the only country against which atomic bombs were used during the Second World War, Japan has always put a priority on nuclear non-proliferation in its diplomacy. As such, it has fully implemented the UN Security Council resolutions regarding the Iranian nuclear issue as well as the financial sanctions imposed by the US-led “coalition of the willing.” Yet, it must be mentioned that Japan is somehow sympathetic towards Iran for a couple of reasons. First, Iran’s criticism of the “double standards” adopted by more powerful states on the issue of non-proliferation, for example, is regarded to have some truth in it. It is accepted that Iran is in fact in “non-compliance”

to the IAEA statute and, therefore, it was necessary to refer the case to the UN Security Council. At the same time, the nuclear weapons that are in Israeli possession are not even talked about. In addition, many in Japan were astonished when the United States extended India an offer of civilian nuclear technology assistance, a step that was supposed to be an exclusive privilege of the NPT signatory states.

Secondly, Japan also went through decades of effort to convince IAEA of the peaceful nature of its nuclear activities. Even today, after Japan has provided all the transparency required by the IAEA to eventually establish the nuclear fuel cycle on its own, some are still “suspicious” about Japan’s nuclear intentions.⁵ Japan thus is very aware of how difficult it is to prove the “non-existence” of something that actually does not exist.

Visiting Iranian Deputy Foreign Minister Abbas Araghchi is greeted by Japanese Foreign Minister Taro Aso for their talks at Aso’s office in Tokyo, 02 March 2007.



⁴ IRNA, “President Khatami arrives in Tokyo for ‘historic’ visit,” October 31, 2000.

⁵ About the “perennial speculation about Japanese nuclear intentions,” see, for example, Christopher W. Huges, “North Korea’s Nuclear Weapons: Implications for the Nuclear Ambitions of Japan, South Korea, and Taiwan,” *Asia Policy*, no.3, January 2007,

Third, the situation of Iran today reminds some in Japan of the path that the country went through at the beginning of the 20th century. Japan was then trying everything to “catch up” with the western powers, believing that it could, without fearing any possible consequences. Prime Minister Koizumi told the Foreign Minister of Iran, Manouchehr Mottaki, for example, that Japan once fought a war against the whole world and had to go through immense hardship because of that. He went on to say that Japan then decided never to isolate itself from the international community again, based on those experiences.⁶ It is in this context that Japanese statement of sympathy with Iran’s case must be understood as when Japanese Prime Minister Yasuo Fukuda asked Iran’s President Ahmadinejad to make a “courageous decision” to stop uranium enrichment.⁷

Japan has also faced US accusations for not “taking responsibility” on the subject of Israel and was criticized for the lack of “strong condemnation by the head of the state” regarding Ahmadinejad’s statements on Israel. While Japan actually condemned the declaration of “wiping a state off the map,” saying that it was unacceptable and the Foreign Ministry summoned the Iranian Ambassador to Japan to express concern about the declaration, it was nevertheless regarded by some in the United States as not going far enough. Instead, it was once again pointed out that Japan cannot be accepted internationally if it is not willing to “take responsibility, internationally.”⁸

Despite such criticism, when an orchestrated call for unity against Iran as a biggest threat to the “regional

order” is repeatedly heard, Japan cannot help but pose the question of who benefits most from such a “unity” and what is in fact meant by the “current order.” For example, is it an order in which Palestinian people are forced to live with what little they are given, or is it the one in which a “fairer solution” can be constantly sought with whatever opportunity that brings the issue forward?

Japan has a similar feeling towards an expression such as “Shiite Crescent” that is supposed to stretch from Lebanon to Iraq and is supported by Shiite Iran to “destabilize” the region. Japan wonders why it has to be presented as a “Shiite” threat, particularly when it seems that Hamas is also included in the “Crescent” these days. Japan then once again poses the questions “who are the ones that want to overtly emphasize the “Shiite” threat, in order to unite Sunni Arab leaders against Iran?” or “who fears most about losing military advantage vis-à-vis Iran?”⁹ Japan has tried to incorporate these ideas in the talks with Iran, in an attempt not to isolate but to engage Iran with the international community. Japan recognizes the huge potential that Iran has as a natural power of the Gulf region in terms of its size and both human and natural resources, and it believes that it is to the benefit of both Japan and Iran to build on the “strategic partnership” based on mutual cooperation in the long run.

Towards Proactive Diplomacy

There is no readymade answer to the question that Japan is faced with today: what kind of role Japan and the SDF should/can play in the changing international security environment.

The Japanese experience shows how difficult it is to get out of an existing security arrangement, whether or not it is a dependent one or a more independent one. What is certain, however, is the fact that the security

‘Strategic partnership’ is one of the key terms in contemporary Japanese diplomacy in the Middle Eastern region. Discussions about how to build strategic partnerships gathered momentum during the visit of Prime Minister Shinzo Abe to five Middle Eastern countries

environment is indeed changing and that Japan needs to be more proactive in pursuing its own foreign policy. Both Japan’s swift dispatch of the SDF to Iraq and its attempt to choose a different approach than that of the US regarding Iran can be regarded as attempts to find its own way more proactively compared to before. The trial and errors in the course of a search for a deeper “strategic partnership” with the Middle Eastern states will inevitably continue due to Japan’s history and the various advantages or restrictions that history has produced for Japan, especially since the Second World War. At the same time, no matter the setbacks it might experience in the future, there is no other way for Japan but to keep constantly trying to “find a better way” to engage with the international security set-up.

Sachi Sakanashi is a visiting researcher at the Gulf Research Center, Dubai

6 The statement made during the meeting of Prime Minister Koizumi and Foreign Minister Mottaki in Tokyo in February 2006. The Ministry of Foreign Affairs of Japan, February 28, 2006, http://www.mofa.go.jp/mofa/kaidan/yojin/arc_06/iran_souri.html

7 The statement was made during a talk between Mr. Fukuda and Mr. Ahmadinejad on the sidelines of the UN Food and Agriculture Organization Conference held in Rome in June 2008. See “Japanese PM asks Iran to Stop Uranium Enrichment,” *Kyodo World News*, June 3, 2008.

8 See Mindy Kotler, “Unrequited Responsibility: Japan and Iran,” *Asia Policy Calendar* 10, no.3, 2006.

9 See Ukeru Magosaki, “Peace and Stability in the Persian Gulf” (paper presented to the 18th International Conference on Persian Gulf: “Grounds for Regional Cooperation, Stability and Security,” June 17, 2008).

Oil Prices Flare Up: Market Fundamentals versus Speculative Activities

Dr. Samir Pradhan

On June 22nd, 2008, major oil producers and consumers met in Jeddah, Saudi Arabia, to deliberate on the causes of oil price spikes and share their concerns. All the participants were unanimous that current oil prices and their volatility are detrimental to the global economy. Oil being an ambivalent commodity (both economic and strategic), price analyses are complex and controversial. Nevertheless, there tend to be two facets of the 'great oil price debate'- structural and cyclical. Structuralists view the abnormal price spikes as a result of structural changes in the oil industry reflecting the huge investment gap over the last decade or so, accompanied by worries about reserves depletion.

The other facet asserts that the current price bubble is cyclical and due to the culmination of certain mutually reinforcing adverse factors pushing prices upwards. In other words, this reflects imminent physical shortages as a result of surmounting demand, geopolitically influenced supply bottlenecks combined with the bull-run in the futures market. This implies that if current prices are cyclical in origin, the bubble will eventually burst; if structural, prices will continue to stay sky-high. This article comprehensively analyses the two conflicting dimensions on the current oil price debate to derive plausible explanations.

Price Trends

Since the oil-glut of the mid 1980s, the real price (inflation adjusted) of a barrel of crude oil on NYMEX had been in the \$25/barrel band

till September 2003. A confluence of adverse events led the price to reach over \$60 by August 11, 2005, surpass \$75 in the summer of 2006, fall below \$60/barrel by the early part of 2007, then rise steeply, reaching \$92/barrel by October 2007 and \$99.29/barrel for December futures in

New York on November 21, 2007. The year 2008 saw oil prices hitting several new record highs¹ (See Figure1).

On January 2nd, 2008 US light crude surpassed the psychological barrier of \$100 before falling to \$99.69, due to political tensions in Nigeria and

Saudi Oil Minister Ali al-Nuaimi gestures as he speaks during a press conference at the end of a summit on the soaring international price of crude in Jeddah on June 22, 2008.



on suspicion that US stocks of crude will have dropped for the seventh consecutive week. The price of oil again rose to \$100.10 a barrel on February 19th after a Texas refinery fire, rumors about OPEC production cuts, and evidence that the supply of oil is decreasing faster than demand of oil. Oil prices rose above \$101 a barrel on February 27, 2008 and surpassed \$103 a barrel on February 29, 2008. The upward trend continued and prices surged above \$111 to a new

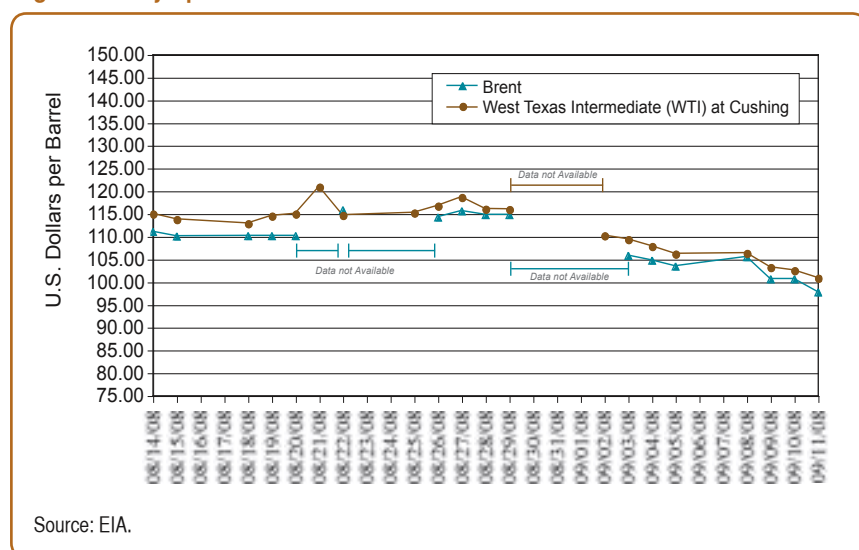
the price per barrel of oil passed \$135. In fact, this historical record oil price on 22nd May 2008 has just doubled from the level on the same trading day of the previous year (2007).

Divergent Views

The structural shift argument stresses on the strong industry view that future oil supplies will be scarcer than in the past because of inadequate investment and hence prices will be

impending supply shortage of crude compared to the conventional supply sufficiency paradigm of the 1990s. Such a prevailing industry view accompanied by tumultuous market fundamentals and geopolitical risk factors created the conditions for continuous northward movement of crude prices since 2003. Importantly, the advocates of peak oil hypothesis⁴, popularly known as 'depletionists' came out with new evidences showing premature decline in world oil reserves, that further added to the pessimistic scenario and panic among industry participants.

Figure 1: Daily Spot Prices of Brent and WTI Crude Oils



inflation-adjusted record on March 13, 2008 before sliding back to below \$110 amid fears of economic recession in the United States.

After continued surge, the record was again broken on March 17, 2008, with U.S. light sweet crude reaching \$119.90 a barrel on April 22, 2008. On May 9, 2008, the oil price exceeded \$125 per barrel for the first time, while on May 21, 2008 the oil price exceeded already \$130 per barrel of Brent Crude. In approximately 24 hours from May 21 to May 22nd, 2008,

higher. The evidence for a structural change in the oil industry lies in the futures curve for oil prices. On the basis of NYMEX futures curve², Paul Horsnell³ argued that between 1986 and 2002 while the front-end of the curve fluctuated between \$10 per barrel and \$ 40 per barrel, the back end (usually four-to-six years out) remained sticky around a band of \$ 18-21 per barrel. However, in the next one and half years, the back-end increased by over \$ 10 per barrel. This signifies a fundamental change in industry view about an

Countering the structural shift argument, Paul Stevens argued that the rising of back-end prices cannot be entirely explained by the perceptions about impending shortages as expounded by the Structuralists.⁵ He asserted that there is a definitive speculative element as spread trading has increased substantially in oil futures. However, if perceptions about shortage are believed partially to be the cause of current higher oil prices, then, it is due to investment deficiency in the oil sector.

It is a fact that huge investment needs to be made along the oil value chain in order to increase supply for the next five-to-ten years at least. The IEA estimated that between 2004 and 2030, an investment of \$ 2, 188 billion (on an average of \$ 81 billion per year) is required to increase oil supply.⁶ In the past higher oil prices would have encouraged higher investments in exploration and production, thereby creating a self-adjusting mechanism which increases production as a result of investment and thereby reduces

1 The price trends ment□

2 Futures curve generated by NYMEX gives futures prices for West Texas Intermediate (WTI) up to six years out.

3 Oxford Energy Forum, August 2004.

4 Peak oil is the point in time when the maximum rate of global petroleum production is reached, after which the rate of production enters its terminal decline. M. King Hubbert first used the theory to argue that the production rate of a limited resource will follow a roughly symmetrical bell-shaped curve based on the limits of exploitability and market pressures. Matthew Simmons, a strong advocate of the hypothesis believe the high dependence of most modern industrial transport, agricultural and industrial systems on the relative low cost and high availability of oil will cause the post□

5 Paul Stevens, "The Future Price of Crude Oil", *Middle East Economic Survey (MEES)*, Vol. XLVII, No. 37, September 13, 2004.

6 International Energy Agency (IEA), *World Oil Investment Outlook*, Paris, 2004.

price. This situation has considerably changed since 2002 and the oil industry witnessed structural transformations⁷ in which the major oil companies increasingly adopted value-based management practices as their main financial strategy amidst mergers and acquisitions. Even with higher oil prices, the major oil companies are not being

at the cost of strategic investments required to acquire new reserves and developing crude capacity.

The other extreme somehow optimistic viewpoint attributes the current spate of price spurts to be purely cyclical. Oil has been traded globally for more than a century, and commodity pricing in

in demand as well as OPEC and non-OPEC supply. In the short term, the movements in crude oil price are influenced by geopolitical events, movement of financial markets, expectations and psychology, whereas, in the medium to long run, the fundamentals of demand and supply (production capacity) will prevail, resulting in a self-price-correction mechanism. Lehman Brothers, an influential investment bank came out with a report arguing that the twin forces of economic recession and expanding supply will moderate upward pressure on the oil price as new refineries being brought on-stream, new fields being opened and falling demand from the China and India. They project that prices could fall to \$83 next year and as low as \$70 by 2010. Against such contrasting viewpoints, it is pertinent to analyze the market fundamentals and the speculative dimension in great detail.

Figure 2: Continental Oil Consumption, 2007

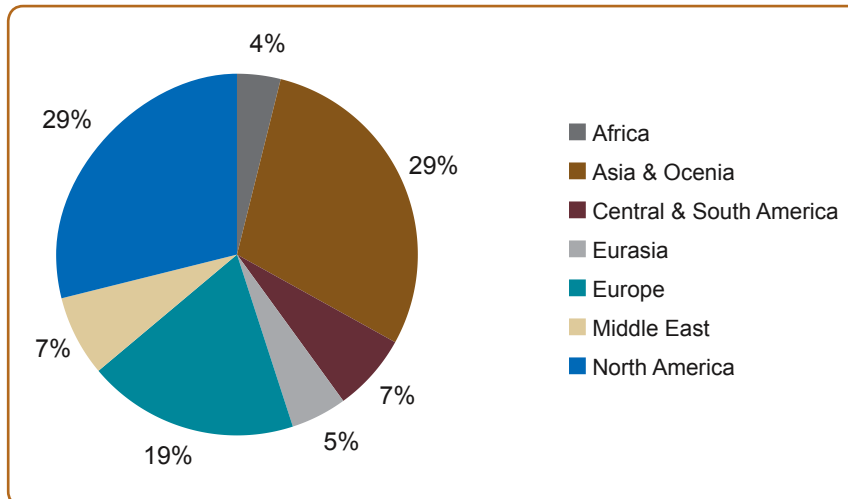
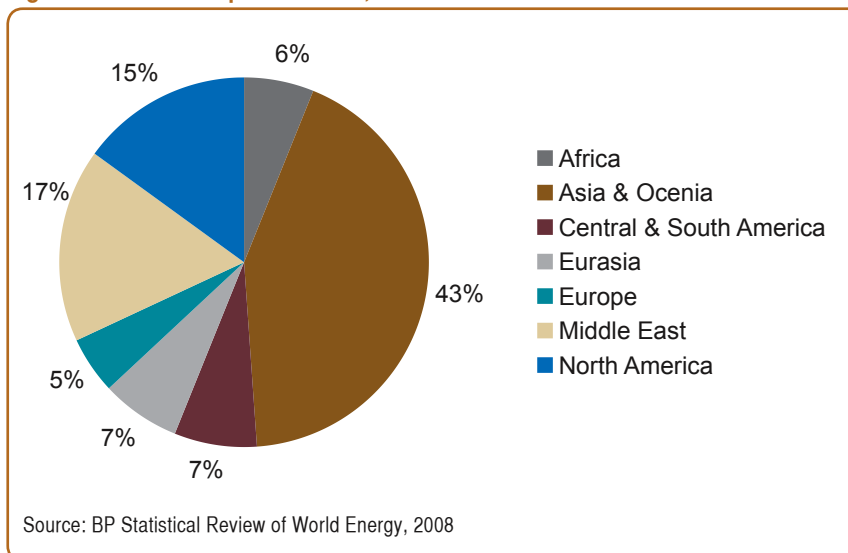


Figure 3: Oil Consumption Growth, 2003-2007



able to invest more⁸ due to the prevailing capital asset pricing model⁹ which saw competition among major companies to keep their shareholders happy by returning funds. As a result, very short term benefits to share prices accrued

the oil sector is well-established. Crude oil prices behave much as any other commodity with wide price swings in times of shortage or oversupply. The crude oil price cycle may extend over several years responding to changes

Market Fundamentals

Barring cataclysms, it is certain that market fundamentals are the main reason for the broader 5-year move up in oil prices and will continue to considerably influence prices. In the last decade or so, the demand-supply configuration of the world oil market has undergone substantial changes. It is no more the industrialized West that is the main demand center, but the emerging locomotive economies of the developing world especially the Asia. With growth spurts, energy consumption especially oil and natural gas has increased substantially, making them an important element in global demand for oil and gas. In 2006, the developed industrialized economies consumed a disproportionate share of the world energy with North America accounting for about half of the total

⁷ For a detail discussion on the subject see Samir Ranjan Pradhan, "The Global Oil and Gas Regime: Analytical Overview of Structural Transition", in *India, GCC and the Global Energy Regime: Exploring Interdependence and Outlook for Collaboration*, Chapter 1, (Academic Foundation, New Delhi, 2008).

⁸ It is estimated that a \$ 1 rise in oil prices increases the earning of the major oil companies by nearly 6 percent.

⁹ If the company cannot provide a rate of return at least equal to the general stock market and to its appropriate sector, it should return funds to the shareholders rather than investing them itself. This is achieved either through higher dividends or share buy-backs pushing up the share prices.

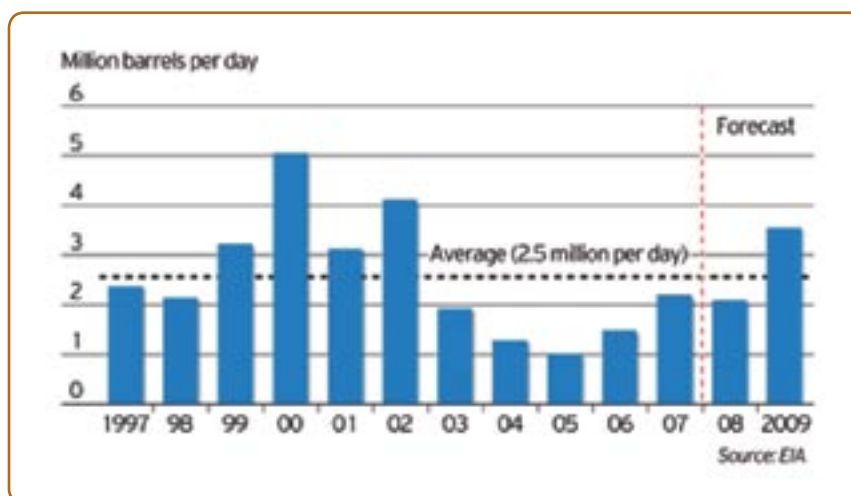
oil use. Important to note that, it is the newly industrialized countries and oil producers that account for the recent rapid growth in demand, with Asia and the Middle East accounting for 60% of the increase in petroleum use between 2003 and 2006. North America and Europe contributed only 1/5 of the growth (See Figures 2 and 3).

The most dramatic in this growth has been China, whose petroleum consumption between 1990 and 2006 increased at a 7.2% annual compound rate. If that rate of growth were to continue, China would be using 20 million barrels a day by 2020, about as much as the U.S. is today. By 2030, China would be up to 40 mb/d, twice the current U.S. consumption.

On the supply side, the main players in the crude oil market are OPEC—which currently provides about 40 percent of world supply and holds about 70 percent of proven reserves. A number of non-OPEC producers and exporters have successfully entered the supply arena. Russia has become an important oil exporter alongside the major OPEC-exporter Saudi Arabia, so as Venezuela and other African countries. OPEC, as the residual supplier, tries to maintain spare capacity in order to influence crude oil prices. In recent years, its policy has been to balance the market while allowing for an ‘appropriate’ level of crude oil inventories in consuming nations. Non-OPEC producers, on the other hand, have relatively limited reserves and spare capacity, and generally behave as price takers.

In the last five years when quantity demanded has been at par with productive capacity, OPEC’s ability to lower prices has become limited. From the last quarter of 2004 to first quarter of 2005, in an effort to meet surging demand, OPEC kept

Figure 4: OPEC surplus crude oil production



production and official quota at record levels. As a result, crude oil inventories rose significantly in major importing markets and prices slid down. This prompted the member countries to cut production in order to boost prices. However, this accommodative stance toward demand, together with limited investment in capacity in the past two decades, has resulted in a significant reduction in OPEC’s excess capacity, currently estimated at 2.2 mbd¹⁰, thus limiting OPEC’s monopoly power and its ability to influence global prices (Figure 4). As a result, the current price-output configuration in the crude oil market is essentially a competitive equilibrium in the short run.¹¹

Thus, price spikes supported by current market fundamentals, appear largely to reflect the uncertain environment and expectations about future tightness in the market. Strong demand continues to put pressure on production capacity, thereby contributing to upward price pressures. It also appears that—unlike in the 1990s, when OPEC’s ability to satisfy excess demand provided a stable anchor for expectations—even transitory events now seem to motivate precautionary or profit-seeking buying, resulting in price movements that at times do not appear justified by current market fundamentals. Indeed,

a large part of the price increase (both spot and futures) appears to reflect uncertainty regarding future market conditions. In this context, geopolitical developments, fears of potential supply and refinery disruptions, and other factors may place upward pressure on spot prices by feeding into expectations. As a result, in May 2008, speculation in futures market seems to overtake market fundamentals in influencing prices to higher trajectory.

Speculative Dimension

The significant rise in longer-dated futures prices reflects the perception of continued tightness in the physical market, and is facilitated by increased investor interest. The futures market in the United States has deepened considerably since 1990s, with short-dated contracts increasing from around 30 percent of the U.S. crude oil production in the 1990s to 85 percent in mid-2007. Longer-dated futures prices are also responding more to daily oil market news, suggesting that while market participants are more actively forming views about prospects for supply and demand, their assessment of the likely impact on future prices has become more uncertain. This has also created incentives for new players who, through hedging or speculative

10 In the year 2006, it was only 1.4 mbd excluding Iraq.

11 Pelin Berkmen, et al, “The Structure of the Oil Market and Causes of High Prices” *IMF Paper*, September 21, 2005.

activities, can potentially benefit from the uncertainty surrounding future supply. As massive money flowed into the oil futures market amid global excess liquidity, open interest of crude futures and options contracts expanded from 700,000 contracts (700 million barrels) in the middle of 2003 to nearly 2.5 million contracts (2.5 billion barrels) at the end of November 2007. Key players in the energy markets span a diverse group of commercial and non-commercial investors. The set of so-called commercial traders—traditionally oil producers and energy companies that tend to hedge—has been expanded by the growing number of investment banks and hedge funds who own energy-producing facilities, and the emergence of specialized energy trading firms in the wake of deregulation. Moreover, it has been noted that various influential market players such as pension funds, hedge funds and sovereign wealth funds have poured massive money into oil futures market which is relatively small in size as compared to traditional asset class, contributing price spike. Furthermore, the distinction between commercial and non-commercial traders is increasingly blurred as non-commercial traders may enter into swap arrangements in which commercial traders act as their agent.¹²

In fact, the new entrants to energy markets have added diversity to the market and could have been a source of liquidity and price discovery. As per industry estimates, approximately \$120-140 billion of new investment in the past five years has been in active and passive energy investment vehicles.¹³ It is also observed that hedge funds, which seek to arbitrage perceived inefficiencies in market valuations, typically employ more active investment strategies and have influenced market outcomes in the short term. In contrast, the index-related vehicles used by passive

investors tend to be strategic (i.e., seeking portfolio benefits such as diversification) and relatively long-term in nature, responding to perceptions of a structural component in recent price movements. However, while the new investors could be instrumental in translating expected future fundamentals into current prices, excessive activity based on limited information have led to a disconnect between the futures and physical markets. In particular, excessive activity by newcomers or herd behavior by investors could have exaggerated the impact of concerns about current and future supply conditions at all points along the futures curve, including spot prices. Given that only about 5 percent of futures contracts are ever delivered as a physical product, increased uncertainty have encouraged speculative behavior in the futures market. This, in turn, has pushed up futures prices beyond that warranted by future market fundamentals.

Conclusion

It is evident that market fundamentals combined with expectations of continued tightness have been the primary influential factor determining world oil prices for the last five years. Investment deficiency, production and refining constraints and surging demand have contributed to tighter market conditions and hence higher oil prices. Though, significant increase in activity in the futures market appears to have an impact on the long dated futures prices, do not considerably influence higher spot prices. Moreover, speculative activities by market participants appear to follow, rather than lead, spot prices. Therefore, it becomes imperative to devise suitable regulatory practices in order to anchor market expectations to facilitate appropriate price discovery. Given the fact that there is a lead time of

The crude oil price cycle may extend over several years responding to changes in demand as well as OPEC and non-OPEC supply. In the short term, the movements in crude oil price are influenced by geopolitical events, movement of financial markets, expectations and psychology, whereas, in the medium to long run, the fundamentals of demand and supply (production capacity) will prevail, resulting in a self-price-correction mechanism

nearly four years between investment and production in the oil sector, new production are expected to come into the market and smoothen prices. Importantly, oil demand expectations as hyped by various projections are not certain to ascend higher trajectories given the current recessionary trends. Thus, it is reasonable to argue that the recent oil price surge is cyclical in nature. Nevertheless, the overall functioning of the crude oil market could be enhanced and excessive upward pressures on prices reduced by providing accurate information. This implies urgent focus should cater to provide better quality and more timely data on current production, consumption and inventory, oil reserves, and planned investment by both international and national oil companies, that would facilitate the adjustment of market participants' expectations to shifts in fundamentals, and improve decision making.

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¹² IEEJ, Oil Market Report, Japan, January 2008.

¹³ Platts Oilgram Database, February 2008.

Turkey and the GCC States: A New Era of Bilateral Economic Relations

Nermina Biberovic

Economic relations and commercial activities between the Turkish Republic and the Gulf Cooperation Council (GCC) have been steadily expanding in recent years. Since 2005, the GCC has adopted a convergent policy towards Turkey, when both entities institutionalized their relations through a framework economic cooperation agreement as part of plans to initiate FTA negotiation talks. Bilateral trade and investment volumes have since then been rising steadily and a series of Memoranda of Understanding (MoUs) and accords ranging from the elimination of double taxation, the prevention of tax evasion, air service regulations, and various further initiatives to increase trade and investment, have strengthened these developments. At the same time, reciprocal high-level official meetings, a rise in trade delegations, increased participation in trade fairs, the establishment of business councils as well as institutionalized committees like the Turkish-Arab Economic Forum have become inherent parts of a pertinent dialogue, which underlines a mutually profitable and beneficial partnership for both economies.¹

In August 2006, King Abdullah of Saudi Arabia visited Turkey, the first official visit by a Saudi King to Turkey in 40 years. According to Saudi Arabia's Foreign Minister, Prince Saud Al-Faysal, the visit opened "a new chapter" in the political and economic relations between the two countries.² A second official visit of King Abdullah to Turkey followed in November 2007. In the same year,

Turkey's Minister for Economic Affairs, Mehmet Şimşek visited Kuwait, the UAE and Qatar to promote investment in Turkey. Later, in early 2008, he particularly encouraged Saudi Arabia to invest in Turkey.³ Relations further consolidated on the sidelines of the 108th GCC Foreign Ministers' meeting under the Qatari chairmanship on September 2, 2008 in Jeddah, when the Foreign Ministers

Qatari Prime Minister Shaikh Hamad bin Jassim al-Thani shakes hands with Turkish Foreign Minister Ali Babacan after signing an agreement to boost ties between the Gulf Cooperation Council (GCC) states and Ankara in Jeddah on September 2, 2008



¹ For a comprehensive overview on GCC-Turkey relations with a special focus on security issues, see Valeria Fiorani Piacentini and Elena Maestri, "The GCC and Turkey vis-à-vis the EU," in *The EU-GCC Relations and Security Issues: Broadening the Horizon*, edited by Christian Koch (Dubai: GRC, 2008), 211-234.

² "Saudi King Abdullah's Turkish Visit 'New Chapter' in Relations," *Today's Zaman*, August 8, 2008. Available at: <http://www.todayszaman.com/tz-web/detaylar.do?load=detay&link=35450> (accessed September 14, 2008).

³ "Turkey Pursues Share of Largest Fund" *Today's Zaman*, January 15, 2008. Available at: <http://www.todayszaman.com/tz-web/detaylar.do?load=detay&link=131677> (accessed September 1, 2008).

of the GCC member countries and Turkish Foreign Minister Ali Babaçan held a joint meeting, during which the Turkish Foreign Minister expressed confidence that the implementation of the planned FTA between the GCC and Turkey “would serve the common interests of both sides.”⁴ In a significant move forward, a strategic MoU was signed between Qatar’s Prime Minister and Foreign Minister Shaikh Hamad bin Jassim bin Jabr Al-Thani, Turkish Foreign Minister Ali Babaçan and GCC Secretary-General Abdulrahman Al-Attiyah. It establishes the base and a regular consultation mechanism for a high-level dialogue, ensuring that the bilateral and regional challenges and opportunities are adequately responded to. One of the driving forces behind this “firm move to bolster bilateral relations in various spheres” was clearly the intention of both parties to broaden economic collaboration.⁵ Al-Attiyah characterized the accord as a “milestone in the history of bilateral cooperation” (...) “further paving the way for the conclusion of the FTA.”⁶

Turkey’s economic focus on the Middle East and the Gulf is multi-dimensional:

Firstly, Turkey – an essential energy corridor - lacks its own vital energy reserves and imports most of its oil and gas requirements. A closer dialogue in energy affairs with the wider Gulf, particularly with Iraq and Iran for natural gas supply and Saudi Arabia for crude oil supply, is seen necessary to secure the country’s energy supplies.

Secondly, Turkey’s economic activism is a response to structural changes in its own economic environment and internal political-economic developments. In the past, Turkey’s considerations to play an active economic role in the Middle East/Gulf have been mainly constrained by the country’s limited economic capabilities.⁷ After several decades of state-led import substitution policies, in the 1980s the government under Turgut Özal triggered an era of growth by following an economic policy of domestic and external liberalization. This period was mainly driven by a dynamic, internationally-oriented private sector, which in turn led to diversified patterns of regional engagement including investment relations with the GCC states. Since the end of the Cold War, Turkey has further engaged in the region, gradually diversifying its foreign (economic) policy in line with the economic approach of the 1980s. The end of the bipolar world enabled a broader engagement in regional trade and opened a new chapter in Gulf-Turkish economic partnership.⁸

As a response to the 2001 financial crisis, substantial macro-economic and structural reforms were implemented. This led to Turkey’s “post crisis recovery period,” with a gradual improvement of the fiscal situation underpinning a period of high growth for the economy. Inflation and interest rates have fallen, the currency has stabilized, government debt has declined and business and consumer confidence

have returned. Overall, economic growth has been strong and stable – with average GDP growth rates of 7.2 percent per year from 2002 through 2007, thus enhancing the attractiveness for foreign investment. The Justice and Development Party (AKP), which took power in 2002 and further solidified its power in the legislative elections in July 2007, has repeatedly pledged its support for the continuation of the ongoing economic reform agenda and the further globalization of the Turkish economy, with Turkey increasing its export share in international markets and encouraging foreign investment in Turkey.⁹ Interestingly, during May 2008 - July 2008, Turkey’s exports to the UAE surpassed its exports to the Russian Federation – one of Turkey’s major export markets - for the first time. While it is clear, that Turkey’s will continue to emphasize trade and investment relations with its traditional partners in its own national interest, strengthening ties with MENA/Gulf markets, will prove to be an important element of a further gradual geo-economic diversification.¹⁰ The recent customs dispute between Turkey and Russia is an interesting indicator for Turkey’s unique sensitive geopolitical position which requires a wise and broadened approach in economic affairs.

Finally, one may also consider Turkey’s economic relations with the Middle East/Gulf in the context of a “reorientation of Turkish foreign policy”¹¹ with the country rediscovering its neighboring Arab

4 “GCC Turkey Eye Strategic Ties,” Kuwait News Agency, September 3, 2008. Available at: http://www.grc.ae/index.php?frm_action=article_details&sec_type=d&sec=News&frm_pkid=426715&frm_str_category=art_details&frm_source_id=&frm_month_year=2008_09&override=&frm_module=news (accessed September 3, 2008).

5 Qatar’s Prime Minister and Foreign Minister Shaikh Hamad bin Jassim bin Jabor Al-Thani, cited in *The Peninsula*, September 6, 2008. Available at: http://www.grc.ae/index.php?frm_action=article_details&frm_module=news&sec=News&sec_type=d&frm_str_category=&frm_pkid=427363&frm_month_year=2008_09 (accessed September 6, 2008).

6 “Gulf States to Boost Links with Turkey,” AFP in *Gulf News*, September 1, 2008. Available at: <http://www.arabnews.com/?page=24§ion=0&article=113671&d=2&m=9&y=2008&pix=world.jpg&category=Gulf>. (accessed September 1, 2008). Mariam Al Hakeem, “GCC Names Turkey First Strategic Partner outside the Gulf,” *Gulf News*, September 3, 2008. Available at: <http://www.gulfnews.com/News/Gulf/gcc/10242265.html> (accessed September 4, 2008).

7 Fiorani Piacentini and Elena Maestri (2008), 211-234. Among the largest share of exports in terms of total value are industrial products (textiles), iron and steel, food, electrical machinery and equipment, machines and mechanical equipments, road vehicles/parts and chemicals. See Oxford Business Group, *The Report 2008 Turkey*.

8 More so, as the loss of the Iraqi market due to Turkey’s compliance with the economic sanctions against Iraq further hurt Turkish export performance. It has to be noted that prior to 1990, Iraq was Turkey’s largest export market. See Valeria Fiorani Piacentini and Elena Maestri (2008), 211-234.

9 OECD Economic Surveys: Turkey, Volume 2008/14, July 2008.

10 Fiorani Piacentini and Elena Maestri (2008), 211-234. Turkey is also developing its multilateral economic relations further under the Organization for Economic Cooperation (ECO) as well as with the countries of the Organization of Islamic Conference (OIC) under the Standing Committee for Economic and Commercial Cooperation (COMCEC).

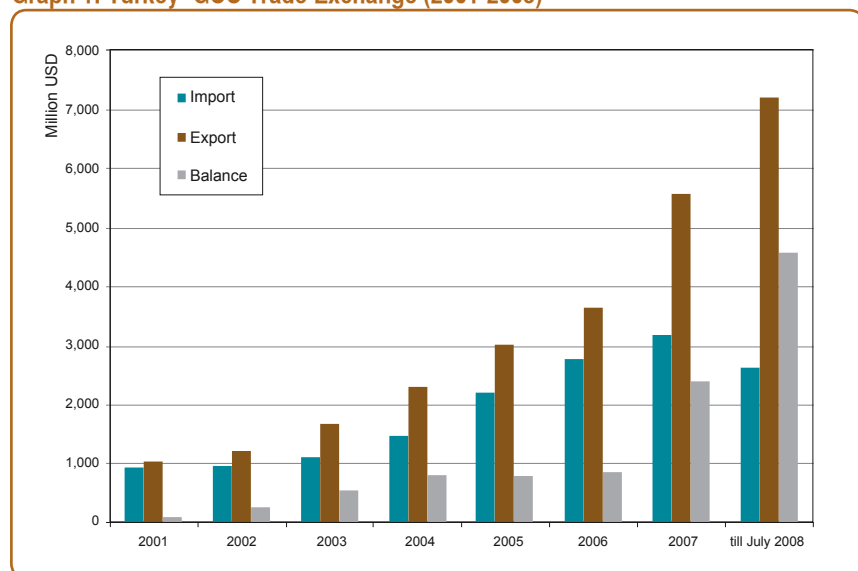
11 Stephen Larrabee, “Turkey Rediscovered the Middle East,” in *Foreign Affairs*, July/August 2007.

countries. From a Gulf perspective, GCC's economic dynamics towards Turkey follow a general trend: based on the inflow of oil revenues, which allowed accumulation of budget surpluses, GCC states are capable of investing abroad – mostly in the form of acquisitions.¹² While – as a matter of course - acquisitions depend on various commercial and strategic considerations and circumstances,

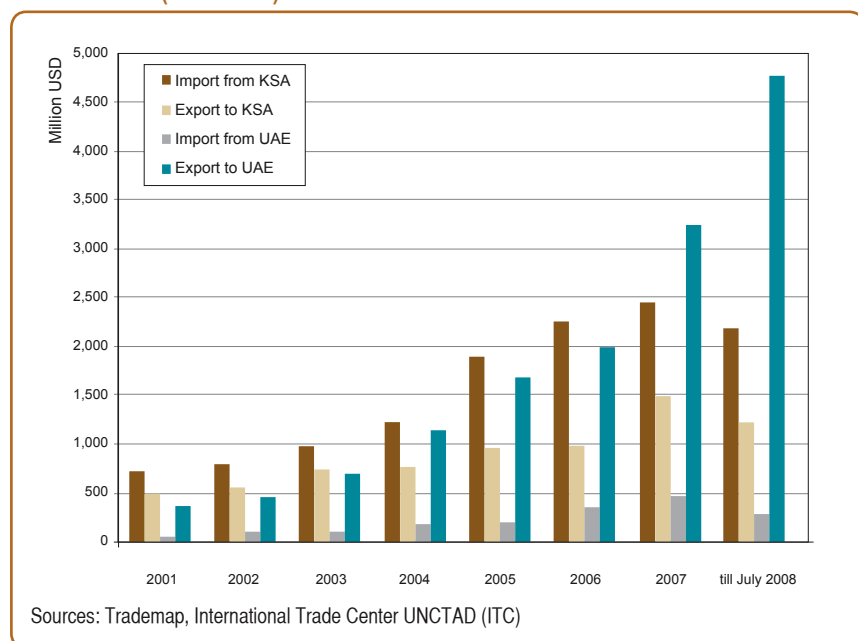
Turkey's central geo-economic positioning also plays a key role in these considerations. The country has one of the largest populations in the Middle East. Strategically located, its proximity to the Balkans and the EU market, as well as to growing emerging markets in MENA and Central Asia, makes it a relevant diplomatic and economic player, internationally. The economic

stability fostered by the official launch of Turkey's EU accession talks in 2005 is another major factor which has boosted investors' confidence. Overall, Turkey's strong macroeconomic growth, substantial reforms in the financial, energy, and telecommunications sectors, including a series of privatizations of large state-owned institutions and revisions of the FDI regulatory laws, have contributed to a rise in FDI inflows, especially from the Gulf. Noteworthy is the fact that Turkey currently has one of the most liberal legal regimes for FDI in the OECD; the private sector is open to FDI – except in areas where national security is concerned.¹³

Graph 1: Turkey -GCC Trade Exchange (2001-2008)



Graph 2: Turkey's Trade with its Major GCC Trading Partners: KSA and UAE (2001-2008)



Bilateral Trade Relations

Turkey and the GCC states enjoy a strong trade relationship. The trade volume between them has been rapidly expanding in recent years reaching a total volume of \$8.7 billion in 2007 and more than \$9.8 billion in the first seven months of 2008. Turkey's most important GCC import partner is Saudi Arabia with 77 percent of all imports from the GCC. Imports mainly consist of mineral oil products. Turkey's main export partner in the GCC was till 2003 Saudi Arabia with a nearly 50 percent share of Turkey's total exports directed towards the GCC. These consisted mainly of iron and steel, machinery and carpets. Since 2004, more than 50 percent of Turkey's exports to the GCC reach the UAE, increasing to a share of 58 percent of total Turkish GCC exports in 2007. In the first seven months of 2008, around 9 percent of Turkey's total exports went to the GCC, thus making the Gulf region the second largest export partner after Germany. Exported commodities mainly comprise iron, steel and

¹² Giacomo Luciani, "International Mergers and Acquisitions: The New Frontier of Gulf Economic Diversification," in *Gulf Yearbook 2007-2008* (Dubai: Gulf Research Center, 2008), 127-142.

¹³ Accordingly, foreign investment is limited to 20 percent of equity participation in broadcasting and up to 49 percent in aviation, maritime transportation, port services and telecommunication. For an excellent introduction on the developments of Turkish FDI regulations, see Svitlana Khyeda, "Foreign Direct Investment in the Middle East, Major Regulatory Restrictions," in *Insight Turkey* 9, no. 2, see in particular p.78 ff

precious stones. The volume of trade between Saudi Arabia and Turkey, and the UAE and Turkey, has grown substantially in the past five years. Saudi Arabia's trade volume with Turkey stood at roughly \$4 billion in 2007, UAE's trade with Turkey accounted for around \$3.7 billion in the same year highlighting Turkey's comparative advantage in iron and steel products and the increasing presence of Turkey's cost-effective and renowned construction companies in Gulf's construction industry.

GCC's Investments into Turkey's Privatized Assets

Turkey-MENA/GCC investment flows are imbalanced. In 2007, over 90 percent of all FDI from MENA to Turkey originated in the GCC, while on the other hand, a relatively small share of Turkey's FDI to MENA went to GCC countries. Overall, the volume of Turkish investment in GCC countries remained marginal in the past. An increase of Turkish FDI towards the GCC, however, is projected, in particular in the context of the planned GCC-Turkey FTA.¹⁴ Currently, Turkey's investments in the GCC mainly focus on the construction and energy sector although country and sector specific data for Turkey's outward FDI are generally inadequate.

Due to the volatile activity of mergers and acquisitions, FDI figures might be distorted if short time periods are assessed. However, if we analyze the last five years, the EU-27 has contributed most to the foreign direct investment in Turkey. It is noteworthy that since 2004, disregarding the exceptional year of 2007, foreign direct investment from the GCC states towards Turkey has accelerated. The GCC states were the second largest

investors in Turkey before the USA. In 2005 and 2006, significant 10 respectively 20 percent of the overall FDI in Turkey originated from the Gulf. Furthermore, already in the first six months of 2008, the Gulf States' contribution to Turkey's inward FDI reached \$1.6 billion, which is roughly half of the EU 27's share or 27 percent of Turkey's overall foreign investment inflow. Hence, the increase of FDI from the GCC into Turkey has been evident since 2003 and is expected to continue as the ongoing privatization offers attractive investment opportunities.

The privatization program in Turkey evolved in the 1980s, as part of the government's liberalized economic policy agenda.¹⁵ In several stages, the objects and assets to be privatized were identified. In the first phase, those sectors which promised the highest profitability, such as telecommunication (Türk Telekom), cement industry and airport services (HAVAS), were privatized. Later, the privatization expanded to include Turkey's largest ports (Izmir, Derinçe), major public banks (Halkbank, Ziraat Bank, Vakıfbank),

petrochemical company PETKIM, electricity distribution networks [Turkish Electricity Distribution Co (TEDAS)] and its affiliated industries, power plants [Electricity Generation Co (EÜAS) Power Plants], rail and road networks, national gas distribution, airports (Istanbul's Sabiha Gökçen Airport), tobacco and cigarette factories (TEKEL), national lottery licenses, food processing industries (edible oil company, Yudum, and the sugar factory, Türkiye Şeker Fabrikaları) as well as smaller assets and companies. Besides its privatization agenda, Ankara consistently sought to encourage foreign investment in the real estate, infrastructure, healthcare and renewable and nuclear energy sectors. Today, FDI is concentrated in the domestic market-oriented activities, which are strongholds of the GCC economies.

Banks and Financial Intermediaries

In Turkey, the number of banks and financial institutions has increased rapidly after the liberalization of the banking sector. A growing number

Table 1: Turkey's FDI Inflows (2003-2008): A Comparison (in \$ Millions) Between EU 27, USA, Asian Countries, Near and Middle Eastern Countries, Gulf Arabian Countries

	(Million \$)	2003	2004	2005	2006	2007	January-June	
							2007	2008
European Union(27)	563	1,027	5,006	14,489	12,918	6,035	3,761	
European Union(27)% of Total	76%	86%	59%	82%	66%	55%	62%	
USA	52	36	88	848	4,213	3,531	233	
USA% of Total	7%	3%	1%	5%	22%	32%	4%	
Asian Countries	59	6	78	17	777	436	78	
Asian Countries% of Total	8%	1%	1%	0%	4%	4%	1%	
Near and Middle Eastern Countries	1	11	3	127	297	178	187	
Near and Middle East% of Total	0%	1%	0%	1%	2%	2%	3%	
Gulf Arabian Countries	0	43	1,675	1,783	311	102	1,617	
Gulf Arabian Countries% of Total	0%	4%	20%	10%	2%	1%	27%	
Total	745	1,190	8,535	17,639	19,435	10,877	6,063	

Source: Turkey Treasury. Available at: [http://www.treasury.gov.tr/irj/go/km/docs/documents/Treasury%20Web/Statistics/International%20Direct%20Investment%20Statistics/Tables/Tables\(2008%20June\).xls](http://www.treasury.gov.tr/irj/go/km/docs/documents/Treasury%20Web/Statistics/International%20Direct%20Investment%20Statistics/Tables/Tables(2008%20June).xls) (accessed September 2, 2008).

¹⁴ Dunia Turkish MENA Investment Survey: June 30, 2008 (Executive Summary). Dunia Frontier Consultant Washington, D.C./ Dubai. Available at: <http://www.dfcinternational.com/files/DuniaTurkishMENAInvestmentSurvey30June2008.pdf> (accessed September 1, 2008).

¹⁵ The intention behind the program was to increase industrial productivity and efficiency and to accelerate the economy's growth. For a detailed overview on the developments, legal and structural adjustments, see Meral Tecer, "Privatization in Turkey," *Cahiers d'études sur la Méditerranée Orientale et le Monde Turco-Iranien*, No.14, Juillet-Décembre 1992. Available at: <http://www.ceri-sciencespo.com/publica/cemoti/textes14/tecer.pdf> (accessed September 2, 2008).

of conventional and Islamic banks from the GCC have established a representative office in Turkey, applied for a license or formed partnerships with Turkish banks. Among them are Doha Bank, Dubai Bank, Dubai Islamic Bank, ABC Islamic Bank, Amlak Finance, Dubai Bank and the National Bank of Kuwait Capital, Qatar Islamic Bank. On the other hand, banks from Turkey, like the Yapi Kredi, have opened a branch in the Gulf (Bahrain).

Kuwait Finance House (KFH) was the first Kuwaiti firm to invest in Turkey when it entered the Turkish market in 1983 with Kuveyt Türk Participant Bank, in which it still holds 62 percent shares. As part of its expansion policy, KFH urged the bank to set up independent banks also in Turkey where it is already a shareholder in Islamic banks like Kuveyt Türk, one of the largest Islamic banks in Turkey in terms of assets.¹⁶

Among one of the most substantial transactions in the finance sector was the acquisition of a 60 percent stake in Türkiye Finans Katılım Bankası AS (TF) for \$1.08 billion by the National Commercial Bank of Saudi Arabia in April 2008.¹⁷ In mid-2007, the National Bank of Kuwait (NBK) acquired a 40 percent stake in Turkish Bank for \$160 million.¹⁸ Increasing interest from Gulf investors is noted in the privatization of the state-run Halkbank, the

seventh largest bank in Turkey by assets, which was included into the privatization portfolio on August 11, 2006. From an initial 25 percent stake that was offered in April 2007 and was 11 times oversubscribed, 11 percent went to Kuwait Investment Authority (KIA) to give it a 2.75 percent stake in the bank. After Turkey's Parliament passed a law in 2007 that allowed the further privatization of the state lender

Halkbank in the near future, without specifying whether it will sell a majority stake to a single investor, or shares in an IPO.²⁰ In April 2008, Shamil Bank, a subsidiary of Ithmaar Bank, announced that it has successfully met the \$90 million target for the Shamil Bosphorus Modaraba. There was a strong interest in the Islamic investment model from regional institutional investors looking for

Turkish President Abdullah Gul shakes hand with King Abdullah of Saudi Arabia during a welcoming ceremony at the Cankaya Palace in Ankara, 9 November 2007



and further paved the way for the privatization of Vakıfbank and Ziraat Bank, KIA has indicated interest in buying more stock.¹⁹ In June 2008, Turkey's Finance Minister Kemal Unakıtan said that the government would announce a sale plan for

access to this high growth sector in Turkey. The focus is on residential and mixed-use real estate developments in Istanbul, and secondary homes on the Turkish coast. The total cost of the projects targeted is approximately \$450 million.²¹ Shuaa Capital, Dubai's

¹⁶ "Kuwaiti Oil Export Success Spillovers to Finance," in *Turkish Daily News*, February 26, 2008. Available at: <http://www.turkishdailynews.com.tr/article.php?enewsid=97343> (accessed September 1, 2008). Also see "Middle East poised to invest in Turkey," *Ameinfo*, August 17, 2008 (accessed September 2, 2008).

¹⁷ Originally, in May 2007, UG and BG announced that they were seeking a buyer for their 50 percent interest in TF. "NCB to Buy Turkish Bank," *Reuters*, March 1, 2008. Available at <http://www.arabnews.com/?page=6§ion=0&article=107365&d=1&m=3&y=2008> (accessed September 1, 2008).

¹⁸ National Bank of Kuwait, "National Bank of Kuwait expands in Turkey with the Conclusion of a 40% Acquisition of Turkish Bank". Available at: <http://www.nbk.com/NBK/About+NBK/Press+Room/Latest+Press+Release/turkishbank.htm> (accessed September 1, 2008).

¹⁹ http://www.invest.gov.tr/haber_display.aspx?haberID=7551.

²⁰ *Bloomberg*, July 16, 2008.

²¹ Mahmood Rafique, "Shamil Achieves \$90m Target for Bosphorus Modaraba," in *Arab News*, April 13, 2008. Available at: <http://www.arabnews.com/?page=6§ion=0&article=108901&d=13&m=4&y=2008> (accessed September 1, 2008).

Abraaj Capital and NBK Capital have also expressed their interest in private equity and real estate opportunities for their Gulf-based clients.

Energy/ Petrochemicals

Implementing the privatization of PETKIM, the largest Turkish petrochemical company, the Turkish authorities handed over a 51 percent controlling stake worth \$2.04 billion to the SOCAR-Turcas-Injaz consortium in May 2008.²² Injaz Projects a developer and provider of technical and financial services for oil and energy projects with base in Riyadh owns 10 percent of the majority share acquired by the consortium.²³ Further, Turkey's Turkerler and the UAE's Crescent Petroleum have formed a joint venture, Inci Gaz, to acquire 3.5 billion cubic meters of gas per year from Iraq.²⁴ Saudi Basic Industries Corporation (SABIC) has formed a polystyrene joint venture with Baser Petrokemya of Turkey. SABIC will hold 70 per cent, with Baser holding the remainder. The joint venture will take over all of Baser's polystyrene assets in Turkey, including an Adana-based plant with a capacity of 40,000 tons. SABIC will market the joint venture's entire product. SABIC is already involved in polystyrene through wholly owned affiliate Petrokemya, while another affiliate, SADAF, produces styrene. On the other hand, business opportunities have opened up for Turkish companies also, for developing the energy sector in

the Gulf. For example, Turkey's Fernas Construction has secured a \$100 million contract from Qatar Petroleum to construct gas pipelines and support systems at its Ras Laffan and Mesaieed complexes.²⁵

Telecommunication

When in November 2004 the Turkish Privatization Agency offered 55 percent of Türk Telekom through a "block sale," there were two telecom majors from the Gulf, Saudi's Oger Telecom and UAE's Etisalat,²⁶ among the bidders. Finally, Oger Telecom Consortium, comprising Oger Telecom, Telecom Italia and BT Consult, purchased the 55 percent controlling stake for \$6.55 billion.²⁷ In May 2008, the Turkish government sold another 15 percent of Türk Telekom shares in an IPO, which turned out to become the fifth-biggest in the world raising \$1.9 billion. According to Turkey's asset sales agency, at least 30 percent of the \$1.15 billion coming from foreign investors, originated in the Gulf and Middle East.²⁸

Construction, Retail, Real Estate, Logistic

Since the 1980s, Turkish construction companies and construction workers have been involved in the Gulf region's construction boom. Currently, in the UAE, Turkish construction companies are involved in the development of Palm Island, Dubai Metro, International

City and various Dubai Municipality infrastructure projects worth billions of dollars. A SR 100 million crane manufacturing facility as part of a Saudi-Turkey collaboration is being set up near Haraaj in south Jeddah.²⁹ Emirates Financial Towers (EFT) has signed a \$120 million agreement with TAV (Tepe Akfen VIE Investment Construction and Operation) to work on the Dubai International Financial Center (DIFC) project. The Islamic Development Bank (IDB) Infrastructure Fund, an affiliate of IDB, and Kuwait's Global Investment House both hold stakes in TAV Airport Holding Company.³⁰

One of the factors restricting the interest of Gulf investors has been the high land prices in Turkey, as much of the land is privately owned and sold at market rate. In North Africa for instance, Gulf developers entered the market relatively quickly as they were able to purchase undeveloped government-owned land at low prices. Among Emaar's key projects in Turkey are retail, commercial and hotel development that could require as much as \$10 billion in investment.³¹ Sama Dubai, a Dubai Holding subsidiary, and the Istanbul Metropolitan Municipality agreed in 2005 to build a multi-use tower complex, called Dubai Towers, in Turkey's commercial city of Istanbul. The first project worth \$500 million within the \$5 billion investment venture is currently on hold awaiting legal clearance in respect of the selling of the land.³²

22 "Consortium Pays \$1.7 billion, Takes over Petkim", in *Turkish Daily News*, May 31, 2008. Available at: <http://www.turkishdailynews.com.tr/article.php?enewsid=106005> (accessed September 2, 2008).

23 http://www.pipelinedubai.com/press/2007/pr_07_0584.html.

24 *Middle East Newsline*, August 1.

25 "Turkey's Fernas Wins \$100m Gas Deal," *MEED*, November 27, 2007. Available at: http://www.meed.com/energy/gas/news/turkeys_fernas_wins_100m_gas_deal.html (accessed September 7, 2008).

26 Will McSheehy, "Etisalat Has Its Sight Set outside the Gulf," in *Financial Times*, June 21, 2008. Available at: <http://www.ft.com/cms/s/2/30e299e0-e26e-11d9-84c5-00000e2511c8.html> (accessed September 1, 2008).

27 Turkcell, "The"

28 "Türk Telekom IPO Yields \$1.9 Billion," in *Turkish Daily News*, May 13, 2008. Available at: <http://www.turkishdailynews.com.tr/m/a.php?id=104332> (Accessed September 9, 2008).

29 K.S. Ramkumar, "Crane Factory to Become Operational Soon," *Arab News*, February 12, 2008. Available at: <http://www.arabnews.com/?page=6§ion=0&article=106700&d=12&m=2&y=2008> (accessed September 1, 2008).

30 "EFT, TVI Sign Agreement on Fully-Automatic Parking Area," *Arab News*, March 14, 2007. Available at <http://www.arabnews.com/?page=6§ion=0&article=93652&d=14&m=3&y=2007> (accessed September 1, 2008).

31 "\$60 Billion Worth Projects by Emaar at Cityscape," *Arab News*, December 3, 2006. Available at: <http://www.arabnews.com/?page=6§ion=0&article=89472&d=3&m=12&y=2006> (accessed September 1, 2008). "Emaar Turkey Unveils Tuscan Valley Houses at Special Dubai Preview," May 26, 2007. Available at: <http://www.emaar.com/MediaCenter/PressReleases/2007/May26.asp> (accessed September 1, 2008).

In March 2007, Kuwait Investment Authority (KIA) acquired the Cevahir Shopping Center in Istanbul for \$750 million. Dubai port operator DP World is developing the Yarimca container terminal at Izmit where it also owns the land.

Food and Agriculture

Aiming to establish strategic food reserves, several GCC states have been eyeing agricultural investment in Turkey. So far, projects have been launched in areas such as agriculture, stockbreeding, biofuels, biomedicine, and agriculture technologies by Gulf Finance House, Ithmaar Group and Abu Dhabi Investment House.³³ In the food sector, Saudi Arabian food company Savola completed its \$71 million acquisition of edible oil firm Yudum Foods in January 2008.³⁴ The Kingdom also showed interest in the privatization of the Türkiye Şeker Fabrikalar, Turkey's major sugar production facilities.³⁵ As part of its effort to address its water shortage challenges, Saudi Arabia has awarded a SR1.44 billion contract to a consortium of Yüksel İnşaat Saudia Co. and Turkey-based Yüksel Construction LLC to build a water transmission system.³⁶

Conclusion

Several states in the Middle East have emerged as dynamic economic forces and as such are actively promoting regional cooperation initiatives. Under the current Qatari chairmanship

Under the Qatari chairmanship of the GCC, Turkish-Gulf relations have been institutionalized to promote a strategic bilateral high-level dialogue. (According to Gulf officials) the accord has been characterized as a "milestone in the history of bilateral cooperation" (...) "further paving the way for the conclusion of the FTA

of the GCC, Turkish-Gulf relations have been institutionalized through the establishment of a regular consultation mechanism to promote a strategic high-level dialogue between the two sides. One essential motive behind this move is clearly the broadening of economic collaboration among the top economies of the region (Saudi Arabia, UAE, Turkey) as their interaction has proven to be beneficial for all parties in the recent past. The GCC states are increasingly interested in strategic, industrial investments in Turkey in areas where they have strong expertise such as banking and finance (including Islamic finance), petrochemical, telecommunication, retail/ real estate/ logistics as well as in the food industry and the agricultural sector. Among Gulf SWFs and state owned entities, KIA and Dubai Holding - as far as disclosed - have been increasing investments in Turkey in the recent past. Whether

the slump in oil prices and KIA's recent announcement to increase its participation in investment funds in the local market will affect their Turkey investment portfolio, remains to be seen.³⁷

On the other hand, Turkey's export-oriented economy is increasingly integrating the Gulf States into its export portfolio. According to figures released by the Turkish Exporters' Assembly for the month of August 2008, Turkey's exports to the UAE were worth nearly \$1.15 billion and hence surpassed Turkish exports to its former number one export partner, Germany.³⁸ This trend clearly indicates a new orientation of Turkish trade flows towards the Gulf and substantiates the future potential of the planned GCC-Turkey FTA. Such a relationship offers the opportunities to engage in broader regional circles, in particular as there seems to be a rising sense among the region's political leaders that long-term economic viability, and thus the security of the region, will be determined by progress in economic realms. At the same time, however, the concept of an enhanced dialogue among the region's strongest economic entities should not evolve into a competition for power among regional players. Rather, it should serve as a paradigm for deeper and wider cooperation aiming at regional prosperity in the broader Gulf.

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32 "Sama Dubai and the Istanbul Metropolitan Municipality Unveil 'Dubai Towers-Istanbul' at \$500 million," October 24, 2005. Available at: <http://www.sama-dubai.com/news/051027.asp> (accessed 14.09.2008).

33 Ebru Tuncay, "Turkey the Winner in Gulf's Investment Hunt," *Turkish Daily News*, September 1, 2008. Available at: <http://www.turkishdailynews.com.tr/article.php?enewsid=114127> (accessed September 1, 2008).

34 "Savola Buys Turkey's Yudum for \$53 Million," *Arab News*, November 25, 2007. Available at: <http://www.arabnews.com/?page=6§ion=0&article=103967&d=25&m=11&y=2007> (accessed September 2, 2008).

35 Hatice Aydođdu, "Turkey May Start Sugar Factory Sale within a Month," *Reuters*, July 12, 2008. Available at: <http://www.turkishdailynews.com.tr/article.php?enewsid=109622> (accessed September 3, 2008).

36 M.Ghazanfar Ali Khan, "Yüksel Secures SR1.44 Billion Water Transmission Project," *Arab News*, July 1, 2007. Available at: <http://www.arabnews.com/?page=6§ion=0&article=90579&d=1&m=7&y=2007> (accessed September 1, 2008). Also see "Saudi Arabia: Al-Hussayen Signs SR 1.4 Billion Deal" Available at http://www.middleeast-electricity.com/upl_images/news/SaudiArabiaAlHussayenSignsSR14bnDeal03March08ArabNews.pdf (accessed September 12, 2008).

37 "KIA to Boost Investment on Local Bourse", in *Arab Times*, September 16, 2008. Available at: [http://www.gulfintimedia.com/index.php?m=economics&id=429281&lang=en&PHPSID=17799f8aede740cc2fc03c5d96a59669](http://www.gulfintimedia.com/index.php?m=economics&id=429281&lang=en&PHPSID=17799f8aede740cc2fc03c5d96a59669&lim=60&PHPSID=17799f8aede740cc2fc03c5d96a59669) <<http://www.gulfintimedia.com/index.php?m=economics&id=429281&lang=en&PHPSID=17799f8aede740cc2fc03c5d96a59669>

38 United Arab Emirates becomes Turkey's main import

Climate Change Brings Water Troubles to a Boil

Dr. Mohamed Abdel Raouf
and Faith Hu Jingyi

Everyone seems to agree that climate change has brought about changes in sea levels and the weather. It is also commonly believed that conflicts in areas like Darfur are caused by a combination of factors such as ethnic differences and resource scarcity. However, it is not often that we draw the links between the global phenomena of extreme weather or acute variations in rainfall to civil strife in Africa and other arid regions. Climate change has become a prominent aspect of national security in recent years, and a water-scarce area like the Arab Gulf region would find it unwise to neglect the climate change issue in policy decision-making.

Hence, besides analyzing the general effects of climate change on water and the impact of water scarcity on civilizations, this article also makes policy recommendations specific to the GCC states.

The More Precious Commodity: Oil or Water?

Natural resources are the real wealth of nations. As is well-known, GCC countries are rich in oil and gas reserves; however, they are poor in water resources and arable lands. According to the UN, all the GCC countries, except Oman, fall in the category of 'acute scarcity.' This means that these countries have an annual renewable water capacity of less than 500 cubic meters per capita. Environmental analysts say it is closer to 100 cubic meters.

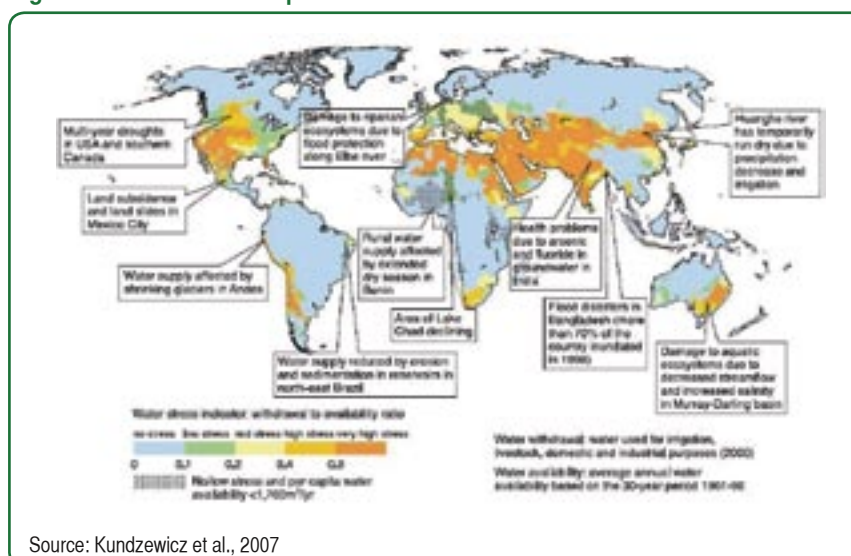
Physical water scarcity occurs because of the area's traditionally low annual rainfall. As a result, the region is largely dependent upon unsustainable groundwater abstractions. The major causes of increasing water demand include

population growth, rapid urbanization, and wasteful consumption patterns in the domestic, industrial and agriculture sectors. Besides, the efficiency of water systems, when compared to those in other parts of the world, could be improved. While water is in short supply because of natural and climatic conditions, water consumption in the GCC countries ranges between 300–750 liters per person per day, which is among the highest in the world. Water policies need a lot of reform.¹

It is worth highlighting that the GCC, while experiencing rapid economic development, is faced with many potential problems relating to availability and use of water. Unless all necessary measures, including policy reforms are adopted, the countries are likely to face water scarcity which in turn will have negative impacts not only on the environmental front but also on the security, economic and social fronts.

To better understand the potential effects of climate change on water resources and the potential fallout of water shortage, the problem of water scarcity is first analyzed from a broader perspective.

Figure 1: Water Stress Map



Source: Kundzewicz et al., 2007

The Effects of Climate Change

Climate change is often equated to global warming. While global warming alters the Earth's climate, there are also other elements in our ecosystem that contribute to climate change. Violent weather, changes in temperature, precipitation patterns and snowmelt, and even the length of seasons are all

part of climate change, and these have severe environmental impacts on the world.

When asked to think about the kind of impacts that climate change has, we intuitively relate it to ecological consequences such as drought, shrinking bodies of water, rising sea levels and land degradation. These ecological symptoms then affect inhabitants in the affected area; some are positive, such as warmer winters in some parts of the world, but, by and large, the poorest regions of the Earth like Asia and

like food and water, can create hotbeds of tension and strife, as people fight for these necessities in a bid to survive. Thus, it is important to better understand how human tragedy resulting from these struggles can be prevented.

To truly appreciate the full effects of climate change on a country's stability and peace, we will first look into how it impacts the key resource for survival – water – and analyze disputes and conflicts, both past and present, to gain a clearer picture of the link between climate change and security.

and a source of conflict. In fact, the English word “rivalry,” derived from the Latin “rivalis,” basically means “one using the same river as another”². Water is also inextricably linked to the health of a population – fresh water is required for consumption, sanitation and irrigation of cropland. Availability of water has a direct influence on agriculture, which in turn affects the harvests and livelihoods, particularly in subsistence farming areas.

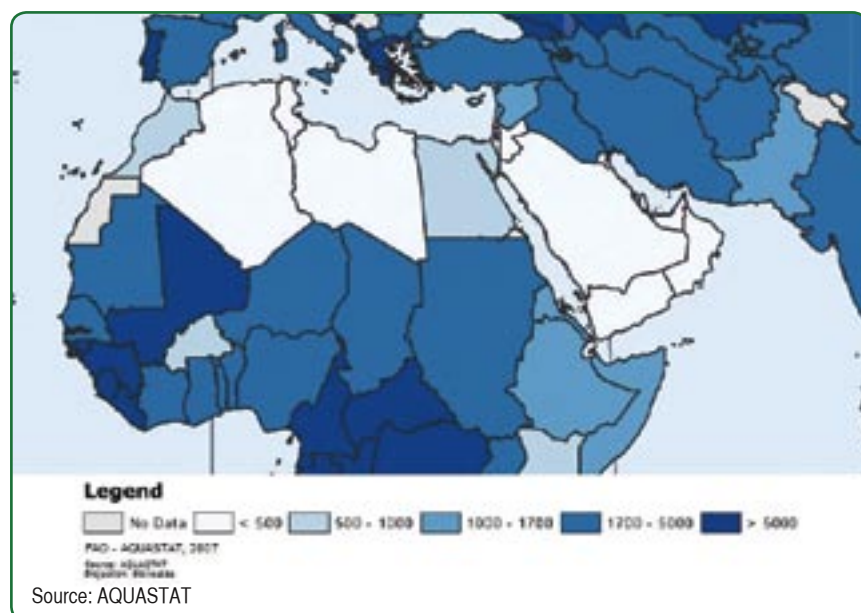
Climate change affects the movement of water and precipitate with erratic temperatures and weather patterns. A strong finding of hydrological impact studies is that:

“[Global] warming leads to changes in the seasonality of river flows where much winter precipitation currently falls as snow. This has been found in projections for the European Alps, the Himalayas... and in many cases peak flow would occur at least a month earlier. Winter flows increase and summer flows decrease... with higher flows in the peak flow season and lower flows during the low flow season or extended dry periods.”³

The rise in overall temperature generates increased snowmelt and glacier melt, and although surface water flows increase in the short term, the receding glaciers due to the warmer climate mean that glacier melt will decrease and so will river flows in the long run over the next few decades⁴.

Besides factors such as increased human demand for groundwater due to erratic rainfall patterns and reduced surface water flows in the summer in snow-dominated basins, rising sea levels will also have an

Figure 2: Actual renewable surface water & groundwater resources per inhabitant - 2005



Africa will suffer the effects of climate change in a less-than-pleasant way – not entirely because of the ecological nature of the region, but also due to the lack of social infrastructure and good governance in the developing countries to cope with the situation. That being said, climate change can exacerbate the conditions and make it even more difficult for countries to recover from existing conflicts or to maintain peace. Scarcity of resources essential to life,

Impact on Water Resources

Water is arguably the source of life and is at the heart of the problem of climate change – glacier melt, rising sea levels, drought and desertification are all water-related issues. Historically, civilizations rise near the banks of major rivers and are heavily dependent on them for water, agriculture, transportation and trade. Water has always been both a blessing

² Tulloch, J. (2008, March 19). Water Conflicts: Fight or Flight? Allianz Knowledge. Retrieved July 10, 2008 from http://knowledge.allianz.com/en/globalissues/climate_change/natural_disasters/water_conflicts.html

³ IPCC, 2007: Climate Change 2007: Impacts, Adaptation, and Vulnerability. Contribution of Working Group II to the Third Assessment Report of the Intergovernmental Panel on Climate Change [Parry, Martin L., Canziani, Osvaldo F., Palutikof, J.

⁴ Kundzewicz, Z.W., L.J. Mata, N.W. Arnell, P. Döll, P. Kabat, B. Jiménez, K.A. Miller, T. Oki, Z. Sen and I.A. Shiklomanov, 2007: Freshwater resources and their management. Climate Change 2007: Impacts, Adaptation and Vulnerability. Contribution of Working Group II to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, M.L. Parry, O.F. Canziani, J.P. Palutikof, P.J. van der Linden and C.E. Hanson, Eds., Cambridge University Press, Cambridge, UK, 173-210.

The major causes of increasing water demand include population growth, rapid urbanization, and wasteful consumption patterns in the domestic, industrial and agriculture sectors

impact on groundwater recharge rates. Changes in saltwater levels could result in saltwater intrusion into aquifers, rendering the groundwater un-potable. Water quality will be affected by higher surface water temperature which promotes algal blooms, increases bacteria and fungi content, creating a bad odor and taste in chlorinated drinking water.⁵

On the whole, all regions of the world show an overall net negative impact of climate change on water resources and freshwater ecosystem.⁶ In the foreseeable future, water shortage will almost certainly be exacerbated by climate change, especially in semi-arid and arid regions. The water stress map in Figure 1 gives a clear indication of areas of water shortage and demand.

It is hardly surprising to note that some of the most parched regions of the world also suffer from perennial unrest. Although superficially it seems that extrinsic factors like rising food prices are the reason for the tensions among the people, it is often the dependence of agriculture on scarce water supply that is at the root of the problem.

Although seldom the trigger for wars, the thirst and desperation created by water shortage or a threatened water supply fuels existing tensions

between peoples. The most reported violence over water resources is probably the simmering conflict between black farmers and Arab nomads in Darfur, Sudan. Drought and desertification in the northern parts of Darfur has led to migration of the Arab nomads to the south of Darfur, where they came into contact with black African farmers and started disputes over land and water resources. Deeper investigations of such conflicts reveal that what seems to be a dispute caused by ethnic divide in fact has its roots in water resource distribution.

The conflict in Darfur is by no means an isolated example. Table 1 uses past water conflicts in history to illustrate the severe consequences that can arise from threats to water resources. Genuine water scarcity refers to situations where there is a real natural shortage of water in the region and not one resulting from restriction or control of water sources. Water used as a political tool refers to the control or cessation of water sources for extortion or threat by neighboring states even when water is abundant in the region.

The importance of water to survival is shown clearly in the above examples. Historically, warring states made use of existing water resources to threaten the opposing country by poisoning wells or controlling access to water supplies that were not necessarily scarce. However, recent conflicts over water are triggered by a genuine shortage more than accessibility. This is a worrying sign as it is no longer a situation of territorial dispute and ownership; the control of the circumstances has left the hands of the warring states and it is now a massive problem that calls for global responsibility and responsiveness.

Who Is Responsible Now?

A malfunctioning hydrological cycle is the cause for water shortage along with an unprecedented increase in demand for water in the areas most affected by conditions like drought, severe heat, land degradation and desertification that makes wasteland of what used to be arable soil. As the freshwater sources dry up gradually over the next few decades, more conflict over this key resource of survival can be foreseen. While resource management is important in order to prevent further deterioration, it is only half of the solution.

The compelling evidence of climate change and its toll on freshwater resources makes every country responsible for water shortages the world over. This complicates matters when it comes to reaching a consensus as to how much each one of us should do in order to curb the problem. Firstly, it is difficult to see from the point of view of a single person or country what difference we can make by reducing carbon emissions or recycling products. Secondly, it is much easier to be indifferent to the plight of others and remain passive about the situation. Thirdly, it is hard to be convinced of the necessity of action when the effects of climate change have not hit us hard enough. This complacency which we suffer from will cost us dearly in the future if we only decide to react when it is too late.

Water has implicitly become part of basic human rights and to be wasteful, or to deprive others of an essential element of survival, or even use it as a military/political tool is increasingly unacceptable. Major polluters of the atmosphere may not initially seem to be taking away this basic right, but their prolonged contamination of the Earth makes them guilty of the same crime.

⁵ Ibid

As defined by the United Nations as anything below 1,000 cubic meters per capita of average annual water supply.

⁶ Gleick, P.H., 2008: Water Conflict Chronology. Pacific Institute for Studies in Development, Environment and Security.

CONFLICTS CAUSED BY WATER SHORTAGE

I. CAUSED BY GENUINE WATER SCARCITY IN REGION			
Date	Parties involved	Description	Sources
1947-1960s	India, Pakistan	Partition leaves Indus basin divided between India and Pakistan; disputes over irrigation water ensue, during which India stems flow of water into irrigation canals in Pakistan.	Bingham et al. 1994, Wolf 1997
1951, 1953	Israel, Jordan, Syria	1951 - Jordan makes public its plans to irrigate the Jordan Valley by tapping the Yarmouk River; Israel responds by commencing drainage of the Huleh swamps located in the demilitarized zone between Israel and Syria; border skirmishes ensue between Israel and Syria. 1953 - Israel begins construction of its National Water Carrier to transfer water from the north of the Sea of Galilee out of the Jordan basin to the Hegev Desert for irrigation. Syrian military actions along the border and international disapproval lead Israel to move its intake to the Sea of Galilee.	Wolf 1997, Samson & Charrier 1997, Naff and Matson 1984, Samson & Charrier 1997
2000	China	Civil unrest erupted over use and allocation of water from Baiyandian Lake – the largest natural lake in northern China.	Pottinger 2000
2004-2006	Ethiopia, Somalia	At least 250 people killed and many more injured in clashes over water wells and pastoral lands. A three-year drought has led to extensive violence over limited water resources, worsened by the lack of effective government and central planning.	BBC 2004a, AP 2005, Wax 2006
2007	Burkina Faso, Ghana, Cote D'Ivoire	Declining rainfall has led to growing fights between animal herders and farmers with competing needs. In August 2000, people were forced to flee their homes because of fighting in Zounweogo province.	UNOCHA 2007
II. CAUSED BY USE OF WATER AS A POLITICAL TOOL			
Date	Parties involved	Description	Sources
1978-onwards	Egypt, Ethiopia	Long standing tensions over the Nile, especially the Blue Nile, originating in Ethiopia. Ethiopia's proposed construction of dams on the headwaters of the Blue Nile leads Egypt to repeatedly declare the vital importance of water. "The only matter that could take Egypt to war again is water" (Anwar Sadat-1979)	Gleick 1991, 1994
1992	Former Czechoslovakia, Hungary	Based on environmental concerns, Hungary abrogates a 1977 treaty with Czechoslovakia regarding construction of the Gabcikovo/Nagymaros project. Slovakia continues construction unilaterally, completes the dam, and diverts the Danube into a canal inside the Slovakian republic. Massive public protest and movement of military to the border ensue; issue taken to the Int'l Court of Justice.	Gleick 1993
1997	Singapore, Malaysia	Malaysia supplies about half of Singapore's water and in 1997 threatened to cut off that supply in retribution for criticisms by Singapore of Malaysian policy.	Zachary 1997
2000	Kyrgyzstan, Kazakhstan, Uzbekistan	Kyrgyzstan cuts off water to Kazakhstan until coal is delivered; Uzbekistan cut off water to Kazakhstan for non-payment of debt.	

Table 1: Selected Water Conflicts adapted from "Water Conflict Chronology" by Gleick, P H of the Pacific Institute for Studies in Development, Environment and Security.⁷

⁷ Raouf, M. A. (2008). Water policies in the Gulf region and recent initiatives. Khaleej Times Online. Retrieved July 17, 2008 from http://www.khaleejtimes.com/DisplayArticleNew.asp?section=opinion&xfile=data/opinion/2008/march/opinion_march85.xml

It is thus important for a collective effort from every region, as indirect perpetrators of today's water conflicts, to reduce the effects of climate change through international cooperation. The only question now is: why isn't more being done?

Ignorance is always a convenient excuse for inaction. However, the existence of international conventions and treaties on various environmental issues give states no excuse to be oblivious to the situation. Being aware of the problems and the need for a concrete plan, it is up to the leaders of states to facilitate nationwide understanding of environmental issues in their home countries so that environmental policies are effectively implemented. The following section of this article provides recommendations to the GCC states on environmental policies and implementation.

The GCC's Bridge over Troubled Water

Climate change does not tolerate procrastination. GCC governments need to act right now in order to find ways to reduce their carbon footprint to stave off climate change and secure water needs in the short, medium and long term for different sectors by using different policy options, technologies, and even political pressure, and deals that can secure water supplies from friendly countries.

Lower Wastage:

A new tariff system was introduced in March 2008 by Dubai Electricity and Water Authority (DEWA). The rising tariffs will make people more conscious of using water efficiently as it would encourage customers who fall into the higher categories of consumption to cut back on use. One must admit that this is a step in the right direction to send signals

to consumers about the true cost of water. However, the new tariff does not apply to UAE nationals. In fact, it would be better to offer them a monetary allowance and charge their wasteful water consumption instead according to the new DEWA tariff.

Sensible Water Usage⁸:

Agriculture accounted for just 3.3 per cent of the UAE's GDP, less than one percent of Kuwait's and about 6.5 percent of KSA. However, agriculture continues to be the prime water-consuming sector in the GCC. In fact, agricultural water use has increased from about 73.5 billion cubic meter

(BCM) in 1990 to over 90 BCM in 2000, exerting immense pressure on the limited water resources in the region.

It is worth mentioning that many corporate companies and environmental NGOs across the region have embraced programs for greening deserts. This is an unwise solution in a water-scarce country, even if the argument is that they are planting indigenous species. We have to accept and adapt with our surrounding eco-system which is a desert area with scattered indigenous species.



⁸ Raouf, M. A. (2008). Water policies in the Gulf region and recent initiatives. Khaleej Times Online. Retrieved July 17, 2008 from http://www.khaleejtimes.com/DisplayArticleNew.asp?section=opinion&xfile=data/opinion/2008/march/opinion_march85.xml

Traditional solutions:

Most of what is traditional is more environment-friendly. It is important to protect traditional systems like aflaj (a system of conveying water from its source through sloping, open channels to irrigation points).

It will be wise to seize upon the chance of making use of the adaptation fund that became available following the Bali negotiations in December 2007. Regional cooperation and joint projects will ensure that the possible consequences of water policies are anticipated and examined and water issues are included in countries' interests.

Reliance on desalinated water alone could be a risky policy considering the volatile nature of oil prices and revenues and various negative environmental impacts. However, there is no doubt that desalination is an important component in the water budget of GCC countries. The sustainable use of groundwater resources should be a consideration in the overall integrated water resource management policy of each country. More research should be devoted to cutting down costs and obtaining new environment-friendly desalination technologies.

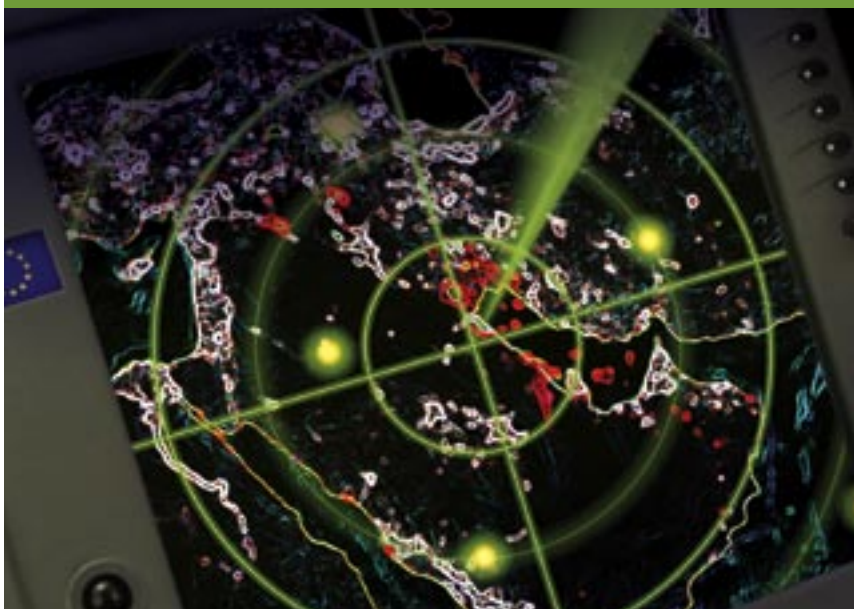
Although the struggle to strike a balance between self-sufficiency and water resource sustainability in the GCC countries will be long and continuous, it is important to strive for better, environment-friendly solutions to mitigate the effects of climate change and to collaborate on finding improved solutions in water management.

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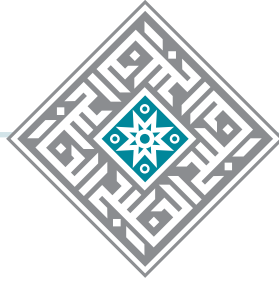


Gulf Research Center
Knowledge for All

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.



Gulf Research Center

K n o w l e d g e f o r A l l

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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