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July 2008, Vol. 2, No. 4

GULF MONITOR

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Cover picture. A Sudanese woman walks past paintings displayed for sale of Chinese President Hu Jintao and the United Arab Emirates' late leader, Sheikh Zayed bin Sultan Al-Nahyan, on a main street in the Sudanese capital Khartoum, June 2008 (Image courtesy of AFP)

REGIONAL RELATIONS

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A Ten-Point Plan for Better GCC-EU Relations

Christian Koch

On May 26, 2008, the 18th GCC-EU Joint Council and Ministerial Meeting took place in Brussels, Belgium. As with previous meetings, the two sides issued a communique that discussed a long list of issues ranging from the Middle East Peace Process, Iran, Iraq, Terrorism, Proliferation, Human Rights, the Dialogue between Cultures and Yemen. With regard to these regional and global areas of concern, the communique underlined the broad areas of agreement between the GCC and the EU member states. In fact, when it comes to the outlines of how to promote security and stability in the Middle East region, the GCC and the EU not only share very similar interests, they also agree on the policy prescriptions to achieve such a goal.

Press conference of the 18th EU-GCC Joint Council and Ministerial Meeting in Brussels, May 2008

More importantly, the communiqué also dealt with the implementation of the Cooperation Agreement in place since 1988 and the status of the Free Trade Agreement (FTA) negotiations which have been going on since 1990, although seriously only since 2002. While in the past, council meetings have been long on words and short of substance, the most recent get-together did provide for some concrete forms of further cooperation. For one, the communiqué lists a clear date of July 2008 by when it is hoped that a "mutually agreed text" for the FTA can be completed. This is indeed good news as it signifies that the two sides are as close as ever and that there is finally a light at the end of the tunnel on the issue of bringing the burdensome negotiations to an end. Given that the GCC-EU FTA would be the first region-to-region free trade agreement, it has significance beyond simple economic relations. It is a precedent that will not only provide for closer GCC-EU ties but more importantly will further strengthen the integration process in the Gulf region. As such, the successful conclusion of the FTA will also be a clear signal of support from the EU for GCC efforts to continue on their path of political and economic development.

Outside of the FTA, the communiqué refers to "implementation of the 1988 Cooperation Agreement in all areas covered." While this has been a standard phrase in the past, this time around there are more specific references to steps that can be implemented. This includes initiatives such as EU-GCC Public Diplomacy project launched by the EU Commission, a dialogue on energy cooperation and environmental issues, exploring cooperation related to research and development, the holding of an education information day in Brussels as well as the convening of a second round of the joint Economic Dialogue. All of these suggestions represent important areas in which GCC-EU relations can indeed be improved upon and one would hope that the two sides can now generate the necessary political will to make them a reality.

At the same time, given the Gulf's present and future strategic importance, the current development of the GCC states, and the EU's interests in overall security and stability in the region, it is time to move the relationship to a higher level beyond the issues mentioned in the communiqué. Joint Ministerial meetings once a year are fine, but they are insufficient for a partnership that continues to fall short both on substance and progress despite the tremendous potential it holds for both sides. It is in this context that ten additional areas of cooperation are proposed that should be taken into consideration.

1 Elevate the status of the relationship. In addition to a yearly joint ministerial council that draws only select foreign ministers, GCC-EU ties should be supplemented with a biannual summit meeting at the heads of state level underlying the strategic relations between the two sides. In addition to raising the profile, it would be an important message about the willingness to engage and expand ties.

2 Finish the FTA negotiations and sign the agreement. This would seem obvious, but the symbolic nature of a successful agreement on Free Trade continues to be underestimated. Thus, whatever issues are still outstanding, it is imperative that they be resolved soon and the agreement is signed. It is high time to move this issue out of the way, also to ensure that it can no longer be used as an excuse to hinder cooperation in other areas.

3 Issue a policy statement on the Gulf region. With the European Neighborhood policy, the EU's Strategic Partnership with the Mediterranean and the Middle East and the soon-to-be-formed Union of the Mediterranean as a successor to the Barcelona Process, the Gulf region does not know where it stands when it comes to EU policy. As such, it would be beneficial for the EU to come out with a specific policy statement on the Gulf in order to clearly outline its vision and relevant objectives. The statement would also be an opportunity for the EU to underline the role it can perform and the functions which fall outside of its scope. It could thus make clear what it can and what it cannot do. It would also provide the Gulf with a clear place in the complicated and confusing EU framework of external relations.

4 Establish a regular political/strategic dialogue between the two sides. Greater political commitment needs also to be shown especially in light of the fact that the GCC states themselves have become more active in regional security discussions, for example in Lebanon, in Iraq and in the Palestinian issue. By establishing a regular political/strategic dialogue on the key issues, the EU would not only begin to draw the GCC into the process but it would also mean that the yearly ministerial meeting can concentrate on the implementation and progress of the Cooperation Agreement. Furthermore, it is absolutely essential for the GCC to be aware of such important issues as the EU-3 negotiations with Iran over that country's nuclear program given the direct impact these talks have on regional security.

5 Coordinate policies on Afghanistan, Yemen and Pakistan. These three neighboring countries of the Gulf are also critical to the stability of Europe. EU member states provide over 20,000 troops of NATO's International Security Assistance Force (ISAF) in Afghanistan while billions of Euros of aid are being provided to both the governments of Pakistan and Yemen. Yet, EU aid is often seen as coming with strings attached and as part of overall Western assistance, and thus envisioned programs are often resisted at the local level. Given that the GCC countries enjoy a high degree of legitimacy in these fellow Muslim countries, it would be of immediate benefit if the EU and the GCC were to work out common programs with an appropriate division of labor. A recently discussed friendship fund for the tribal areas of Pakistan would be one possible example.

With the European Neighborhood policy, the EU's Strategic Partnership with the Mediterranean and the Middle East and the soon-to-be-formed Union of the Mediterranean as a successor to the Barcelona Process, the Gulf region does not know where it stands when it comes to EU policy

6 Open additional EU representation in the GCC states and upgrade the GCC representation in Brussels. There still exists a great deal of confusion and misunderstanding in the two blocs about how the other side works. The GCC remains as mystified about decision-making structures in the EU as the other way around. The current representations located in Riyadh and Brussels are insufficient to overcome this deficit and thus they need to be expanded and upgraded. With an increased presence, more information and public relations activities can be conducted that would begin to raise the respective profiles and, thereby, awareness.

7 Promote educational/training partnerships. While educational issues remain a prerogative of the states, there are nevertheless steps that can be taken to increase awareness of the GCC and the EU in the respective regions. Examples are plentiful but could include a partnership

Press conference of the 18th EU-GCC Joint Council and Ministerial Meeting in Brussels, May 2008

of the College of Europe with a respective GCC national university or institution to promote European studies, the creation of a research post dedicated to the Gulf region within the EU Institute for Security Studies in Paris, training and exchange programs for young journalists as well as technical assistance programs extended to the GCC secretariat to elevate administrative capacity and as follow-up to implementing integrative mechanisms. The list of possibilities is long but more concrete proposals need to be put forward.

8 Fund research and development on carbon capture sequestration. Given their concerns over climate change as well as the obligations and targets that the EU has set itself in terms of meeting environmental protocols, cooperation on CO2 capture and sequestration represents a win-win option for all concerned. Not only do the GCC countries offer excellent opportunities for experimenting in this field given their CO2 emitting sources, capture and sequestration in depleting oil and gas reservoirs is also an increasingly proven commercial technology. With EU assistance, significant gains can be made in this field with benefits for consumers, producers and the environment.

9 Decrease concern over Sovereign Wealth Funds (SWFs). While there is general agreement that SWFs are a positive fund for the global economy, there exists a degree of public anxiety in Europe that is not justified in its present dimension. In order to counter this sentiment, the EU can provide a clear statement on the topic portraying SWFs for what they are and putting public concern into relevant context. This would particularly include making clear that SWFs are not some sinister force endangering the long-term stability of Western economies but rather they should be seen as a positive mechanism to spur development and stabilize economies.

10 Provide matching funds for outreach activities. With its call for proposals for Public Outreach and Research Activities on EU-GCC relations, the EU Commission took an important step in the direction of activating all aspects of the Cooperation Agreement. Understandably, the Commission provided only 50 percent of the project funding given the fact that this was a pilot project and it was deemed important for participating organizations to have their own stake in the success of the project. Yet, it would have been better if the GCC had immediately matched the EU's offer given that such activities benefit both sides equally and due to the fact that participating institutions do not necessarily have the funds available by themselves. This would also be better than the GCC creating their own projects which would run in parallel and possibly overlap with one another.

There can be no doubt that GCC-EU relations are beginning to expand and that serious thought is being given to filling the ties with substance. This is a pertinent development that requires mutual support and a willingness to consider engagement across a variety of areas. With all it has to offer, GCC-EU ties could emerge as a model in their own right if cultivated properly.

This would particularly include making clear that SWFs are not some sinister force endangering the long-term stability of Western economies but rather they should be seen as a positive mechanism to spur development and stabilize economies

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International Dynamics in Africa: Should the GCC States Enter the Race?[1]

Marie Lillo

International politics are dominated currently by energy and food security issues as well as new struggles for influence between traditional and emerging powers. As oil prices have reached historical heights, the strain on most economic sectors is pushing many countries to try to secure future supplies. This increased competition is in itself a political risk that could also have damaging consequences for oil exporting regions. Vice versa, oil exporters are gaining political leverage which gives rise to new power balances. An additional, correlated and non-negligible issue has been the increase of the price of food as shortages and rising transportation costs have curtailed food availability leading at times to significant social unrest and similar international political tensions.

A Sudanese man weeds a field of sorghum raised for seed, near Juba, Sudan

In both the energy and food security context, Africa has gained a new degree of strategic importance given that the continent is seen by many as providing a short- as well as long-term answer to the current crisis. Traditional partners such as the US have worked towards strengthening their role and influence in the continent while new actors such as China and Iran are trying to get a piece of the cake. Given their geographic proximity and their need for natural resources as well as food, a related question is whether the GCC states should also look at spreading their influence and thereby establishing a strategic partnership with Africa to prepare for future challenges in the region.

Soaring Oil prices: Major Importers Enter a Race to Secure Oil Supplies

At the outset, it is important to understand that a correlation exists between the high price of oil and its impact on international politics. Indeed, as prices have soared, the balance of global power between oil-exporting and oil-importing countries has shifted somewhat including a fierce competition for influence in resource-rich countries by energy-hungry nations. While the recent price spike has merely exacerbated a trend initiated a few years ago by big consumers such as the US, the current environment has meant that the competition for influence in oil-exporting countries has grown fiercer and now involves more players such as China and India.

Africa has become the center of attention and the main host to the race for energy as its resources remain considerable and, in certain areas, largely unexploited. China, for example, became the second largest oil consumer after the US in 2003 and is expected to lead global consumption in around 20 years.[2] Since becoming an oil importer in 1993, China's oil consumption has been growing by about 8 per cent a year since 2002,

1 The author would like to thank Aruba Khalid for her research support.
2 International Crisis Group, Asia Report No 153, June 2008.
3 Ibid.

while production has only been growing slowly at 1.5 per cent in the last decade.[3] Rising consumption and domestic demand have pushed the

Africa has become the center of attention and the main host to the race for energy as its resources remain considerable and, in certain areas, largely unexploited

Chinese government to diversify their sources including supplementing its domestic supply of commodities with imports from resource-rich developing countries in Africa. In 2006, 60 per cent of Sudan's oil yield and 25 per cent of Angola's were exported to China.[4]

China's entry strategy into Africa is characterized by an "aid-for-oil strategy" that has resulted in increasing supplies of oil from African countries in return for comprehensive trade deals. China's approach lies in offering major aid projects or huge infrastructure investments in return for exploration rights of African oil. Although it has only managed to secure a small share of the African oil production, the Chinese tactics have worried some policymakers. Competitors fear that it is "locking up" resources through equity deals, thereby diminishing overall energy security by reducing the oil avai lable to the world market. Beijing's race for resources, meanwhile, is driven be fears that international giants such as the US or OPEC members will one day deny it access to oil sources.

Pressed by the current crisis over energy security and allegedly as a response to Beijing's "threat", the US has renewed its interest in Africa and taken some significant measures, such as the creation of a military command dedicated to Africa: AFRICOM. AFRICOM has four official objectives: i) to bolster security on the continent; ii) to prevent and respond to humanitarian crises; iii) to improve cooperative efforts between the US and African nations in order to stem trans-national terrorism; and iv) to sustain enduring efforts that contribute to African unity, with a central focus on preventing wars rather than fighting wars.

Despite these noble objectives, AFRICOM remains a military command post. This has led to skepticism around the "real" national security interests and strategic economic motives of the US. Indeed, the creation of AFRICOM may indicate that the US does not want to take chances with instable regions such as, for example, the Gulf of Guinea, that contain some of the greatest potential to meet energy requirements for oil in the medium term.

The race for energy security has thus created new dynamics, and put Africa back on the map. A corresponding influence of high oil prices has led to the entry of new players. Increasing surpluses accumulated thanks to oil trade has given exporters not just more revenues to fund their activities but also greater leverage over countries dependent on their imports. One example is Iran, whose oil money is helping finance its overseas political and diplomatic ambitions in Africa. Although, for the moment, the Iranian influence in Africa remains limited, Tehran could become a new player in the continent as it seeks to pursue its national interest and enter the competition for influence at a later stage.

Soaring Food Price: Major Importers Enter a Race to Secure Food Reserves

In addition to the energy dimension, rising concerns over food security have caused states to turn to Africa as a supplier continent. Among many, China and the GCC states have begun to look earnestly into this direction, generating new dynamics of power with the onset of a competition for farmland and investments in agro-businesses. Africa offers conditions that meet the needs of the investors. As Susan Payne from Emergent Asset Management noted: "Land values are very inexpensive compared to other agriculture-based economies. Its microclimates are enticing, allowing a range of different crops. There's accessible labor. And there's good logistics — wide open roads, good truck transport, sea transport."[5]

As land in China becomes scarce, its water more polluted and its population growth soars, the necessity to diversify its food imports is crucial. Currently, China is taking the lead in efforts to boost Africa's farm production. Among many other deals, from 2009, a Chinese seed company will cultivate rice in Tanzania. This project is actually part of a larger plan between China and African countries designed at the China-Africa summit in November 2006. According to this plan, China will set up 10 agricultural centers in Africa. Furthermore, another organization, the China Africa Business Council has been very active in diversifying Chinese agricultural investments in Africa. According to them, several thousand acres of land outside of Nairobi are unused and could be turned into farms. The example of Uganda where Chinese

4 Africa Action, *A Strategy for Extraction*, June 2008.
5 ParaPundit, *Africa attracts farming investments*, June 2008
6 *"China eyes idle farmland in country," Business Daily* (Nairobi), April 2008.

farmers have grown corn and other crops and employ hundreds of local workers over an area of about 10,000 acres illustrates the potential that Africa represents.[6] China, however, is not the only one looking at Africa to contribute to the resolution of their food crisis.

Given that the effects of the food crisis is beginning to be felt by the local population, some of the GCC countries have begun to react as well. The GCC states are particularly vulnerable to food shortages as their agricultural sector, which is already limited in size and capacity, is declining and suffering from water scarcity. This is occurring at the same time that the GCC countries are experiencing exponential demographic growth. Consequently, authorities have called for the securing and building up of food reserves by diversifying sources of imports as well as agricultural investments. An Emirati scheme has been sealed to buy farmland in Sudan and grow crops that will be used to increase the UAE's strategic food reserves. Crops will be planted on a farm of about 29,400 hectares. Ultimately, the Abu Dhabi Fund for Development is looking at buying up to 420,000 hectares.[7]

Talks about more projects for agricultural investments in Africa are underway. For example, Saudi Arabia is eyeing Ethiopia as a great food supplier especially as favorable fiscal and climatic conditions are offered. Ethiopian agricultural potential is largely unexploited as 56 percent of its land is arable and only 14.8 percent is cultivated.[8] Furthermore, agriculture is the basis of the Ethiopian economy as the country has the soil and climate for the production of a variety of crops. To encourage Saudi investment and promote the inflow of foreign capital and technology into Ethiopia, 100 percent exemption from import customs duties and other taxes levied on imports are granted to investors.

In a similar fashion, Eritrea has called for Kuwait's attention and promoted the advantages of investing there. The President of Eritrea emphasized that the country has been enjoying a great degree of peace and security and is focusing on creating the infrastructure facilities, institutions and the legal framework necessary to welcome investments. He also called for Gulf investors to take into consideration the country's strategic geographical location and virgin natural resources. Similarly, Rwanda is actively trying to attract Qatari agricultural investment by canceling restrictions on FDI's linked to its agriculture sector. Finally, Sudan has always been of interest for the UAE, Saudi Arabia and Kuwait who, in the 1980's thought of developing the country into their bread-basket. Consequently, they have already all invested in its agricultural development.

However, the clock is ticking and the competition is getting fiercer as Mohammed Al Suwaidi, the acting director general of the Abu Dhabi Fund for Development, said "within a short time, it will be very hard to secure these kinds of crops worldwide."[9] Indeed, while China and the GCC states have been looking at Africa for food supplies, more countries are turning their attention to the continent especially as climatic catastrophes this year have badly affected harvests. Given the rising competition, there is a need to look at how the GCC states should approach Africa and how the Arab Gulf States can build a more lasting strong partnership with African countries.

Should the GCC States Enter the Race for Influence?

High oil prices have benefited the GCC states who, as major world oil exporters have gathered substantial surpluses which they are looking to re-invest in various sectors. The ownership of oil reserves as well a substantial cash flow are putting the GCC states in a strong position to enter political competitions, for example, for influence in Africa. As the new political struggles being staged in Africa are motivated by basic national self-interest, the

Robert Kiri flow station in Kula, in the Niger Delta.

7 "UAE reaps farmland in Sudan," *The National*, 10 June 2008
8 K. S. Ramkumar, "Ethiopia Invites Saudis to Invest in Agriculture," *Arab News*, May 28, 2008.
9 "UAE reaps farmland in Sudan," *The National*, 10 June 2008

question is whether it would be in the GCC states' own interest to take part in this competition. As far as the food security issue is concerned, it is certainly a necessity for the likes of Saudi Arabia, Qatar or the UAE to enter the game as soon as possible as there is a non-negligible need for them to build food reserves and to grasp all opportunities to do so. The same is true for different raw materials such as alumina or iron ore as the region is experiencing a construction boom. Yet, the GCC states should carefully plan their response to the pressing needs of their fast-growing economies in order to ensure that their activities do not turn into a damaging venture for African nations. As has been shown before, foreign investments can sometimes prove harmful for the recipient countries as self-interest

prevails and the impact on the local population is overlooked, generating discontent and instability which is not in the interest of the investors.

For example, oil trade has not always been a blessing for some African countries. While in the context of sky-rocketing oil prices, the African oil exporters have been able to accumulate a substantial amount of surplus, the majority of the benefits rarely trickle down to the population. Although, oil from the Niger Delta produces about 90 per cent of the value of Nigeria's exports, the Niger Delta remains one of Nigeria's poorest regions, lacking basic social infrastructure such as schools and health care facilities. The main problem lies in the fact that the wealth generated by the oil business has failed to benefit most of the population and the intrusive process of oil extraction has drastically reduced the ability of communities in the Delta (and elsewhere) to engage in traditional economic activities. The Niger Delta, for example, holds the largest mangrove forest in Africa but polluting oil operations have decimated this ecologically crucial habitat. As a result, fishing and agriculture are no longer possible in many communities.

In order to be productive, ecologically sound and sustainable, any foreign investment must therefore ensure that the resulting activities of that investment benefit the local population. The alternative is social unrest and instability which only produces negative repercussions. As far as the GCC states are concerned, it is thus in their own interest to focus on building a mutually beneficial and solid strategic partnership with Africa in order to answer needs and interests on both sides.Investment in the African agricultural development would play a crucial role in building this partnership. It would directly profit the development of some regions especially if investments are dedicated to small scale farmers as roughly 65 percent of sub-Saharan Africa's population relies on subsistence farming. Their production though suffers from a substantial lack of infrastructure such as good roads, irrigation systems or agricultural techniques. For example, according to the Food and Agriculture Organization (FAO), Sub-Saharan Africa adds less than 10 kilograms of fertilizer per hectare of land; in comparison, Asia uses 144 kilograms. Furthermore, the World Bank argues that cereal yields for sub-Saharan African farmers has declined or stagnated since the 1970s and now stands at roughly one-third of those in South Asia.

The first goal would be to answer the food need in Africa by investing heavily in infrastructure and technology. Such need is not only particularly pressing as the population of Africa is growing exponentially and expected to double to 1.4 billion people by 2040 but given existing pressure on food supplies, it is an urgent answer for future demand.[10] In the medium to long-term, such investments will thus allow surpluses for export. This would be of benefit both to Africa and the food importers especially as long as food prices are relatively high and returns on commodity investments remain lofty.

To conclude, as Africa has become a key stage in the renewed international race for natural resources, the GCC states cannot afford to sit idly by. Instead, they must become part of the game but with a view towards Africa as a long-term partner and not as a quick fix for what appears to be a temporary crisis. Done correctly, the self-interests of both regions can be served in a mutually beneficial manner.

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10 Karthala, CEPED, AFD, "L'Afrique face a ses défis démographiques : Un Avenir Incertain" (Directed by Benoît Ferry), Paris, 2007

Development of Pakistan's FATA Region: A Possible GCC Role

Faryal Leghari

The Federally Administered Tribal Areas (FATA) of Pakistan, bordering Afghanistan, have in recent times become the focus of world attention. The FATA comprises seven semi-autonomous agencies and six Frontier regions. Of the seven agencies, Bajaur, North and South Waziristan, and Mohmand to some extent, continue to be the most troubled. These areas are the stronghold of several militant groups and many of these areas are virtually controlled by militants. Not only have the militants succeeded in undermining local administrative control – specifically that of the Political Agent –they have also killed more than a hundred tribal leaders who challenged their activities. They have also engaged the Pakistan armed forces deployed in the region since 2002. At present the total strength of the armed forces deployed along the Afghan border is 100,000 with two division-sized forces in Waziristan, despite the lull in military operations.

Considered a safe haven for the Al-Qaeda high command and the Tali ban, the region allegedly could be used as the launching zone for future terrorist acts against the US and the rest of the world. It has been alleged that the region is a training ground for terrorists, especially suicide bombers; it is also home to the Pakistani Taliban who have vowed to continue supporting the Taliban in Afghanistan in jihad against the United States and allied forces. Baitullah Mehsud, who heads one of the most organized insurgent groups in the region, the Tehrik-i-Tali ban Pakistan (TTP), and spearheads the insurgency in South Waziristan, has categorically stated his intent to continue supporting the Taliban in Afghanistan. He has also stated that any peace agreement with the government of Pakistan is doomed unless the government changes its policies and stops being subservient to the US and asserts its sovereignty. Negotiations with Mehsud for a peace agreement were reportedly shelved after the US voiced concern over the purported objectives. The US and the NATO forces in Afghanistan are particularly concerned about the cross border incursions and the fact that the tribal area has become a "safe recuperating zone" where the Taliban and al Qaeda gain logistical and fighter support.

Shortfalls in US Strategy

Major flaws in the US strategy for Pakistan's troubled border region and Afghanistan have only compounded the problems. As if the missile attacks from unmanned predator aircraft which caused civilian casualties – frequently alluded to as "collateral damage" – were not enough, it is now rumored that the Pentagon has planned ground operations in the tribal areas. It is beyond comprehension that Washington seems to totally disregard ground realities, instead revealing signs of panic by committing policy errors. Their rhetoric about successes in Iraq and control of the situation in Afghanistan is in contradiction to reality, and it seems that the policy makers in

A Pakistan army vehicle patrols in Spinkai village of the district of South Waziristan, in the north-west of Pakistan, where the army destroyed most of the houses harboring militants after an offensive last January in this troubled region, May 2008

Washington are scrambling to take any measures that might indicate some semblance of control over the situation in these two countries. It seems that the US has failed in its “winning the hearts and minds” strategy; in fact, it has not bothered to work in this context in the FATA region. Conducting air strikes, dismissing civilian casualties as ‘collateral damage,’ and then expecting local people to be grateful for development aid seems incomprehensible. While development funds are badly needed in the impoverished and radicalized region, the truth is that the tribesmen view any development aid from western quarters as blood money. There is evident hostility towards western aid, a fact exploited by the militants who have termed it as haram and have vowed to wage all efforts to sabotage any such projects. As a result of the huge socio-economic deficit – a problem that can be partly considered a failure of the Pakistan government and partly of the international community which abandoned the region after the ouster of the Soviets from Afghanistan – the region has tilted towards extremism and terrorism. The conflict in Afghanistan became the cause for the consequent radicalization, terrorism, weapons proliferation and trafficking of narcotics.

The US and allied forces should also focus on strengthening the institutional structures in Afghanistan and make concerted efforts at rooting out criminal and corrupt elements within the establishment. A hard-hitting strategy for narcotics eradication and a viable alternative livelihood plan for the opium farmers is the need of the hour. The vested interest of the international organized crime groups, specifically the narco-mafia, in an unstable Afghanistan and Pakistan cannot be ignored. In order to deter cross border incursions of the al Qaeda and Taliban to gain logistic support from the Pakistan side, the US should at this point focus on increasing troops on the Afghan border. The refugee problem and the villages that have sprung on the Afghan side of the border have been largely ignored. The efforts made by Pakistan in the past to fence and mine the border were met with strong resistance from Kabul for it feared the action to be tantamount to recognition of the border. The truth of the matter is that the Pakistani people, in general, do not consider the war on terror as their war; they feel they have been dragged into it. Despite being subjected to a wave of suicide attacks and the spread of Talibanization, they feel these are reactions to the government’s support of US policies. Instead of aggravating an already volatile situation by staging ground operations to hunt down Al-Qaeda, the US should place the onus on the Pakistan military and beef up the regional security forces with technical training and intelligence support.

Need for a Comprehensive Strategy

FATA has suffered due to the lack of a concrete government strategy; the failure of the government to allocate adequate resources for the region and come up with a comprehensive socio-economic package has worsened the situation. Besides, the absence of political and judicial reforms in line with tribal traditions has also had a negative effect in the region. The use of military force has only added a severe burden on the existing fragile structure.

As is clear from historical evidence, the unilateral use of force to address the situation in the tribal areas is not the answer to the problem

As is clear from historical evidence, the unilateral use of force to address the situation in the tribal areas is not the answer to the problem. So far, the effort to use military deployment as a means of political negotiation and facilitator of economic development has been missing. A political strategy drawn up in consultation with tribal elders to spread awareness among the local tribes could clear up any misconceptions and mistrust created by the militants. At this point the presence of military forces in the region as a means to apply sustained pressure to deter any sabotage attempts is important. Furthering economic development in FATA should receive the highest priority from policymakers. Besides, spreading the message of tolerance is important. It is an acknowledged fact that if political and socio-economic problems are not addressed in time, they can give rise to factors which feed extremism.

While many of those expressing concern about the enormity of the threat emanating from the tribal areas rest the blame entirely on the Pakistan side, it is important that there should be a corresponding effort from across the border to tackle the problem. Intelligence sharing between Pakistan, Afghanistan and the allied forces should be a joint effort.

FATA's Socio-Economic Development: Lack of Resources

The government of the Frontier province plans to initiate a $4 billion development fund for the province including the FATA region. This is in addition to several other multimillion dollar development projects that have been proposed for the area. However, the implementation of such projects has not really taken off; in fact a major portion of the funds for such projects is going towards consultants' fees in western capitals with very little trickling down to benefit the locals. Afghanistan is facing the same problem where reconstruction funds amount to a meager $7-8 billion compared to military costs of $80 billion.

GCC Role in FATA Development

A comprehensive regional plan encompassing provision of jobs besides development of infrastructure, education, health, agriculture and trade is the need of the hour. It is important that any future development plans for the FATA should include the GCC states as an integral partner with a leading role. Firstly, this would counter the widespread hostility in the area towards western aid and the fears of a perceived 'design' to subvert the people from their religion and beliefs. Secondly, it would help tackle the attempts by local militant groups and the Taliban to sabotage such programs. The locals, who would see such programs as an Islamic initiative, would resist sabotage attempts by militants. A key element in the successful implementation of any development work in the region is consolidating and strengthening local support. It is important to reach an effective agreement with the tribes in the FATA region to implement development projects. Such projects would also address the concern about unemployed youth getting drawn to extremism as they would aim to provide jobs to young people. There would also be opportunities for export of labor from the area to the GCC states. Youth comprise approximately 15 percent of the population in Waziristan alone and many of them could be provided jobs in the Gulf States after careful monitoring from the Pakistan side. In fact, Pakistan would have to take stringent measures to screen the recruits keeping in mind the security concerns of the GCC states as the area is a highly radicalized one. Provision of training to recruits in the semi-skilled sector must be undertaken in a systematic manner that would include field training both by mobile units as well as in existing centers outside the FATA region. The Political Agent and the tribal elders would also be involved in the process and facilitate the endeavor besides propagating the initiative regionally.

It is expected that there will be a large turnout for labor recruitment in the construction and services sector. This will be mutually beneficial for the FATA region and Pakistan as well as the Gulf States due to the booming construction and real estate development in the Gulf. The Pakistani labor force in the GCC region in 2008 is estimated to number approximately 2 million, with the biggest numbers in Saudi Arabia and the UAE. A majority of the workers, about 90 percent, is in the skilled and unskilled labor categories, and the rest comprises technicians and professionals. The total annual remittances of the Pakistani labor force worldwide now averages $4 billion and above, with the GCC's share of remittances constituting a good part of this amount. Keeping in mind the above factors, it is assumed that the export of manpower from the FATA region to the GCC would have an immediate impact and alleviate problems in the troubled region. There are some key areas that demand immediate priority in terms of development work. These include construction of roads making the region accessible to the outside and thereby facilitating transport and trade; education; health; agriculture and water resources; land reclamation and forestry; livestock farming; tunnel farming of off season high-value vegetables and fruits; small industry and mining; energy sector and provision of electricity to villages and for irrigation; development of solar energy, and utilizing the large reservoirs of coals.

Conclusion

The policies formulated for the stability and development of the region must be based on the fact that any initiative will need concerted, long-term effort. The time period required could range from anywhere between 5 and10 years. Policymakers will have to make sure that development efforts are evenly spread out and not concentrated on a few sectors while ignoring others. It should also be noted that each agency would need different development solutions. Development plans will have to show a degree of flexibility keeping in mind the particular nature and requirements of the agency where they are being implemented.

It is hoped that the international community, especially the GCC states, will reach out to extend cooperation for the development of the FATA region. It is also mandatory that the internal dynamics of the region be incorporated in any strategy that seeks to deal with the conflict situation.

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Food Inflation in the GCC Countries

Eckart Woertz

Inflation in the GCC

The GCC countries and the UAE and Qatar in particular have witnessed accelerated inflation rates for three years now. Besides the dominant rent inflation, food inflation has been put in the spotlight in the wake of food price hikes on a global scale. Thus, the impact of rising global food prices on the GCC countries and possible measures to mitigate this impact have moved to the forefront of the GCC inflation debate in recent months.

After two decades of low inflation rates, inflation has returned as a global phenomenon. Most notably food inflation affects lower income brackets disproportionately as they have to spend a relatively high share of their disposable income on food. The GCC countries have felt the impact as well; inflation, which was mostly below 1 percent and virtually non-existent until 2002, has developed into a serious problem in the Gulf nowadays. Especially the last two years have seen a marked rise in inflation. The UAE and Qatar were particularly affected with official inflation figures in double digit territory. But other countries like Saudi Arabia and Kuwait have also witnessed a pronounced pick up in inflation in 2007, reaching more than 6 percent. In 2008 this trend has continued and has propelled inflation rates in these countries to around 10 percent, thus reaching the worrying heights of UAE and Qatar inflation rates. Compared to other regions in the world, the Gulf and the Middle East countries as a whole thus witnessed comparatively high inflation rates.

Inflation in GCC Countries 2002-2007 (%)

	2002	2003	2004	2005	2006	2007
Bahrain	-0.5	1.7	2.3	2.6	2.1	8.4
Kuwait	0.5	1.2	1.3	4.3	3.3	6.6
Oman	-0.7	-0.3	0.9	1.9	3.1	5.3
Qatar	0.2	2.2	6.8	8.8	11.8	12.8
Saudi Arabia	0.2	0.6	0.3	0.7	2.2	6.5
UAE	2.9	3.1	5.1	7.1	11.3	11.6

Note: Inflation figures have been calculated from changes in CPI data as reported by Central Banks of GCC countries. For Saudi Arabia, it is based on the cost of living index, as reported by SAMA. 2007 data is based on second quarter of the year

About two thirds of this inflation is homemade and can be attributed to abundant liquidity and a domestic investment boom that faces increasing capacity constraints, most notably in real estate and construction. Annual money supply and private sector credit growth in the UAE run well above 30 percent for example.

About one third of GCC inflation, however, is imported. Food and commodity prices have risen globally, especially in dollar terms. Such price hikes are not mitigated by an exchange rate mechanism in the GCC (with the partial exception of Kuwait), as the GCC economies have tied their currencies to the US dollar, which has devalued considerably against other major currencies. For Saudi Arabia, Saudi British Bank estimates a 35 percent share of imported inflation in overall inflation. For Kuwait, estimates of 25 percent have been given using food imports as a proxy for imported inflation.[1] In Qatar, the index of tradables increased by almost 15 percent from the year 2005 to 2006. In Kuwait, the general level of wholesale prices of imported goods (whose relative weight in the General Wholesale Price Index is 76.9 percent) also increased in the year 2007. The inflation rate of food prices in the UAE was between 27 and 30 percent in 2007, according to a survey conducted by the Emirates Consumer Protection Society (ECPS)[2] and official UAE sources recently stated that 50 percent of the inflation can be attributed to rent and 33 percent to imported inflation.

1 Saudi British Bank, "Giving a Boost: Helping Cope with the Rising Cost of Living in Saudi Arabia," SABB, Economic Reports, February 2008.
2 Gulf News, March 6, 2008.

Inflation Rates World (%)

	2000	2001	2002	2003	2004	2005	2006	2007
Africa	13.3	9	8.3	6.8	5.3	6.1	7.2	6.5
ASEAN-4	2.9	6.7	5.8	4.1	4.6	7.3	8.2	4
Central and Eastern Europe	18.5	21.1	10.3	8	6.1	4.4	5.1	4.7
Developing Asia	2.4	2.6	1.8	3	4.2	4	4.1	5.7
European Union	3.2	2.6	2.3	2.2	2.4	2.3	2.2	2.4
Major Advanced Economies (G7)	2.3	1.1	1.9	1.5	2.4	2.3	1.9	2.3
Middle East	3.3	4.3	6.3	6.9	8.9	5.7	9.4	9.9
Newly Industrialized Asian Economies	1.8	0.7	2	1.6	2.2	2.3	1.6	2.7
World	4.2	4	3.7	3.2	3.9	3.6	3.5	4.2

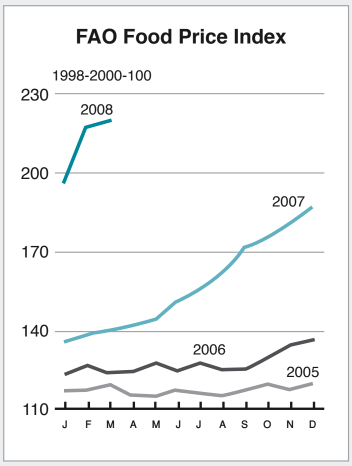
Source: International Monetary Fund (IMF), World Economic Outlook Database, April 2008

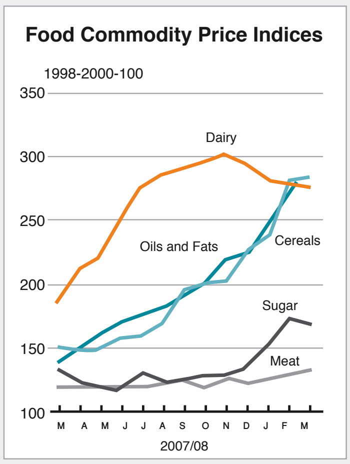
Food therefore constitutes a considerable part of imported inflation as import dependency will reach 60 percent in the arid GCC countries by 2010, according to the FAO.[3] In Saudi Arabia, for example, about 15 percent of all imports are food items.[4] The amount spent on food in the GCC is mostly between 10 and 20 percent of disposable household income, according to a Bayt/ YouGov survey.[5] Food price rises in the GCC thus contribute significantly to overall inflation. With growing population, growing food imports and rising food prices, this ratio is likely to remain on an elevated level. The GCC countries are a price taker for agricultural imports and heavily exposed to the global price hikes in food items. Food inflation can also be the source of significant social unrest, as it hits lower income groups especially hard because they have to spend a relatively high share of their disposable income on food. Especially in smaller Gulf states where the blue collar expatriate workforce forms a majority of the population this could develop into a serious issue.[6]

Global Food Inflation

In the last decade, real world output and world trade increased at an annual rate of 5 percent and 8 percent respectively with a low inflation rate of 2 percent. But the last two years witnessed dramatic changes. While primary commodity prices have been increasing gradually from 2002 to 2005, they virtually soared since around the middle of 2006, with rises in cereals, dairy products and oils and fats particularly pronounced.

The reasons for this rise are manifold. Population growth, change to richer diets in emerging markets, additional demand from biofuels production and limited availability of arable land, droughts and soil erosion in some regions have led to a strained supply-demand equation and stock piles at historic lows. Interest by speculative investors has strengthened the upward momentum of food prices, which was particularly pronounced in dollar terms as the greenback devalued considerably.





Source: Food and Agriculture Organisation (FAO)

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3 Twenty Seventh FAO Regional Conference for the Near East, Doha, March 13-17, 2004, 6, available at: ftp://ftp.fao.org/unfao/bodies/nerc/27nerc/J1655e.doc .
4 Government of Canada, Agri-Food. Past, Present & Future Report, Saudi Arabia, December 2006, 3, available at: http://atn-riae.agr.ca/africa/4290_e.pdf .
5 Bayt.com conducts Consumer Confidence Index (CCI) surveys across the GCC, Levant and North Africa on a quarterly basis in conjunction with YouGovSiraj, a market research and polling company. For reports see www.bayt.com.
6 For a good overview of the issue of GCC migration workers, see Andrzej Kapiszewski, *Nationals and Expatriates. Population and Labour Dilemmas of the Gulf Cooperation Council States* (Reading: Ithaca, 2001).

Population Growth Plus Declining Agriculture = Rising GCC Food Imports

Population growth in the GCC countries is about 2.4 percent annually (simple average), well above the global average of 1.1 percent. Birth rates have come down considerably during the last two decades and there is some beginning of a demographic transformation, but it will take another two or three decades for associated youth bulges to level out; population growth will remain high during this period, also because some Gulf States attract large numbers of expatriate workers. By 2030, the GCC population will have doubled from its level in 2000 reaching nearly 60 million people. This growing population will meet a declining agriculture. Arable land is very limited and conventional water sources in the GCC – currently the feedstock of irrigated agriculture – are predicted to last for 30 years at most. The agricultural sector currently demands around 80 percent of the total water supply in the GCC. The fast growing population and the expected developments on the industrial side will lead to competition for allocation of scarce water resources. By 2025, domestic water demand is expected to double, and the industrial sector will ask for threefold the current water amount.

GCC Population (in thousands)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE	GCC
1990	493	2143	1843	467	16256	1867	23069
2000	650	2228	2402	617	20807	3247	29951
2010	799	3080	2791	891	26643	4770	38974
2020	951	3832	3473	1072	33332	5963	48623
2030	1095	4555	4137	1225	39950	7125	58087

Source: United Nations World Population Prospects 2006

Desalination will hardly be able to function as a large scale substitute for conventional water sources in agriculture as it is energy-intensive and costly.[7] The subsidized agricultural schemes that larger GCC countries like Saudi Arabia and the UAE have developed are therefore economically doubtful and ecologically unsustainable. After the Saudi wheat bonanza of the 1980s that made the country a wheat net exporter, there is a clear trend away from such crops that consume a relatively high amount of water per unit of value added. Recently, the Government of Saudi Arabia announced its plan to reduce the purchasing price of wheat by 12.5 percent per year from 2008. Instead production will focus more on higher value crops like fruits and vegetables. But growing population, declining agriculture and scarce water resources will cause import requirements of the GCC countries to rise further in the future.

For GCC countries this means that they will need to deal with their dependence on food imports and geo-economic vulnerability more proactively

The rising need for food imports in the GCC comes at a time when the exportable agricultural surplus worldwide has declined, as food markets are tight and stockpiles declining. Many exporter countries like India and Vietnam have also implemented export restrictions in order to supply food to their domestic markets and avoid bread riots that have already occurred in some countries like Mexico, Haiti, Egypt and Indonesia.

Counter Measures against Food Inflation in the GCC

For GCC countries this means that they will need to deal with their dependence on food imports and geo-economic vulnerability more proactively. Most notably, this vulnerability can be exacerbated in times of political crisis. During the Arab oil boycott of 1973 the US, for example, indicated that there could be a boycott of food deliveries to the region as a retaliatory measure. Besides attempts to increase domestic food production, this threat prompted plans to develop Sudan as a bread basket for the Gulf that were later on abandoned.[8] However, now they

7 World Bank (2007): Making the Most of Scarcity. Accountability for Better Water Management Results in the Middle East and North Africa, UN FAO Statistics available at: http://www.fao.org and http://faostat.fao.org/, UN FAO Aquastat Statistic available at: http://www.fao.org/nr/water/aquastat/main/index.stm, UN ESCWA Compendium of Environment Statistics in the ESCWA Region (2007) available at: http://www.escwa.un.org/information/publications/edit/upload/scu-2007-2.pdf. Further see Nermina Biberovic, "Water and Agriculture Issues in the Gulf," *Gulf Monitor*, January 2008, Vol. 2, No.1 and Mohamed A. Dawoud, *Water Scarcity in the GCC Countries: Challenges and Opportunities* (Dubai: Gulf Research Center, 2007).

8 David E. Spiro, *The Hidden Hand of American Hegemony: Petrodollar Recycling and International Markets* (Ithaca/ London: Cornell University Press, 1999), 26.

are resurfacing. To attain import security GCC countries have started to envisage agricultural investments in Africa and Asia, mostly in geographically close countries like Sudan, India and Pakistan with which established political and cultural ties exist. Private equity company Abraaj Capital and other UAE companies and institutions have already acquired 800.000 acres of farmland in Pakistan, and GCC countries engage now in close dialogue with food producing countries. The UAE government has also decided to build up a strategic food reserve to reduce exposure to market volatility.[9]

One has to realize that inflation has risen globally, and the GCC countries can hardly decouple from that trend, especially at a time when their economies are experiencing abundant liquidity and a diversification boom powered by high oil prices

On a day to day basis, the GCC countries have chosen administrative measures to dampen inflation, like continued subsidy schemes, price controls and wage increases, mainly in the public sector. All these measures are piecemeal efforts, may have a limited impact on inflation or may limit supplies. They may even exacerbate inflation in case of second round effects. With a dollar peg and in the absence of a free floating currency, the GCC countries cannot follow an independent monetary policy. They cannot raise rates in order to curb inflation but have to follow the interest rate moves of the Fed in Washington. The falling interest rates at present thus mean rising inflation and a real effective appreciation of the local currencies. Kuwait depegged from the dollar and switched to an undisclosed currency basket in May 2007. Since then the Kuwaiti Dinar has appreciated around 9 percent against the dollar; still Kuwait has witnessed accelerated inflation as well. Revaluation and possible re-pegging to a currency basket can provide some relief with regard to imported inflation but it is hardly a panacea, as about two thirds of inflation are homemade and gradual appreciations cannot make up for larger price rises in the global arena. Inflation in Euro terms might be less, but it is still palpable.

An agriculturist shows grains of rice in a regional rice silos plant during harvest time

Thus, one has to realize that inflation has risen globally, and the GCC countries can hardly decouple from that trend, especially at a time when their economies are experiencing abundant liquidity and a diversification boom powered by high oil prices. Food prices might correct after the recent run-ups but are likely to remain on elevated levels. Influences like population growth, factor input inflation and dollar weakness are structural in nature and do not show signs of abating in the near future. The GCC countries are highly dependent on food imports and particularly exposed to global food inflation. As their agriculture is on the decline while their population is growing, this exposure will increase in the future – self-sufficiency is not an option for the arid and increasingly populous GCC countries. Therefore, close dialogue with exporter countries and investments in agricultural projects in Africa, South East Asia and Eastern Europe could add to the GCC countries' food security.

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9 *Gulf News*, April 24, 2008; Meena Janardhan, "Gulf Eyes 'Oil-For-Food' Deal With Neighbors," IPS News, June 19, 2008, available at: http://ipsnews.net/news.asp?idnews=42877 .

A market for Arabian Heavy

Giacomo Luciani

Saudi Arabia has taken a courageous step in calling for a conference of oil producers, consumers, companies

In a market in which demand continuously rises while supply is constrained, investors have reached the conclusion that prices can move in only one direction: upwards

and "speculators" to discuss the runaway price of oil. As the main global exporter of crude oil, Saudi Arabia is naturally in a position to be the price maker for internationally traded oil. However, since the early 1980's it has shunned away from this role and instead chosen to behave as price taker, indexing its crude oil to Brent or WTI futures, depending on their final destination. The Kingdom and other major OPEC oil exporters have not favored the idea of open trading in their own crude oil qualities, and have prevented the birth of a market by selling to final customers (i.e. refiners) only, on the basis of long-term evergreen contracts and price indexation.

Now the Kingdom seems ready to play a more significant role and wishes to inject greater stability and possibly moderation in prices that have increased beyond what is considered reasonable and suffer wide gyrations. In so doing, not only the Kingdom risks the hostility of other producers, most importantly it might also be proved unable to bring prices back to the level that it sees desirable.

The announcement of a production increase of 200,000 b/d may even have the opposite effect, and be interpreted by the market as confirmation that even Saudi Arabia has only limited effective spare capacity, and the world is very much headed towards a supply crunch. It is difficult to envisage that global demand might increase by less than 1 million b/d per year, and this is sufficient to put the Saudi production increase in perspective. On the same day that the increase was officially confirmed,

Nigerian insurgents attacked an oil producing platform 135 kms offshore, provoking the shutdown of the Bonga field (shell) and the loss of 200,000 b/d of Nigerian oil: back to square zero.

The Jeddah meeting was expected to narrow the gap dividing some Western governments, who argue that rising prices are due to fundamentals and OPEC should increase production, and OPEC governments that argue that speculation is to blame. In fact, most observers, including

Prince Abdul Aziz bin Salman bin Abdul Aziz, Saudi assistant minister for Petroleum Affairs, holds a press conference, on the eve of a meeting of the world's top oil producers and consumers to consider ways of ending the spectacular rise in crude prices, June 2008.

Western analysts, point to the weakness of the dollar and the inflow of investors' liquidity into the commodity market to justify the increase in prices.

In a market in which demand continuously rises while supply is constrained, investors have reached the conclusion that prices can move in only one direction: upwards. At the same time, the US balance of trade and federal budget deficits, coupled with the excessive level of debt throughout the American economy, have convinced investors that the dollar also can move in only one direction: downwards. The unofficial announcement that Saudi Arabia will increase production to about 9.7 million b/d - its highest level since 1981 - was saluted by a new peak in the price of WTI futures - due to, in the words of a trader quoted by the FT, "the fresh weakening of the dollar".

So, what could the Jeddah Summit have accomplished? The problem of the oil market is not that it attracts "speculators": traders and investors are needed for liquidity and risk management. The problem is rather that the oil market lacks a "reality check". In most other markets, if "speculators" temporarily push the price beyond or below what is justified by fundamentals, the latter finally prevail and speculators are punished. In contrast, the oil market lacks an effective "reality check", because the price of all major crude oil streams – notably the Saudi Arabian crude oils – are indexed to the prices of futures contracts, which are financial instruments.

There is no physical market for oil which may discipline speculation. Buyers of physical oil – refiners and traders – are price takers, and the price that is offered to them is dictated by the futures market. In turn, refiners pass on price increases to the final consumer, whose demand tends to be rigid. He cannot in the short run change the kind of car he drives, nor the home he lives in or the distance between home and work. This means that the physical market reacts only very slowly to changes in the price of oil, and primarily through an income effect (a slow down of the economy) rather than through a price effect.

In a presentation at the Bank of England on June13, Christopher Allsopp and Bassam Fattouh of the Oxford Institute of Energy Studies spoke of the disappearance or diminution of 'feedbacks' stabilising longer term expectations of the oil price. They argue that elasticity of demand has been declining over time and is close to zero in the short run – somewhat higher in the long run but still very small. Elasticity of supply is also close to zero if not negative (some producing countries, flush with extra revenue, may decide to postpone increasing production rather than making a concentrated effort to do so as quickly as possible).

Now the Kingdom seems ready to play a more significant role and wishes to inject greater stability and possibly moderation in prices that have increased beyond what is considered reasonable and suffer wide gyrations

Is it possible to re-establish some "reality check" or "feedback" from fundamentals to the futures market that will limit and possibly reverse recent increases? Saudi Arabia laments that some of the oil the Kingdom produces goes unsold (the official statement is that all oil demanded has been supplied, and no customer has been turned away for lack of oil). Therefore, how can fundamentals be blamed for the high prices? The seeming paradox is explained once we take into consideration quality issues: the oil that is available is heavy and sour, and global conversion and desulphurisation capacity is not sufficient to absorb all such crude oils. The differential between light and heavy crude oil has greatly widened: "Refiners are paying up to $5-$6 a barrel on top of current record prices to secure high-grade oil, traders said, double the level of a year ago. (...) At the same time, though, refiners are obtaining unusually large discounts for low-quality crude oil (...). The premium for Nigeria's high-grade Bonny Light oil has surged this month to $4 a barrel, up from $2.50 a year ago. In the same period, the discount for low-grade Iran Heavy oil has widened to $13.05 a barrel from $7." (Financial Times, June 12, 2008).

In order to regain some influence on oil prices, major oil producers must abandon their hostility to trading of their own crude oils

It is said that Saudi Arabia and Iran are reluctant to offer further discounts to encourage the market to absorb their heavy oils. Apart from the fact that – as said – the quality differential has hugely widened in recent months, it is the opinion of this writer that offering discounts is not what is needed. Discounts are not likely to be transparent and will exert no influence on the futures market, they will not constitute the "reality check" that is required.

In order to regain some influence on oil prices, major oil producers must abandon their hostility to trading of their own crude oils. They should themselves organise a broadly based and transparent physical market. The DME contract for Oman crude is a step in the right direction, but remains insufficient, because of limitations in the total volume of Oman crude available. Alternatively, Saudi Arabia might accept to price its Heavy oil off the Oman crude contract, but this solution as well is unlikely to generate the required feedback effects on the futures markets for Brent and WTI.

The idea that a market for Gulf oils cannot exist because each quality has only a single producer is nonsense: a market can be created by resorting to auctions. Ideally, Saudi Arabia may consider setting up a system of weekly auctions to sell its Arabian Heavy crude oil, which is the effective "marginal crude oil" in today's conditions: any incremental production that we may expect from the Gulf would consist of heavy crude oil. (This may change with the coming on stream of the Khursaniyah oil project, which will add light crude; but this project is the exception: by and large additional oil from the Gulf will be heavy and sour).

Auctions should be based on inviting bids without specifying ex ante the quantity that will be sold through auction: this would be decided - together with the settlement price - in the light of the shape of the "demand curve" that bids would reveal. This method guarantees the seller against unwelcome surprises. Information acquired in the process would definitely clarify whether existing supply is sufficient, as claimed by OPEC, or more oil needs to be pumped, as OECD political leaders advocate.

Auctions should be for standard lots of physical oil to be delivered not earlier than three months forward – in fact a longer delay may even be preferable. This would create an element of certainty in the market which would greatly improve the "reality check" for traders and investors in financial futures. Buyers should be free to trade their contracts in an open and transparent secondary market, which would facilitate price discovery on a continuous basis. A financial futures market in heavy crude would then naturally develop: futures are not the devil; they are in fact a useful tool to manage risk. In fact, futures can provide some stability to consumers, and retailers of petroleum products may very well be obliged to publish prices that they could not change for at least three months: such a rule would force them to rely more on hedging and futures for their purchases of crude oil, and may stimulate some more interesting competition than the totally free prices that we see today in the industrial countries.

Creating a transparent and effective physical market for Arabian Heavy would also facilitate the discovery and trading of quality differentials, which in turn would help justifying investment in enhanced refinery conversion capacity. The physical market in Arabian Heavy would of course still be influenced by trading in Brent and WTI futures, but the link would be quite more elastic than it is today, and the influence might be in both directions.

Creating a transparent and effective physical market for Arabian Heavy would also facilitate the discovery and trading of quality differentials, which in turn would help justifying investment in enhanced refinery conversion capacity

On a market so designed, Saudi Arabia would have substantial influence yet not outright control. Other forces –fundamentals and speculation – would still have a powerful influence, and it is again not a foregone conclusion that the Kingdom would be able to steer the price to the level it desires. But surely the influence of fundamental would be much greater than it is today.

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