



EDITED BY VALERIA TALBOT

# THE RISING GULF

## THE NEW AMBITIONS OF THE GULF MONARCHIES

INTRODUCTION BY PAOLO MAGRI

ISPI



# **The Rising Gulf**

## **The New Ambitions of the Gulf Monarchies**

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Edited by Valeria Talbot

ISPI

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## Introduction

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Over the last decade the Gulf monarchies emerged as increasingly proactive players. The steady rise in hydrocarbon prices, up to 2014, has represented a significant source of wealth for these oil and gas producers, enabling them to maintain sustained domestic economic growth rates and high public expenditures, on the one hand, and to invest heavily in key sectors both domestically and abroad, on the other. Gulf Sovereign Wealth Funds (SWFs), which amount to 40 per cent of the world's total SWF assets, have been diversifying and expanding investments into the Americas, Europe and especially Asia. Futuristic cities such as Abu Dhabi, Dubai and Doha have become the symbols of the Gulf's growth driven by oil wealth, which transformed these states into important financial hubs and international business centres.

The rise of the Gulf States has gone hand in hand with a dramatic change in the world system, where Asia has been emerging as a new global economic centre and major energy consumer. With their huge hydrocarbon reserves, these monarchies have become crucial energy suppliers of the growing Asian markets as well as key investors. In a global order ever more marked by new regional powers, the Gulf monarchies took advantage of their assets and strategic position to seize new opportunities and increase their international leverage. This has resulted in a growing diversification of interests and international relations, which became crystal clear in the Middle East and North Africa (MENA) region after 2011. The Arab uprisings provided the Gulf monarchies with the opportunity to deepen their political, cultural and economic influence in the area. Relying on their huge economic assets, they succeeded in limiting instability within their borders while at the

same time expanding their reach outward. For them the uprisings had mainly economic roots. As a result, they used the financing tool, both internally and externally, to support real economy and income distribution with a view to reducing socio-economic discontent in the Arab countries. The Gulf regimes intervened, directly or indirectly, in all the major regional crises, from Libya to Syria and Yemen. Despite the clear will to influence regional dynamics in order to maintain – or in some cases to alter – the *status quo*, it is difficult to grasp the rationale behind the Gulf monarchies' policies. One should bear in mind that these monarchies are anything but a monolith with a single strategy. Rather, they encompass a wide range of interests and agendas. Indeed, in spite of common features, they have adopted different positions and policies. The most striking example is given by the opposite approaches of Saudi Arabia and Qatar towards the Muslim Brotherhood and the rise of political Islam.

Gulf assertiveness comes at a time when the monarchies are facing important challenges. At the internal level, economic diversification is by far the main challenge. In spite of many attempts to diversify their economies, these monarchies continue to be highly dependent on hydrocarbons. The real question here relates to the sustainability of the *rentier* state model and its ability to preserve wealth along with social and political consensus in the long-run. A further critical issue is the hand-over of political power to the next generation of the ruling families. In addition, when it comes to the regional context, the nuclear deal with Tehran and Iran's growing influence are perceived as foremost concerns for the Gulf's security, in spite of US reassurance to maintain, and reinforce, a partnership based on sound geopolitical factors. Last but not least, shifting dynamics in global energy markets, due to weaker demand in many countries coupled with stronger US production, may prove to have negative effects on these hydrocarbon producers, should oil prices remain low in the long-term.

In the complex Gulf puzzle, this report puts together the pieces of the domestic dynamics with those of the external policies. The aim is to assess to what extent the rising Gulf monarchies are able

to play as key actors at both the regional and international levels. The Gulf's new stance marks a significant change from its traditionally cautious approach. In particular, the report addresses the following key questions. Are Gulf monarchies adopting sustainable domestic policies in the medium- and long-term? How have they extended their influence in the MENA region? How are they reshaping their international relations? How do they act in the world energy market?

In the first chapter, Toby Matthiesen focuses on the global and regional dynamics that, in the 21<sup>st</sup> century, have favoured the rise of the Gulf monarchies as assertive players both regionally and globally. As the author puts it, oil wealth allowed these states to buy 'soft power' and to consolidate their role as international hubs in finance, transport, higher education and the arts. At the same time, as a result of the international status acquired by the Gulf regimes, their political systems and the poor situation in terms of human rights and civil freedoms have been put into the spotlight. These regimes proved to be resilient to change unleashed by the Arab uprisings. At the regional level, this gave them the opportunity to increase their role and to influence developments in other Arab countries. On the internal front, they increased public spending to buy consensus and at the same time strengthened control over their populations, further restricting already limited participation in the public sphere. While this approach proved to be successful in maintaining order and stability in the short-term, it remains to be seen if it will be sustainable in the long-run, due to the number of challenges and internal pressures that these monarchies are facing.

The Gulf States' proactive stance in the MENA region after 2011 is the main focus of chapter two by Elena Maestri. In spite of some convergences, the Gulf Cooperation Council (GCC) members have pursued different strategies based on diverging interests. Financial aid was the main tool these states used to respond to the challenges of the uprisings within the GCC and to support other Arab regimes outside the Gulf with the aim of prioritizing internal stability (this is especially the case with Bahrain, Oman, Jordan

and Morocco) and the stabilization of North African countries in transition (Tunisia and Egypt). Outside the official government channels, Gulf charities played a significant role in providing considerable, and untraceable, financial support, raising questions concerning the real final recipients. The author stresses that the 'economic dimension' of security has acquired growing importance in the Gulf States' relations with the rest of the Arab world, as shown by the amount of Gulf investments flowing to the other Arab countries. In the current regional context, dealing with transnational Islamist networks and reshaping relations with Iran after the nuclear deal emerge as the main regional concerns for these monarchies.

The third chapter by Abdullah Baabood goes beyond the regional context and places the spotlight on the diversification of the Gulf's international relations between East and West. While the US continues to be the main guarantor of the GCC countries' security, Asia has acquired growing importance over the past decade. Given their significant reserves of oil and gas and their leading role in world energy supplies, the Gulf monarchies' strategic relations have been increasingly intertwined with the changing dynamics of the global economy and energy markets. In fact, energy supply to booming Asian economies has been the main driver of Gulf-Asia relations. This has also entailed a considerable increase in trade and investment, while Gulf business has gradually moved eastwards. Furthermore, in light of the US foreign policy pivot towards Asia and its 'leading from behind' policy in the MENA region after the Arab uprisings, the Gulf States have strengthened their ties with Asia, especially with China and India, including dialogue and cooperation not necessarily in economic and energy-related sectors. However, the author concludes that Asian powers are unlikely to fully replace the strategic role played by the West anytime soon, as the US still remains the sole security guarantor in the region.

In chapter four, Sara Bazoobandi highlights the goals, strategies and motives of GCC SWFs as well as the evolution of their geographical scope all over the world. From a domestic point of

view, SWFs have socio-economic and political agendas. First, they serve to diversify the Gulf's hydrocarbon-rich economies and to protect them against volatile oil prices and demand. Second, SWFs are considered a tool to maintain the sustainability of the social contract between states and their citizens, which is based on the redistribution of wealth and the stability of regimes. Furthermore, they have been used to finance a variety of economic projects aimed at addressing energy, water and food security challenges. Globally, SWFs have contributed to increasing the international prestige and financial leverage of these monarchies. This is particularly the case of Qatar and the United Arab Emirates (UAE), which have been transformed into new financial giants. While North America and Europe were privileged destinations in the past decades, SWFs have gradually diversified their investment targets and registered a geographic shift towards emerging markets and the whole MENA region. However, especially in the aftermath of the 2008 financial crisis, these funds also contributed to supporting European economies.

Saudi oil strategy and its key role as 'swing producer' in the global energy market are examined by Naser al-Tamimi in chapter five. In particular, the author takes into account the strategy that Saudi Arabia adopted in the past year after the decision not to cut oil production by OPEC countries, of which it is the undisputed leader. On the one hand, changing dynamics in the global oil market – in particular increasing hydrocarbon supplies from the US, Canada, Russia and potentially Iran – are challenging Saudi Arabia's leading position. On the other, growing domestic consumption and fuel subsidies play a role in Riyadh's policy. By putting together the international and the domestic factor, the author explains the ongoing changes in Saudi oil strategy to keep its market share and expand its role in the refining sector. He finally argues that Saudi Arabia is gradually withdrawing from its role as swing supplier and stresses that reducing its dependence on oil through economic diversification is the only choice for the kingdom.

What are the implications for the EU of the Gulf States' new assertiveness both at the regional and global levels? What is the

impact on Europe of the Gulf's increasing financial leverage and of the shifting of its international economic interests, energy strategy and potential security partnerships? Luigi Narbone and Valeria Talbot address these questions in the last chapter, which identifies areas of common interest for Europe and the Gulf and their policy implications. The chapter also includes some priority actions for Europe to pursue in order to strengthen ties with the GCC and to take full advantage of intense economic, energy and defence relations between EU member states and Gulf monarchies. Given the impact of MENA region dynamics on both Europe and the Gulf, convergence of action in the Middle East should be by far a key sector of bilateral cooperation.

*Paolo Magri*

ISPI Executive Vice President and Director

# **1. Conservative Monarchies in a Transforming Region**

*Toby Matthiesen*

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In the 21<sup>st</sup> century, the monarchies of Saudi Arabia, Bahrain, Kuwait, Oman, Qatar, and the UAE – the group of countries constituting the GCC – have emerged as one of the most dynamic and fast-changing regions of the world. These countries have strengthened their position as global hubs for financial transactions, investments, air travel, shipping, diplomacy, sport and, increasingly, also art and culture. They have profoundly transformed their cities, as symbolised by the rise of Dubai and other Gulf cities such as Doha, Abu Dhabi or Sharjah. Almost all of this was fuelled and made possible by revenues from oil and gas, the price of which was historically high since the mid-2000s and stayed at very high levels until a sudden crash in mid-2014.

## **Timid openings allowed the articulation of oppositional discourses**

At the same time, however, these profound transformations in the Gulf, and the fact that the Gulf States were “put on the map”, could not overshadow the evidence that the GCC states were located in a highly volatile region, that subnational identities competed with national identities and that the political systems of the GCC were undemocratic and authoritarian. In the first decade of the 21<sup>st</sup> century there were a few ‘reconfigurations of authoritari-

anism' across the GCC<sup>1</sup>. Several states such as Bahrain, Saudi Arabia, the UAE and Oman created representative bodies with limited or no legislative powers, and held municipal elections (Kuwait has had the strongest parliament in the GCC since its 'liberation' from Iraqi occupation in 1991). These changes allowed a discourse of democracy, rights and issue-based politics to be discussed more broadly. They also brought to the fore political movements that had hitherto operated in secret, such as remnants of old leftist and Arab nationalist parties, as well as various forms of Islamist movements, both Sunni and Shia. This was coupled with a greater openness of the media landscape as well as with the emergence of social media. As such, these developments made the public more aware of the different political trends that were active in the region, but because of the limited powers of the councils, they also proved that the regimes and the ruling families were not actually trying to embrace profound reforms or to give up power, but rather to co-opt new sections of society through these representative institutions. This was not dissimilar from the situation in other Arab countries, which had experienced revolutions since 2011 and which had also opened up their public spheres to a slightly more critical political debate (for example Egypt and Syria)<sup>2</sup>. This allowed political dissidents to articulate oppositional discourses in a more public way and set precedents for the post-2011 era.

## **The Arab uprisings and the Gulf States**

So when the Arab uprisings of 2011 swept throughout the region, all the Gulf States except Qatar and the UAE saw protests, at times by large numbers of people, which were quelled with government

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<sup>1</sup> For a discussion of the Saudi case, see A. Kapiszewski, "Saudi Arabia: Steps toward Democratization or Reconfiguration of Authoritarianism?", *Journal of Asian and African Studies*, vol. 41, no. 5/6, 2006, pp. 459-82.

<sup>2</sup> S. Heydemann, *Upgrading Authoritarianism in the Arab World*, Saban Center, Brookings Institution, Analysis Paper no. 13, October 2007, <http://www.brookings.edu/~media/research/files/papers/2007/10/arabworld/10arabworld.pdf>.

handouts as well as harsh repression against those that could not be bought off. Protests in Oman started in January 2011, and Saudi Arabia and Kuwait experienced small protests in the following weeks. Regime responses differed. In Saudi Arabia it was co-optation, repression, and sectarian rhetoric. The sultan of Oman mixed repression with reforms and immediately initiated some changes. Kuwait became embroiled in an internal protest movement largely led by Sunnis and stateless people, the *Bidun*, while Kuwaiti Shia mobilized in support of the protests in Bahrain and Saudi Arabia.

Only Qatar and the UAE saw no protest movements emerge, although there were vocal demands for change. Qatar largely deflected demands for political reform at home by supporting revolutions abroad. In the UAE, petitions for political reforms circulated in 2011, and the state reacted with a campaign of repression against political and human rights activists as well as handouts of money and an increase in salaries to government employees. The UAE's crackdown also specifically targeted local sympathizers with the Muslim Brotherhood (MB), a sign of the country's rulers' concern over the possibility that the MB in the Gulf could be inspired by their Egyptian counterparts to demand more political power.

The protests and challenges to the political systems in the different GCC countries followed distinct trajectories. But all the GCC states have similar systems of government, in which the major decisions are made by a small number of people in almost complete secrecy. Therefore, demands by activists across the GCC were also similar, and mainly centred around calls for more political participation and accountability, as well as social justice.

In Bahrain, which has been the GCC country most affected by the Arab uprisings, and where the survival of the regime was seriously threatened, the protests were led by Shia Muslims. This should not come as a surprise since they represent the majority of the population with estimates ranging from 55 to 70 per cent. While initially many Sunnis were supportive of the demands that protesters called for on the central Pearl Roundabout, as the pro-

tests went on more and more Sunnis became dissatisfied with the direction of the uprising (the more radical elements of the opposition were demanding the establishment of a republic by March 2011). The regime also did much to sectarianize the conflict and to prevent the formation of a united opposition front made up of Sunnis and Shia<sup>3</sup>. The protesters called for more political say and a fairer distribution of wealth, as well as a stop to discrimination against the Shia. The uprising was preceded by a deterioration of the political situation and the arrest of key bloggers and political activists in 2010.

In Oman, the slogans of the protesters were less confrontational, and rather urged the Sultan to get rid of corrupt officials, improve administrative procedures and increase political participation. While there were protests in urban centres such as the capital Muscat, the Omani protests were also an outcry from the peripheries against the dominance of the centre. In the port town of Sohar, where the protests turned deadly when police shot several protesters, the demonstrations were fuelled by the displacement of whole communities as a result of an expansion of the port and the local Aluminium smelter<sup>4</sup>.

Oman and Bahrain are the poorest of the GCC countries, where the share of revenues from hydrocarbons per capita is relatively small compared to the other GCC states. As such, the protests did have an economic component to them. In response, the GCC decided in March 2011 to grant Bahrain and Oman a \$10bn aid package each.

In Kuwait, like in many other countries that saw protests, tensions had already become more visible before 2011 and sporadic protests had highlighted the key issues that were to become the core demands of protesters after 2011. An alliance of youth as

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<sup>3</sup> For more on this see T. Matthiesen, *Sectarian Gulf: Bahrain, Saudi Arabia, and the Arab Spring that Wasn't*, Stanford, CA, Stanford University Press, 2013. Some Sunni opposition leaders such as the leftist Ibrahim Sharif were also imprisoned.

<sup>4</sup> For more see Sa'îd Sultan al-Hashimi (ed.), *al-rabi' al-'Umani: qira'a fî al-sayyaqat wa-l-dalalat* (*The Omani Spring: A Reading of the Contexts and Meanings*), Beirut, Dar al-Farabi, 2013.

well as Islamists (mainly MB members) and tribal activists had, since 2009, organised a number of protests, which in particular challenged Prime Minister Nasser al-Muhammad al-Sabah, who was accused of corruption. In addition, protests by *Bidun* activists, people without citizenship who face serious discrimination in the country, had been going on for years but were galvanised by the Arab uprisings.

In Saudi Arabia, the protests were mainly confined to the Shia areas in the Eastern Province. In the country the Shia, who make up 10-15 per cent of the citizen population, face serious discrimination in government employment and other fields, and have mobilised for decades in an attempt to change their position as second-class citizens. In 2009 there were protests and clashes, inspired by the fiery rhetoric of one Saudi Shia cleric, Nimr al-Nimr. When in February 2011 the protests in neighbouring Bahrain took off, al-Nimr encouraged young people to protest in Eastern Saudi Arabia too. The protests were met with harsh repression, but continued especially after the killing of the first Saudi Shia in late 2011. Repeated clashes between armed locals and security forces left two dozen Shia and a number of policemen dead<sup>5</sup>. In the rest of the country, small but persistent protests occurred for the release of thousands of people imprisoned for years on suspicion of harbouring sympathies for the Sunni militants of al-Qaeda in the Arabian Peninsula (AQAP). They were usually small flash-mob-like protests that were filmed and then posted online. Other challenges came from a number of human rights groups and in particular from the Saudi Association for Civil and Political Rights (ACPRA), which demanded a profound political reform in the country. A number of petitions were also circulated demanding a constitutional monarchy and democratic elections. Some of these petitions were signed by key clerics who were broadly associated with the MB movement. Key clerics and individuals such as Salman al-Awda have, in the wake of the Arab uprisings, embraced democracy as the solution to the issues that Saudi Arabia is facing

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<sup>5</sup> For more on the Saudi Shia case see T. Matthiesen, *The Other Saudis: Shiism, Dissent and Sectarianism*, Cambridge, Cambridge University Press, 2015.

and have contributed to the acceptance of these ideas in the country. The government reacted harshly to all these challenges and imprisoned the key activists of all different strands, from human rights activists such as Waleed Abu al-Khair of ACPRA to the leaders of the Shia uprising such as Nimr al-Nimr (who was sentenced to death). It also enacted new cyber crime laws limiting what people can say on social media, which had become a platform for discussing many of these ideas.

The GCC as a whole has reacted to these challenges with direct military intervention (in Bahrain), economic largesse, as well as an attempt to foster greater GCC integration through a “Gulf Union”. The latter project was announced by King Abdullah and enthusiastically greeted by Bahrain, while other Gulf States (in particular Oman) showed concern over the possibility that such a union would in effect result in their coming under an even stronger Saudi influence. As of 2015, the project seems to have stalled.

So far, all the GCC monarchies have survived the Arab uprisings without being overthrown or having to make serious adjustments to their political systems. Yet the protests and the reactions to domestic and foreign challenges have profoundly transformed the Gulf States. All Gulf States have stepped up their efforts to monitor and control their populations, and none of them has reacted with greater political openness and transparency to the challenges of popular mobilisations in the region. This might have been a short-term solution, but it is far from certain that this will ensure stability in the long-term.

## **The ‘new’ politics of interventionism**

The Gulf States have also embraced a new more proactive foreign policy across the Middle East and beyond. The period since 2011 has witnessed a profound shift in the foreign policies of the GCC states from petrodollar diplomacy to direct involvement in the politics of other states and even military intervention with the de-

ployment of special forces and the use of air power<sup>6</sup>. This has taken the form of the special forces' involvement in the overthrow of Gaddafi in Libya in 2011, of the GCC intervention in Bahrain in March, of the use of Gulf air forces against Islamic State targets in Syria and Iraq as well as, most strikingly, of the Gulf military intervention in Yemen. The GCC-led force that started airstrikes on Houthi targets in Yemen in 2015 brought to the world's attention the extent of the GCC's ambition to dominate regional affairs and underscored the military support that Egypt in particular is presumed to be giving to the Gulf States' security in return for financial and political backing<sup>7</sup>. The other main foreign policy priority of many GCC states is to counter Iran, and they have not spared funding or diplomatic capital to achieve the aim of containing the country.

However, there were also divisions amongst several Gulf States over these foreign policy priorities and over the preferred outcomes in the region. Oman, for example, has not agreed to GCC initiatives designed to counter Iran. Furthermore, Qatar, which shares a gas field with Iran, is also more cautious. Dubai and other Emirates engage in substantial amounts of trade with Iran, as does Kuwait, which also has an influential Persian Shia community. So it is mainly Saudi Arabia, Bahrain, and Abu Dhabi that are giving priority to the anti-Iran agenda.

The rivalry between Qatar on the one hand and the United Arab Emirates and Saudi Arabia (plus Bahrain) on the other, dominated much of Middle East politics in the period between 2011 and 2015. These divisions have become less pronounced after the leadership transitions in both Qatar in 2013 and Saudi Arabia in 2015, but they will likely remain a source of tension.

This Qatari-UAE/Saudi rivalry has had a particularly strong impact on Egypt as well as on Libya, where the two sides support opposing factions in an increasingly vicious civil war. The rivalry

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<sup>6</sup> See, for example, K. Young, *The Emerging Interventionists of the GCC*, LSE Middle East Centre, Working Paper Series, December 2013.

<sup>7</sup> H. Hendawi, "Arab League unveils joint military force amid Yemen crisis", *The Associate Press* (AP), 29 March 2015.

also had an impact on Tunisia. But in Tunisia it did not play out in such an open and violent way, and the country became the only success story of the Arab uprisings with a limited amount of political violence and democratic transitions. The MB is probably the organised political movement that could pose the most serious threat to the Gulf monarchies. Having said that, however, the Gulf regimes also have a long history of interaction with the MB and in some cases the new post-2011 anti-Muslim Brotherhood propaganda paints a very a-historic picture of the relations between the MB and the Gulf States. This propaganda in particular negates the history of migration and economic cooperation that has characterised the relationship between Gulf States and the MB over the last few decades. Among all the Gulf States, only Qatar has publicly emerged as a backer of the MB, and has continued to provide its support after 2011. And this backing of the MB has been the main bone of contention between Qatar on the one hand and the UAE/Saudi Arabia on the other.

But the new interventionism of the GCC also carries severe risks. In fact, it has directly linked Gulf security to the security of a whole array of Arab regimes, whose over-reliance on repressive tools fuelled the grievances leading to the Arab uprisings.

## **The challenge of succession**

As monarchies, the Gulf States share similar problems of succession. Unlike the Arab republics, in which ageing dictators tried to hand over power to their sons – a practice that fuelled discontent amongst the population and led to the Arab uprisings – one would assume that succession in the monarchies is less contentious<sup>8</sup>. While that may be the case, intra-ruling family rivalries, shifting elite alliances, and the preferences of Western allies also play a role in determining succession in the GCC. At the outset of the Arab uprisings, all the leaders of the GCC states were old and

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<sup>8</sup> R. Owen, *The Rise and Fall of Arab Presidents for Life*, Cambridge, MA., Harvard University Press, 2012.

there was uncertainty about how and when they would be able to hand over political power and offices to the next generation of the ruling families.

In Bahrain, for example, such a succession in theory happened with the appointment of Crown Prince (CP) Salman bin Hamad al-Khalifa in 1999. He tried to negotiate an agreement with the opposition during the street protests of February and March 2011, but to no avail. Rival factions within the ruling family such as the Prime Minister Khalifa bin Salman and the “Khawalid” torpedoed his initiatives and opted for a hard security approach to the uprising, which in effect also seriously undermined the position of the CP<sup>9</sup>. This attempt to involve the younger generation in decision-making and introduce the possibility of a ‘liberal’ political opening in the GCC failed. In Qatar, Emir Hamad bin Khalifa al-Thani handed over power to his son Tamim bin Hamad al-Thani in June 2013. The new emir was very young by Gulf standards (b. 1980), and this transition set a precedent that many thought would be difficult to follow for the other GCC states. The new emir also faced challenges when he tried to assert his authority amongst the al-Thani, the wider Qatari society, as well as within the GCC. In a system based on seniority, such a young emir could be seen as a challenge to the status quo in the region. But Saudi Arabia soon followed suit, when in 2015 the new King Salman appointed his youngest son Muhammad as Minister of Defence and Deputy Crown Prince and appointed Muhammad bin Nayef as CP. Therefore he settled the question of who amongst the third generation of princes would come to power for now (although rumours about tensions over this issue within the ruling family abound). Muhammad bin Salman was between 29 and 34 years old when he was appointed, something that set him apart from the ageing ministers and princes attending the Saudi cabinet meetings (although a number of other young ministers were simultaneously appointed

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<sup>9</sup> T. Matthiesen, “Elite fragmentation and securitization in Bahrain”, *The Washington Post*, 5 December 2014, <http://www.washingtonpost.com/blogs/monkey-cage/wp/2014/12/05/elite-fragmentation-and-securitization-in-bahrain>.

and many princes, including his own father Salman, had initially been appointed to their positions at a very young age).

Oman too faces serious challenges of succession. Sultan Qaboos has not yet appointed a successor, and has been seriously ill. He had been abroad for much of 2014 receiving medical treatment in Germany, and many Omanis seemed worried about what would happen if he were to die<sup>10</sup>.

In Kuwait, succession has been officially settled. However, rivalries between different branches of the ruling family have dominated Kuwaiti politics for years. The al-Fahad and al-Salim branches of the ruling families have fallen out over succession issues and have dominated different sides in Kuwait's parliament, and have also reportedly sponsored parts of the protest movement that emerged in 2012.

In the UAE, middle-aged princes had taken over power after the death of Shaykh Zayed bin Sultan al-Nahyan in 2004. The main dynamic amongst UAE ruling families (each Emirate has its own ruling family) is the consolidation of political power in Abu Dhabi and amongst its ruling family, the al-Nahyan. This consolidation intensified after the financial crisis and Dubai World's default in 2009, which required a bailout by Abu Dhabi. In addition, the securitisation of the UAE, which increased as a response to the Arab uprisings since 2011, was led by Abu Dhabi and has further strengthened its position.

## **Buying soft power**

The Gulf States have also emerged as financial hubs, both as centres for companies and for FDIs (Foreign Direct Investments), and particularly also as institutional investors around the world<sup>11</sup>. This financial role has obviously increased the profile of the GCC in the eyes of other countries, and has given the GCC states more

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<sup>10</sup> For succession in Oman see <http://www.orientxxi.info/magazine/succession-incertaine-a-oman,0751>.

<sup>11</sup> The chapter on Sovereign Wealth Funds will elaborate further on this point.

leeway in diplomacy and in how they manage domestic political dissent, since a whole range of actors and countries are increasingly dependent on Gulf financing. The 2008 financial crisis intensified this process and gave the cash-rich Gulf countries further inroads into the cash-poor economies, particularly of Europe. But Gulf investments are also increasingly important in the US, in Africa, Asia, Australia and Latin America.

Most major international banks have their Middle East headquarters in the Gulf, and Islamic finance is another major asset of the Gulf. Beirut was the Middle East's major banking hub until the start of the civil war in 1975, after which many banks relocated to Bahrain. However, the political troubles in Bahrain led many to relocate to other Gulf destinations, a process that intensified after the violent crackdown on the protest movement in 2011. The Gulf also tried to become a major hub for international media, even though its political systems are not conducive to critical reporting on the Gulf States themselves. Nevertheless, the Gulf States are now a major base for international TV channels, and all Gulf States have established their own TV channels. Among these, *Al Jazeera* has been the most prominent and controversial, and has been a major factor in Qatar's soft power strategy.

Hosting sport events has emerged as another key strategy for GCC states to increase their public profile. F1 (in Abu Dhabi and Bahrain), tennis, equestrian sports, and particularly Qatar's winning of the 2022 World Cup bid have firmly put the GCC on the map of the global sports circuit. But this high profile also led to greater scrutiny. The annual F1 race in Bahrain has emerged as an opportunity for journalists to report on the country's political troubles and on the ongoing uprising. Similarly, the World Cup bid of Qatar has led to strong criticism of the Kafala (sponsorship) system for migrant workers and the dire conditions under which they live and work across the GCC. The ubiquitous allegations of corruption and vote-buying in FIFA in association with Qatar's bid have tainted Qatar's international image. Qatar is a prime example of how a small state can gain an international reputation and 'brand recognition' by using soft power and encouraging a range

of international bodies and institutions to work in the country<sup>12</sup>. On the other hand, however, the Qatari case also shows how too much international attention can backfire, in particular when international human rights and labour standards are not upheld. The country has also arrested journalists trying to cover labour conditions, which has led to even more negative press coverage<sup>13</sup>. The creation of knowledge and art hubs, mainly by opening chapters of internationally recognised institutions in the Gulf, has equally been a double-edged sword. Universities with branches in the Gulf had their terms of employment scrutinised (most prominently New York University in Abu Dhabi). The same happened with museums that opened Gulf franchises, such as the Louvre and Guggenheim museums in Abu Dhabi<sup>14</sup>.

So, while this kind of buying of ‘soft power’ has worked in many ways, and has turned the GCC states into key players in a whole range of fields, from sports to higher education and the arts, it has also led to much greater scrutiny of their political systems, human rights standards and labour conditions.

## Global hubs

Apart from becoming financial centres, the GCC states have also managed to position themselves as strategic transport hubs between Europe and Asia. Ports and airports are the backbone of this strategy, together with national airlines, several of which have emerged as global players in the airline industry. Despite the accusations of having unfair advantages over their Western competitors, they have secured a significant market share on routes not

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<sup>12</sup> For an analysis of Qatar’s soft power strategy see M. Kamrava, *Qatar: Small State, Big Politics*, Ithaca, NY, Cornell University Press, 2013.

<sup>13</sup> See for example *The Guardian* coverage of the labour conditions in Qatar as well as <http://www.hrw.org/news/2015/05/12/dispatches-qatar-quashing-reporting-world-cup>.

<sup>14</sup> A group of artists decided to boycott the museums if they would not reconsider the employment conditions of construction workers at the sites. All these projects have been suffering from delays, <http://gulflabor.wordpress.com/2011/03/11/for-immediate-release-100-international-artist>.

just to and from Gulf destinations, but also more generally on flights from Australia and Asia via the Gulf to Europe and America. This is all part of a strategy of putting the GCC on the map. The Jebel Ali port in Dubai has emerged as one of the biggest and most important deep-sea ports for container shipping in the world. Dubai and the wider Gulf have thus strengthened their position as a key part of global shipping lanes. It is worth remembering that it is a bit of a detour for ships to enter the Strait of Hormuz and dock in Dubai, rather than docking in Oman or Yemen (Aden) on the way from India through the Suez Canal. The Dubai port therefore had to make an extra effort to succeed. The establishment of a duty-free zone was one key factor, and rates at the port are also very competitive. Apart from Dubai, Oman has also embraced a strategy of expanding its ports massively and becoming a global transport hub. The port of Sohar has been expanded, mainly with Dutch assistance from Rotterdam port and has emerged as another major hub in the region. All these projects have profited from the instability around the port of Aden in Yemen, which used to be one of the biggest ports in the world. The war in Yemen, which escalated in 2015, will intensify these developments.

## Conclusion

Over the past decades, the GCC states have emerged as increasingly important global players. A number of global and regional developments have led to this rise of the Gulf, which some have termed the “Gulf moment” in Arab history<sup>15</sup>. The financial crisis has led to huge new opportunities for Gulf governments, businesses and SWFs, and it coincided with a period of historically high oil prices. Investments across the world have greatly increased the political influence of GCC states, a process that is even more striking in key areas of Gulf soft power involvement, such as higher

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<sup>15</sup> A. Abdulla, *Contemporary socio-political issues of the Arab Gulf moment*, Kuwait Programme on Development, Governance and Globalisation in the Gulf States, no. 11, September 2010, <http://www.lse.ac.uk/middleEastCentre/kuwait/documents/paperabdulla.pdf>.

education, sports and the arts. At the same time, while the United States had professed a tendency to “pivot towards Asia” in the early 2000s, the start of the Arab uprisings in 2011 reaffirmed the position of the Middle East as the key arena for geopolitical rivalries between global players. While the legitimacy of the Gulf governments was also tested, their enormous financial power, as well as their alliance with the West, coupled with an American tendency to “lead from behind”, put the GCC states in an unprecedented position to influence regional events. Several historic rivals of the GCC had been eliminated or severely challenged (Saddam Hussein, Muammar Gaddafi, Bashar al-Assad, as well as Nuri al-Maliki). Several states had collapsed and became arenas for regional struggles (Iraq, Syria, Libya, Yemen and, to a lesser extent, Egypt and Tunisia).

At the same time, however, figures that had been presented as ‘liberal’ and ‘reformist’ royals, such King Abdullah of Saudi Arabia or the Crown Prince of Bahrain Salman bin Hamad al-Khalifa, were unable or unwilling to profoundly change the political systems of their countries. On the contrary, since 2011 the GCC has witnessed an increased securitisation of the political, media, and public spheres, and a far-reaching crackdown on dissent and free speech. This has undermined some of the soft power and public diplomacy initiatives of the GCC states and has, in the long-run, probably undermined the legitimacy of the Gulf ruling families in the eyes of their citizens. For now, however, it has allowed the GCC states to become even more important players on the regional and global levels, enabling them to pursue their interests more aggressively and independently than ever before.

## **2. The Gulf's Proactivism in the MENA Region**

*Elena Maestri*

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Despite some signs of foreign policy coordination, Arab Gulf monarchies have rarely exhibited joint foreign policy-making as member states of the GCC. The worrying scenario developing from the Mashreq to the Maghreb since 2011, the inability of the EU and the GCC to establish concrete cooperation on issues of common concern in the Mediterranean (such as humanitarian problems or conflict and post-conflict management), the huge mistakes of the US, the disruptive strength of transnational radical Sunni and Shia fundamentalist groups, and rising Iranian interference in Arab affairs can be considered the major factors leading the GCC leaderships to re-adjust their foreign policy strategies in order to address the multifarious threats, while trying to find alternative balances and to re-shape the political landscapes in the MENA region.

The strategies and political instruments of Arab Gulf monarchies confronting chaos and power vacuums in the Middle East may be different, as they tend to respond to domestic interests, but their vision of sustainable Gulf security founded on inclusiveness against sectarianism and radicalism has not changed much in substance throughout the years. The ideological struggle between Saudi Arabia and Iran has certainly been assuming a new dimension in its regional ramifications in the MENA region, but pragmatism and flexibility are generally stronger than ideological shackles in Arab Gulf rulers' reactions when it comes to international and mutual relations. This approach can be explained by a deeply rooted tribal political culture, largely affecting relation-

ships within a system that generally implies the principle of equality, working hand in hand with the principle of seniority among its leaders.

Within this framework, the first paragraph will analyse diversified GCC reactions towards a series of crisis and opportunities that emerged during the Arab Spring inside (Bahrain and Oman) and outside (Tunisia, Jordan, Morocco) its ranks, as well as its stance towards a series of phenomena that are significantly affecting the regional balance. The second part will focus on the challenges posed by transnational Islamist networks to the Gulf regimes and the responses they have adopted. The final part of the chapter deals with the diverse and complex relations existing between the GCC actors and Iran, relations that are far from being completely hostile, especially when considering the plurality of positions that have emerged inside the GCC.

### **Proactivism and diversified reactions after the 2011 uprisings**

Growing activism has certainly given some actors of the GCC greater prominence at the international and regional levels since 2011. A prompt response of the Council to the challenges faced by Bahrain and Oman after the uprisings resulted in an economic package of \$20bn over ten years to both countries, in addition to security support for Bahrain. The GCC initiative to mediate and promote a 'national dialogue' in Yemen emerged as another interesting attempt at joint diplomatic action: despite the failure of these prolonged mediation efforts, the Arab Gulf negotiators involved in the process proved, on several occasions, to be able to coordinate effectively while trying to deal with the unique and largely unknown dynamics of a tribal society in a highly decentralised country like Yemen, exposed to increasing foreign funding

from radical Islamic transnational groups and movements<sup>1</sup>. GCC efforts of diplomatic coordination within the Arab League soon emerged with reference to the dangerous situation developing in Syria and in Libya. Differences in the approach to the transition process in countries like Tunisia and Egypt did not prevent the enhancement of defence and intelligence cooperation among all the monarchies under the GCC counterterrorism treaty.

The traditional Saudi leadership's confrontational attitude towards the Muslim Brotherhood (MB) inevitably had an impact on the uneasy development of relations with the al-Nahda government in Tunisia. Saudi-Tunisian relations have been marked by some scepticism on the part of the Saudis about the transition process in the country. The asylum given in 2011 to the former Tunisian President, Ben Ali, was soon justified in the kingdom as the mere result of a policy inspired by the Saudis' delicate role of Custodianship of the two Holy Mosques, a role that generally prevents authorities from refusing protection to Muslims who ask for it. Nevertheless, Ben Ali was immediately forbidden to engage in any political activity liable to affect the Tunisian transition<sup>2</sup>. In 2012, during the official visit of the new Tunisian Prime Minister, the Saudi leadership emphasized the importance of a smooth transition in the North African country. The commitment to provide some aid packages and development funds to the new government was mainly conceived within the logic of prioritizing stabilisation of the region against chaos, despite the fact that Saudi authorities never disguised being quite uncomfortable with Islamist parties. That uneasiness was clearly expressed by the official Saudi press, as on several occasions it backed the Tunisian secularists' position against the MB of al-Nahda<sup>3</sup>. Therefore, some clear divergences in this direction have been emerging in the kingdom between the offi-

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<sup>1</sup> Personal interview with one of the negotiators involved in the GCC initiative in Yemen, September 2013. See also A. al-Salmi, *Social-political Implications and Religious Education in Oman and Yemen*, paper presented at the University of Pavia, 21 April 2015.

<sup>2</sup> N. al-Obaid, *Saudi Arabia: the Kingdom in a Post 'Arab Spring' Environment*, King Faisal Centre for Research and Islamic Studies (KFCRIS), Riyadh, February 2012, pp. 22, 24.

<sup>3</sup> M. al-Rasheed, "Saudi Arabia: local and regional challenges", *Contemporary Arab Affairs*, vol. 6, no. 1, 2013, p. 37.

cial Salafi-Wahhabi line and the line of Saudi Islamists within the *Sahwa* (Awakening) movement<sup>4</sup>, which proved to be quite supportive, on the contrary, of the ascendancy of Islamist parties in the post-2011 period.

Rising polarisation in the Islamic camp in Saudi Arabia and in the Gulf has certainly had an impact on the MENA region as a whole. The emergence and consolidation of Salafi groups as political actors and, alongside them, of extremist Salafi-Jihadi militants, led to further diversification in post-Arab Spring Islamist movements in the MENA region. At one and the same time, Arab Gulf capitalism, clashing with the Islamic socialist thought of the reformist wing of the MB, was increasingly mistrusted by some groups in the Arab world, and Salafi networks were often indicated as main supporters of an aggressive Arab Gulf ‘intrusiveness’ within the economic sphere. Concurrently, in the Gulf there were Arab exiles, already associated with the MB, who had developed further links with Arab Gulf Salafi scholars and circles; they contributed to strengthening a conservative wing quite close to *Salafiyya* – in its various ramifications – within the MB, while proving to be able to exploit their connections with some powerful Arab Gulf business circles.

Both conflicts and transitional processes since 2011 have been affected by such a rising complexity in ties and relations. Some of these ties certainly contributed to the rise of puritanism and radicalism in the MENA area against local Islamic traditions and practices, such as Sufism in North Africa. Here, the rise in the number of Salafi preachers, for instance, was a fact: some of them tended to endorse the quietist Salafi religious interpretations of the Saudi Mufti and of the Saudi Higher Council of Ulama, as often absorbed during the pilgrimage (*hajj*) to Mecca, but others had been brainwashed by radical preachers heard in newly-built mosques,

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<sup>4</sup> The *Sahwa* is a Saudi Salafi movement developed from an effort at merging the Muslim Brotherhood’s ideology with *Salafiyya*. See S. Lacroix, *Awakening Islam. A History of Islamism in Saudi Arabia*, Harvard University Press, Cambridge Mass., 2010.

often linked to Pakistani and Afghani jihadi networks, and were receiving unchecked funds from Gulf charities and NGOs as well<sup>5</sup>.

Private aid to post-Arab Spring environments from the Gulf started growing in parallel with the official financial packages, established by GCC governments for the benefit of various local Islamic institutions and groups. The risks of combining humanitarian and religious goals with support for some extremist elements were soon evident, which led to some allegations of abuse, despite the existing regulations on international bank transfers, particularly strict in Saudi Arabia after 9/11, but still quite loose in Qatar and in the UAE in 2011. Besides, the use of cash couriers and the bypassing of the banking system was widely recognised as much more common everywhere among private charities. Apart from the aid programs from the Arab Gulf governments, with the Saudi in the forefront, followed by Qatar and the UAE, the rising activism of independent charities led to a new awareness among GCC authorities of the need to regulate their activities and to enhance their transparency, in order to avoid the possibility that Arab Gulf funds were supporting violent militant groups abroad. One can easily guess that family and tribal networks linking the Hijaz to Syria, for instance, had their own crucial role in helping to support, through charities, one group or the other in the Syrian civil war. Gulf charities certainly assumed an important role in other countries as well, from the Mashreq to the Maghreb<sup>6</sup>, and even farther, as attested to, for instance, by rumours accusing Qatar of funding various militias in Africa, such as *Ansar al-Din* in Mali. If Doha's authorities soon vigorously denied any direct official role in the matter, it was clear that Qatar lacked the necessary monitoring capacity in a theatre like Africa, despite the proactive role initiated with the UAE in Libya, with the military participation in the NATO coalition against Gaddafi<sup>7</sup>.

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<sup>5</sup> Y.H. Zoubir, L. Dris-Aït-Hamadouche, *Global Security Watch – the Maghreb: Algeria, Libya, Morocco, and Tunisia*, Praeger, Santa Barbara, California, 2013, pp. 101-102.

<sup>6</sup> J. Benthall, R. Lacey (eds.), *Gulf Charities and Islamic Philanthropy in the 'Age of Terror' and Beyond*, Gerlach Press, Berlin, 2014.

<sup>7</sup> "Qatari PM denies meddling in Mali", *The Peninsula*, 30 January 2013, <http://thepeninsulaqatar.com/news/qatar/223824/pm-denies-meddling-in-mali->

Against this backdrop, the need to go beyond aid programs emerged as an essential step in dealing with post-2011 regional situations: Arab Gulf monarchies had committed billions of dollars, but business had to gain a new role in re-shaping relationships with the countries of the region. The ‘economic dimension’ of security affecting the re-definition of GCC member states’ relations with the rest of the Arab world, in light of the various challenges, certainly started gaining more attention as of 2013: during the first international conference of the Arab and International Relations Council, held in Kuwait in February 2013, the Prime Minister and Foreign Minister of Qatar, Hamad bin Jassim al-Thani, emphasised that change in the Arab world needs to be conceived within a wider perspective, going beyond uprisings and protests and addressing economic, social and cultural aspects.

‘Securing markets’, however, represents an essential prerequisite for GCC economic operators willing to invest in development projects in the region; uncertainty and conflicts have been hindering a more constructive involvement of Gulf businesses in the MENA region. In the case of Libya, for instance, during the 2012 official visit to the Saudi kingdom by Muhammad al-Muqairef, President of the Libyan National Conference, the establishment of the Saudi-Libyan Business Council was welcomed and Saudi businessmen were invited to invest in the country<sup>8</sup>. The same year Qatar decided to purchase the Bank of Commerce and Development in Libya, and the UAE reiterated its support for rebuilding the North African country via trade and economic institutions, confirming the Arab Gulf support for having the country join the World Trade Organisation (WTO), and its assistance in the implementation of infrastructures and technology projects, but all these initiatives have been seriously compromised by rising violence and chaos in the country.

Few exceptions could actually provide promising business environments in the Arab world after 2011, and quite inevitably Arab Gulf investors focused their attention on such exceptions,

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<sup>8</sup> ‘Libya looking for better economic relations with the Kingdom’, *Arab News*, 18 November 2012, <http://www.arabnews.com/libya-looking-better-economic-relations-kingdom>.

looking at Jordan and Morocco as the most attractive destinations. In November 2011, Qatar's Sovereign Wealth Fund and Rabat agreed to establish a 50-50 investment joint-venture worth \$2bn, aiming to fund major development projects, within a multilateral accord signed by Qatar, Morocco, Kuwait and the UAE and regarding the creation of a tourist investment fund in this country<sup>9</sup>. In December 2011, the GCC decided to establish a special Gulf development fund worth \$2.5bn to support other development projects there. In October 2012, the visit of King Muhammad VI to Saudi Arabia, Qatar, the UAE and Kuwait reconfirmed the crucial importance of Arab Gulf support for development, in the light of a 'privileged partnership' with the North African country. During the Saudi-Moroccan Joint Commission for Bilateral Cooperation held in Jeddah in August 2013, Rabat and Riyadh agreed to promote further cooperation in trade, investment, transportation, housing, infrastructure, agriculture, and tourism. Economic and trade relations between the two countries have been growing steadily ever since, and about 40 projects were financed by the Saudi Fund for Development in the last few years<sup>10</sup>.

Strengthening relations with Jordan was certainly another crucial step on the part of all the Gulf monarchies in the light of rising threats in the Arab East. The GCC membership proposal to Jordan, however, does not seem to have survived, except for a recommended five-year development plan submitted to Amman, an aid fund and a series of new official GCC-Jordanian discussion meetings. Saudi political willingness to support economic reforms and development in the country was expressed both during an official visit of King Abdullah II to Riyadh in 2012 and during another meeting that he had with the Saudi king in Jeddah in 2013. However, all the official statements could not conceal the irregular flows of public financial aid to the neighbour. Domestic Jordanian

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<sup>9</sup> "Qatar, Morocco sign \$ 2bn investment deal", *Gulf Times*, 25 November 2011, [http://www.gulfinthemediamedia.com/index.php?m=economics&id=581320&lim=&lang=en&tblpost=2011\\_11](http://www.gulfinthemediamedia.com/index.php?m=economics&id=581320&lim=&lang=en&tblpost=2011_11).

<sup>10</sup> "Saudi Arabia, Morocco boost economic ties", *Asharq al-Awsat*, 28 August 2013, [www.aawsat.net/2013/08/article55315058/saudi-arabia-morocco-boost-economic-ties](http://www.aawsat.net/2013/08/article55315058/saudi-arabia-morocco-boost-economic-ties).

problems of lack of transparency and corruption were put forward to justify the fact, but one cannot ignore that in the last few years the Saudi social media, by raising a real campaign against excessive public aid to other Arab countries, have been increasingly acting as a check on the financial engagement of the kingdom in its neighbourhood. In a way, the limits to Saudi public financial support to Jordan, and to other Arab countries as well, intertwine with some changing internal dynamics: public criticism of some policies, while expressing rising frustration among the Saudis, is certainly a factor which seems likely to influence the foreign-policy making process in the future as never happened before in the kingdom<sup>11</sup>.

The bloody Syrian conflict remains one of the thornier issues, with major consequences on the Saudi role in the Middle East, also given the already mentioned historically-rooted Syrian-Hijazi tribal-family networks. Events in Syria deeply influenced relations with Lebanon as well, in particular after Hezbollah's decision to participate in the Syrian war in 2013. Not surprisingly, that development in the conflict led the Saudi ambassador to Lebanon to emphasize the efforts of the kingdom "to unite and not to divide", in opposition to "the disruptive policies of Hezbollah", to quote his words<sup>12</sup>. Such statements were soon followed by a meeting between the Saudi ambassador to Lebanon and Michel Aoun, the head of the Free Patriotic Movement (FPM), in a move apparently aimed at contrasting rising sectarian divisions: if, on the one hand, the Saudi dialogue with this Christian leader emerged as a way to exploit differences between the FPM and Hezbollah, on the other it pointed out a foreign policy line interlinking with that process of 'securitisation of sectarianism', which started to be considered more and more crucial to Saudi and GCC interests both at the regional and domestic level. That is a line already anticipated in a

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<sup>11</sup> N. Partrick, *Saudi Arabia and Jordan: Friends in Adversity*, Research Paper, Kuwait Programme on Development, Governance and Globalisation in the Gulf States, 2013, p. 17.

<sup>12</sup> Interview to *As-Safir*, 3 July 2013, <http://www.assafir.com/Article.aspx?EditionID=2502&ChannelID=60323&ArticleID=306#.UdN88pNOKM8>.

way by the previous Saudi engagement and mediation initiatives in Lebanon, generally aimed at involving all the factions, Hezbollah included, in order to keep 'a balance of interest' and achieve some level of agreement, contributing to stabilisation<sup>13</sup>. Keeping some influence in Lebanon obviously represents, for the Saudis in particular, a way to counterbalance their ever-declining influence in Iraq and Syria.

'Securitisation of sectarianism' is increasingly seen as a crucial challenge. Following the suicide attacks on Shia mosques in Saudi Arabia and Kuwait in May and June 2015, the public rejection of sectarian categorisation of citizens and the authorities' awareness of the urgent need to enhance social cohesion and security against disruptive sectarian orientations seem to be stronger, as an expression of renewed national narrative and political strategy. Within this strategy, 'securitisation of sectarianism' has been more and more intertwining with 'securitisation of the neighbourhood', which has also been leading to a shift in the Saudi position towards the situation in Syria since 2013, in light of the twofold objective of avoiding a backfire for the kingdom and of stopping the bloodshed in that country. Such a shift caused rising divergences with Turkey and Qatar over Syria, after a period of cooperation within the group called 'Friends of Syria'<sup>14</sup>. More assertiveness at the diplomatic level on the Syrian issue resulted from all that, and Saudi Arabia rejected the Security Council seat in protest against the UN body's 'double standards' and failure to act on Syria. That was certainly a decision, largely backed both within the GCC and in North Africa, aimed at once again drawing the international community's attention to that conflict, but it was also the outcome of rising anxiety about radical militant groups' consolidation in that territory<sup>15</sup>.

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<sup>13</sup> M. Kamrava, *Mediation and Saudi Foreign Policy*, Foreign Policy Research Institute, Elsevier Ltd., 2013, p. 10.

<sup>14</sup> M.B. Altunışık, *The AKP's Middle East Policy: Amidst Domestic and Regional Challenges*, in V. Talbot (ed.), *The Uncertain Path of the New Turkey*, ISPI-Epoké, Milano, 2015, p. 72.

<sup>15</sup> See "Arab League, OIC, Turkey, UAE join anti-UN chorus", *Arab News*, 21 October 13, <http://www.arabnews.com/news/468329>;

Against this backdrop, Egypt was and is reconfirmed as pivotal to the Gulf monarchies' interests. The immediate Saudi support for the new course and government in Egypt, after the deposition of Morsi, and the announcement of an aid package of \$5bn to the country in October 2013, on the occasion of the visit of the Egyptian interim President Adly Mansour to the kingdom<sup>16</sup>, cannot be decoupled from the cautious Saudi reaction to Egypt's post-revolutionary government, despite the announcement of \$4bn in grants and loans to the country in 2011. During Morsi's official visit to Jeddah<sup>17</sup>, relations with the Muslim Brotherhood's government had been described as 'constructive', although Saudi authorities had soon highlighted their support for the Egyptian military, seen as the fundamental institution of the state and the only one able to guarantee a stable transition in the country.

## Challenges ahead in confronting transnational Islamists

The risk that both state and non-state actors in the Gulf could be hijacked by transnational Islamist movements has been interweaving with the presence in the region of Arab exiles and expatriates affiliated with such movements. Such a risk, for instance, was a very concrete one in Qatar after 2011. The country's leadership, striving to assume an 'independent global role', adopted a strategy leading Qatar to an overextension of the network of its co-opted actors, which turned out to hurt both Qatar's and GCC interests and ended up complicating relations with Saudi Arabia and the UAE, in particular<sup>18</sup>. Despite some re-emerging rivalries between royal families, these complications could not certainly be ascribed

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"GCC, Egypt back Saudi rejection of UN seat", *Saudi Gazette*, 22 October 2013, <http://www.saudigazette.com.sa/index.cfm?method=home.regcon&contentid=20131022184267>.

<sup>16</sup> "The visit of Adly Mansour to the Kingdom", *Okaz*, 8 October 2013.

<sup>17</sup> "Saudi King Abdullah, Morsy in Jeddah talks", *Saudi Gazette*, 12 July 2012, <http://www.saudigazette.com.sa/index.cfm?method=home.regcon&contentid=20120712129717>.

<sup>18</sup> L. Khatib, *Qatar's involvement in Libya: A delicate balance*, World Peace Foundation, 7 January 2013, <http://sites.tufts.edu/reinventingpeace>.

to serious ideological rifts between the parties, but rather to a 'Qatari strategy' conceived in contrast to other GCC countries but aimed at facing the same threats. Given the Egyptian crisis and persistent instability, the UAE without hesitation reassumed the traditional confrontational attitude towards the MB, as attested to by the arrest of several Egyptian citizens in the country in 2013. The transnational MB network is perceived to be as dangerous as the transnational Shia network<sup>19</sup>, as "they both want to export the revolution", quoting the police chief of Dubai<sup>20</sup>. Qatar simply tried to get round the problem at first, both by showing the members of the network, among its naturalised citizens and expatriates, a stronger political willingness to support the Muslim Brotherhoods in their countries of origin (Egypt first of all), and by giving some of their leading voices and representatives an extraordinary outlet through *Al Jazeera*, which could channel their ideological engagement out of Qatar towards other Arab environments. As a consequence, relations between the Qatari leadership and most GCC leaderships – above all the Saudi, Emirati and Kuwaiti governments – got more and more strained, until the accession to the throne of a young new emir, Shaykh Tamim bin Hamad, contributed to a general re-adaptation of Qatar's global and regional role, making it more convergent with that of its neighbours.

Beyond the enduring tribal rivalries that re-emerge from time to time, the major objective of defending the whole system that the GCC represents is always shared by the Gulf's ruling families when they have to face serious threats. Qatar, despite the 'alternative strategies' it attempted in the aftermath of 2011 events, is no exception. Trying to adopt different approaches to address common challenges is nothing new in the Gulf: a member state's choice can be criticised by one party or the other, it can also be si-

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<sup>19</sup> L. Louër, *Transnational Shia Politics: Religious and Political Networks in the Gulf*, London, Hurst & Company, 2008.

<sup>20</sup> E. Boulter, "Iran and Egypt: An Unrequited Union", Institute for Near East and Gulf Military Analysis (INEGMA), Dubai, 12 February 2013.

lently approved within a 'division of labour' approach<sup>21</sup>, or it can suddenly change if it proves to be ineffective to safeguard security. The most recent outcomes of this flexible orientation can be detected, for instance, in Qatar's decision to expel some MB members from the country and to join the other GCC states in the coalition against the terrorist organisation of the 'Islamic State' (IS) in Iraq and Syria in 2014. 'Omanibalancing' is another expression of this orientation<sup>22</sup>, which has been most recently re-proposed with the start of the Saudi-led military campaign against Yemen's Houthi rebels in March 2015.

No doubt the unsettling role of militias in failed states in the MENA region is seen with growing anxiety, and new threats to GCC borders are real since the territorial expansion of the IS in Iraq in 2013-2014, and since the occupation of San'a by the radical Shia Zaydi Houthi militants in Yemen in 2014. Gulf monarchies, while trying to readjust their differentiated approaches, have been concentrating on their immediate neighbourhood because they perceive it as more and more disrupted both by the IS and by the Iranian Revolutionary Guards Corp (IRGC), that is training and arming militias in Iraq and Yemen<sup>23</sup>.

## Re-defining relations with Iran

The need to avoid direct confrontation with Iran is widely recognised in the GCC, despite the fact that Arab Gulf-Iranian relations have become more strained due to some strongly diverging views on thorny regional issues. The anti-Shia pressures from Salafi

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<sup>21</sup> On this aspect see S. Colombo, *The GCC Countries and the Arab Spring. Between Outreach, Patronage and Repression*, IAI Working Papers 1209, Roma, 2012, p. 9, <http://www.iai.it/sites/default/files/iaiw1209.pdf>.

<sup>22</sup> S. Neubauer, A. Vatanka, "Central Sultanate. Oman Balances Between Iran and Saudi Arabia", *Foreign Affairs*, 5 May 2015, <https://www.foreignaffairs.com/articles/persian-gulf/2015-05-05/central-sultanate>. Cf. M.J.O. Reilly, "Omanibalancing", *Middle East Journal*, vol. 52, no. 1, Winter 1998.

<sup>23</sup> R. Kahwaji, "Iranian Threat: It's Not Nuclear Program, but the IRGC", INEG-MA, Dubai, 12 June 2015.

'*ulama*' and the enhanced Sunni-Shia tensions of the last few years in the Middle East have been shaping, in particular, Saudi-Iranian relations, and yet on several occasions Arab Gulf foreign policies towards Iran were accommodating.

Despite the ideological competition between Saudi Arabia and the Islamic Republic of Iran, the kingdom's leadership showed some goodwill signs in the past, being apparently eager to normalise relations with post-revolutionary Iran since 1990. In 2007, Prince Turki al-Faisal al-Saud, in a keynote address at an international conference in Abu Dhabi, declared: "Instead of being alarmed by talk of a 'Shia crescent' we ought to work towards establishing a 'fertile crescent', the prosperity of which will benefit every state in the region [...]. Regional problems and crises require realistic solutions rather than debate over Sunni and Shia disputes and fuelling sectarian conflicts"<sup>24</sup>. These words are quite indicative of the fact that Saudi Arabia's foreign policy can be shaped much more directly by pragmatic forces, able to minimise doctrinal differences, than by religious forces, when GCC security can benefit more from such an approach. Rising polarisation and extremism in Iraq, and the most recent events in Syria and Yemen, have been deteriorating the Saudi-Iranian dialogue, while re-confirming the instrumentality of the 'Islam factor' in mutual relations.

As for the other GCC actors, it is interesting to consider their variety of positions towards Iran. While the Bahraini leadership is always obsessed with Iranian interference, aimed at destabilising the country, Qatar certainly shares its neighbours' most recent misgivings enhanced by the dangerous developments in the region, but has been assuming its own dynamic independent foreign policy towards Tehran, along a line that is largely aimed at accommodation. As for Kuwait, the meeting of the Emir with Khamenei in 2014 apparently took place in a spirit of friendship, although Kuwait's concerns related to sectarian tensions and nu-

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<sup>24</sup> T. al-Faisal al-Saud, *Keynote Address*, "Arabian Gulf Security: Internal and External Challenges", Emirates Center for Strategic Studies and Research (ECSSR) Annual Conference, 5-7 March 2007.

clear proliferation in the Gulf are very strong. The UAE's territorial dispute over Abu Musa and the Greater and Lesser Tunbs islands never prevented most Emirates from keeping an open door to Tehran, in order to solve the dispute and to defend national interests, related both to Gulf security and business, and yet at this stage, in a UAE perspective, the IRGC's role is much more worrying than the nuclear deal.

Oman is the only GCC member state that has kept very good relations with Tehran at this delicate juncture. As the centre of Ibadism, the Sultanate ideologically opposes both the Salafi-Wahhabi influence and the IRGC's Islamist revolutionary logic, and it cannot ignore that Omani society includes large numbers of Sunni and Shia minorities as well. Spreading sectarianism is perceived as the real threat in the Middle East and the Arabian Peninsula, that can only be addressed through a dialogue with Iran, in the awareness that "the future of the region must be one of good neighbourliness and good neighbourliness requires a mechanism to find solutions to different interests", according to the Omani Foreign Minister, Yousuf bin Alawi bin Abdullah<sup>25</sup>.

## Conclusion

King Salman's decision to organise a coalition of Arab States, joined by five GCC states, to launch airstrikes against the Houthis, certainly opened a new chapter in the Saudi foreign policy line, marked by greater assertiveness in the GCC neighbourhood. It is a line immediately joined and supported by all the other Gulf monarchies, with the exception of Oman. The latter, while recognising Iranian interference in the MENA region, has been assuming a key role of mediator, in a delicate balancing role between Arab Gulf States and Iran. 'Omanibalancing' at this stage certainly aims to contain both Saudi Arabia's growing influence and Iranian lever-

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<sup>25</sup> "Omani FM: Hostility with Iran does not serve Arab Gulf Interests", *Asharq al-Awsat*, 9 November 2014, <http://www.aawsat.net/2014/11/article55338336/omani-fm-hostility-with-iran-does-not-serve-arab-gulfs-interests>.

age in the region, while trying to support negotiations with the Houthis in the Yemeni theatre, in order to stabilize the neighbouring country. And yet this last objective poses a huge challenge, since the talks recently held in Geneva to put an end to the conflict in Yemen miserably failed.

Most GCC authorities seem to have lost hope in the ability of the Obama administration to guarantee security in the Gulf and to stabilize the MENA region. The nuclear deal with Iran, achieved in July 2015, was seen as inevitable: some official voices from Qatar, Kuwait and the UAE clearly stated that the GCC is not against the nuclear deal as such, but major concerns derive from Iranian support for Bashar al-Assad, for Hezbollah, for Iraq's Shi-ite militias and Yemen's Houthi group. Although the US is bound to remain a strong ally, despite severe criticism, relationships with other countries, such as France and Russia, are more attentively considered in their unrealized potential, in order to enable Arab Gulf monarchies to regain a balance of power in the region<sup>26</sup>.

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<sup>26</sup> "Gulf States get more assertive as Iran nears N-deal", *Saudi Gazette*, 25 June 2015, <http://www.saudigazette.com.sa/index.cfm?method=home.regcon&contentid=20150625248343>.



### 3. The Gulf Between East and West

*Abdullah Baabood*

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The external relations of the Gulf monarchies have been largely determined by colonialism, great power rivalries, regional competition, and *realpolitik*<sup>1</sup>. Until the British withdrawal from the East of Suez in the late 1960s, Britain almost exclusively controlled the small Gulf States' foreign relations. The "Pax Americana" that replaced the waning "Pax Britannica" engulfed the region in Cold War strategy over several decades and, through several policies, prevented other global powers from gaining access to the oil-rich region of the Gulf. Although Gulf monarchies became independent after British withdrawal and started to develop their own foreign policies and external relations, they had to take on board the United States, the new hegemon and security guarantor, bringing in new sensitivities and policy preferences when it came to conducting their foreign relations. Maintaining a close relationship with the West (the US and Europe) continued to be their main priority, especially as energy and economic links started to cement the existing security relations.

These small and vulnerable Gulf monarchies have become ever more dependent on the US/Western security umbrella and guarantee, especially given the geostrategic location of these states in a conflict-ridden area and surrounded by larger and more populated countries like Iran and Iraq. While under a Western security shield, the Gulf monarchies are also engaged in an unrelenting regional balancing game between the main countries in the region. At the top of their priorities is securing the monarchical regime

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<sup>1</sup> B.R. Kuniholm, *Great Power Rivalry and the Persian Gulf*, Praeger, New York, 1993.

system and their wealthy states from would-be predators. The US invasion of Iraq in 2003 complicated the balancing game between Iran and Iraq, as the former started to dominate the latter, and this was viewed by the Gulf monarchies as an unwelcome consequence of misguided and problematic US foreign policy.

As the Gulf monarchies became more confident, with decades-long state-building and economic prosperity propelled by their hydrocarbon wealth, they began to expand their external relations, helped considerably by the end of the Cold War and of the bipolar world system. Not only did they create their own regional organization, the GCC in the early 1980s, with the aim of securing their region and of integrating their economies, they also started to develop wide-ranging external relations at both the bilateral and the collective levels.

The GCC states' hydrocarbon wealth and windfall revenues, especially since the year 2000, enabled them to emerge as important actors in both the regional and international arena. Increasing hydrocarbon revenues have enabled what were once subsistence economies to become some of the most important regional economies, with unprecedented economic growth and large financial surpluses. In fact, these small states have started to assume international economic leadership and have been called upon to shore up the international financial system.

This change in the fortunes of the Gulf monarchies has made them more active and assertive players at the regional and international levels, coinciding with a dynamic shift in the global system. Over the past two decades, global economic power has gradually shifted to Asia. China's economic rise has been nothing short of remarkable and the same can be said about India. Economic growth in Asia has shifted global energy demand as energy consumption has drastically increased to fuel such a rapid growth. With less hydrocarbon demand coming from the stagnant Western economies due to their dwindling rates of economic growth and the availability of alternative energy sources such as shale gas, Gulf energy suppliers have found new markets in growing Asian economies. Trade and investment has also followed suit with an

increase in Gulf-Asia trade, bringing with it more political dialogue and the prospect of future security cooperation. With Europe still recovering from its long economic malaise and the US' ambivalent policy towards the region, given its reorientation and pivot towards Asia, these Gulf monarchies are diversifying not only their economic and energy ties but also their political and potential security relations.

### **The Gulf region subjected to great powers' interests**

Even prior to the discovery of oil, the Gulf region possessed a strategically pivotal position between Europe, Africa and Asia, attracting the interests of the great powers. Since the 19<sup>th</sup> century, emerging European powers competed for domination of the region, culminating in British predominance<sup>2</sup>. Initially, the guardian of the Arabian Peninsula and its rulers was Great Britain, whose geostrategic interests expanded to this area in order to secure its trade route to India. The Gulf region offered British trade and military vessels safe passage, communications, naval facilities and an excellent and valuable harbour for trade and military facilities between East and West<sup>3</sup>. However, British guardianship was replaced by the US' when Britain withdrew its troops from the region in 1971. The British withdrawal resulted in the handing over of Gulf security to the Americans, which entailed the independence of the Gulf States after centuries of British domination that effectively controlled their foreign relations. The US' "over the horizon" and "twin pillar" policies provided security to the Middle East by relying on regional actors, Iran and Saudi Arabia. This gave regional states room to conduct their own independent external relations that took into account the interests of the new hegemonic power, especially US Cold War sensitivities and geostrategic calculations. Over the four decades of American dom-

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<sup>2</sup> C.E. Davies (ed.), *Global Interests in the Arab Gulf*, Exeter, University of Exeter Press, 1992.

<sup>3</sup> B.R. Pridham (ed.), *The Arab Gulf and the West*, New York, St. Martins, University of Exeter, Centre for Arab Gulf Studies, Croom Helm, 1985.

ination, this part of the world witnessed several conflicts and major wars, ushering in a change in US policy leading to American “boots on the ground”. In 1995, the US Middle East Force (MEF), established in 1949, was replaced by the US Fifth Fleet to better manage American military operations, increasing the US’ military footprint in the Gulf<sup>4</sup>. The main purpose of US military commitment in the region has been to ensure the free flow of oil supplies at a reasonable price and to protect the Gulf countries from any external threat. The coinciding interests of the US and the Gulf monarchies set the stage for the foundation of the traditional partnership between the two sides.

## **US ambivalence amid regional dynamics**

Several factors have contributed to changing Gulf regional dynamics. Since the US “Pax Americana” replaced the British “Pax Britannica” as the new hegemonic power and the main security guarantor of the Gulf in 1970s, there have been some underlying shifts within the regional and global systems. These include: the overthrow of the Shah by the Islamic Revolution in Iran in the late 1970s, the Soviet invasion of Afghanistan in 1980, the Iran-Iraq War (1980-1988), whose outbreak set the conditions for the creation of the GCC in 1981, the Iraqi invasion of Kuwait (1990) and Kuwait’s subsequent liberation by Operation Desert Shield and Operation Desert Storm (1991), the formal end of the Cold War (1990), the fall of the Soviet Union (1991), the ratification of the European Union (1993), the invasion of Iraq and the downfall of Saddam Hussein’s regime (2003), the Arab Spring (2011) as well as a plethora of global energy and financial crises. During this period of turmoil, relations between the GCC and the West (the US and Europe) were challenged and tested but remained intact due to their interdependency and mutual interest in energy, economic, and security cooperation. However, the recent shifts and changing

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<sup>4</sup> J.K. Cooley, “U.S. Presence in Persian Gulf: A History”, *ABC News*, 13 March, <http://abcnews.go.com/International/story?id=81402>.

dynamics of global geopolitics have shaken the enduring cooperative relations between the two sides, creating a new dimension of GCC relations with the US and Asia.

Firstly, US foreign policy is pivoting towards the East, which consequently gives the impression that US commitment to the Gulf region is waning. The shale boom in the US has allowed the country to become less dependent on Gulf oil and gas, which will have substantial implications on the volumes of energy trade between the US and the GCC states. In addition, the US' and the Gulf States' opinions on the critical issues in the MENA region have begun to diverge. Starting from the Arab Spring, the crises in Iraq, Syria, and Yemen to the latest issue of the US-Iran nuclear deal, the two parties are increasingly growing apart. In the particular case of the US-Iran nuclear deal, the agreement was close to being considered a betrayal from the perspective of the Gulf monarchies, given the strong sense of rivalries between the Gulf States and Iran based especially on Sunni-Shia sectarian tension. The Syrian crisis is another major issue that has weakened the bond between the US and the GCC states. From the Gulf States' perspectives, the continuing survival of the Assad regime remains a source of instability that may result in a "dangerous spillover effect in neighbouring countries such as Lebanon, Jordan, and Iraq"<sup>5</sup>. Accordingly, the Arab Gulf countries have thrown their support behind the opposition movement and called for the lifting of the arms embargo, which has prevented necessary outside arms support from being delivered to the people on the ground. Meanwhile, the US has resisted calls for the lifting of the arms embargo and even vetoed the possibility of supplying adequate weaponry to the rebel forces. Although the threat from the self-declared Islamic State has somewhat converged their interests, the gap remains large and the growing mistrust between the two sides is encouraging the Gulf monarchies to seek future realignments driven by

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<sup>5</sup> A. Sager, *Whither GCC-US Relations?*, Gulf Research Center, 29 March 2013, [http://www.grc.net/?frm\\_action=view\\_newsletter\\_web&sec\\_code=grcanalysis&frm\\_module=contents&show\\_web\\_list\\_link=1&int\\_content\\_id=80613](http://www.grc.net/?frm_action=view_newsletter_web&sec_code=grcanalysis&frm_module=contents&show_web_list_link=1&int_content_id=80613).

their need for security and vitalized by their stronger economic power.

### **Energy is at the heart of the Gulf monarchies' foreign and economic policy**

The Gulf monarchies' core foreign policy goal is regime security, which conflates with state interest. Regime security is the paradigm through which their policy is defined and the prism through which events are analysed, and the priority is how these policies will affect the future of the ruling families. For the Gulf monarchies, the objectives of survival and security have required neutrality, secret diplomacy, reliance upon international powers, international legal norms and negotiations and attempts to balance protection by the main great powers with channels to others; these foreign policy calculations and means always had to be conceived as part of the wider all-balancing strategy that accounts for domestic, regional and global challenges and economic resources.

Economic security and economic wellbeing are at the core of Gulf States' foreign policy decisions. Since the 1970s the economies of the Gulf States have witnessed enormous growth thanks largely to their hydrocarbon resources and the rise in oil prices, especially since the last decade. Although oil prices have recently fallen due to oversupply and competition from non-traditional energy sources, oil windfall revenues have made considerable contributions to the growth of their economies.

Over the past decades, the GCC countries have been witnessing rapid economic growth with the value of their combined economy reaching \$1.6tn by 2013, making it the twelfth largest economy in the world and the largest in the MENA region<sup>6</sup>. With oil income exceeding their economic absorption capacity, the Gulf monarchies have accumulated financial surpluses in Sovereign Wealth

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<sup>6</sup> Economist Intelligence Unit (EIU), *GCC trade and investment flows, the emerging-market surge*, 2011, [http://graphics.eiu.com/upload/cb/GCC\\_Trade\\_and\\_Investment\\_Flows\\_Falcon%20South\\_Web\\_22\\_MARCH\\_2011.pdf](http://graphics.eiu.com/upload/cb/GCC_Trade_and_Investment_Flows_Falcon%20South_Web_22_MARCH_2011.pdf).

Funds (SWFs) touching \$2tn, or around a third of total assets accumulated by SWFs worldwide<sup>7</sup>. Their investments have become increasingly global in terms of geographical spread and sectorial diversification, awarding them a regional and global status where they have been frequently called upon by international organisations like the International Monetary Fund (IMF) to contribute a growing share to economic stabilisation and rebuilding packages for European and North American economies. Their roles have ranged from reshaping the global financial architecture in the aftermath of the 2007-2008 global financial crisis to greater involvement in South-South networks and debates over the international politics of climate change<sup>8</sup>.

The rise of the Gulf monarchies is taking place within a rapidly globalized multipolar system in which power is more diffused and increasingly refracted through overlapping layers of national, regional, and global governance<sup>9</sup>. At its heart lies a global rebalancing of geopolitical and geo-economic power from West to East, centring on the pivotal commercial and strategic position of the oil-rich monarchies of the Arabian Peninsula.

As a direct consequence of oil wealth, these Gulf monarchies have become an increasingly important node in global trade exchange with \$1.42tn worth of trade in 2013, ranking fifth in the world<sup>10</sup>. This trade volume is broken down into: \$921bn worth of

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<sup>7</sup> KPMG, *Emerging trends in the regional SWF landscape*, [https://www.kpmg.com/AE/en/Documents/2013/Emerging\\_trends\\_in\\_the\\_regional\\_SWF\\_landscape.pdf](https://www.kpmg.com/AE/en/Documents/2013/Emerging_trends_in_the_regional_SWF_landscape.pdf). For an in-depth analysis of Gulf's SWFs see chapter 4 in this Report.

<sup>8</sup> K. Coates Ulrichsen, *The GCC States and the Shifting Balance of Global Power*, Occasional Paper no. 6, Center for International and Regional Studies Georgetown University School of Foreign Service in Qatar, 2010, [https://repository.library.georgetown.edu/bitstream/handle/10822/558292/CIRS\\_OccasionalPaper6KristianCoatesUlrichsen2010.pdf?sequence=5](https://repository.library.georgetown.edu/bitstream/handle/10822/558292/CIRS_OccasionalPaper6KristianCoatesUlrichsen2010.pdf?sequence=5).

<sup>9</sup> K. Coates Ulrichsen, *The Gulf States and the Rebalancing of regional and the global power*, James A. Baker III Institute for Public Policy, Rice University, 8 January 2014, <http://bakerinstitute.org/media/files/Research/ec7b03d8/CME-Pub-GulfStates-010813.pdf>.

<sup>10</sup> K. Shams Abdulqader, *GCC's Economic Cooperation and Integration: Achievements and Hurdles*, Aljazeera Center for Studies, <http://studies.aljazeera.net/en/dossiers/2015/03/20153316186783839.html>.

exports, making them the world's fourth largest exporter after China, the US and Germany, and \$514bn worth of imports, where they rank tenth globally. Most of their exports consist of crude oil, gas and petrochemical derivatives and they import large varieties of manufactured goods and technology for their developing economies. These figures indicate the significance of their economies and markets, making them attractive trade and investment partners and offering them economic bargaining power and greater political confidence. The Gulf region is thus internationalizing rapidly and emerging as the centre of gravity in western Asia by virtue of its hydrocarbon reserves and production, trade opportunities and financial resources.

However, despite many years of economic diversification attempts, the GCC states' economic structure is still largely driven by hydrocarbon exports<sup>11</sup>. The oil and gas sector accounts for 63 per cent of the public revenues of these countries, or 41 per cent of their GDP and more than 70 per cent of their total export revenues. Given their level of oil and gas reserves (30 per cent and 15 per cent respectively) and their global oil and gas production (40 per cent and 15 per cent respectively)<sup>12</sup>, it will be no surprise if the GCC states' strategic relations become increasingly responsive to global shifts and more aligned to the emerging changes in the energy markets, especially energy demand coming from Asia. The future of the Gulf States' economic conditions depends heavily on energy demands and on how their trade and investment relations with each world region will advance. They have become increasingly diverse in terms of external trade and investment relations as part of their economic diversification and political survival strategy. Therefore, as a result of internal growth dynamics and global headwinds, the GCC's external relationships are incessantly shift-

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<sup>11</sup> P. Devaux, "Economic diversification in the GCC: dynamic drive needs to be confirmed", *Conjoncture*, July/August 2013, <http://economic-research.bnpparibas.com/Views/DisplayPublication.aspx?type=document&IdPdf=22570>.

<sup>12</sup> Institute of International Finance (IIF), *GCC: Strong Diversified Growth, Limited Risks*, 4 May 2014, <https://www.iif.com/publication/regional-overview/gcc-strong-diversified-growth-limited-risks>.

ing from the historically dominant EU and US to the emerging markets of Asia.

## **Global change dynamics and the rise of Asia**

Since the turn of the millennium, the global economy has undeniably been undergoing a profound and momentous transformation and, as a consequence, the centre of global economic activity is shifting eastwards towards Asia. The first half of the 21<sup>st</sup> century will be dominated by the consequences of new Asian growth and dynamism, in particular the rise of China and India. While the Organisation for Economic Cooperation and Development (OECD) economies are experiencing sluggish growth, by 2030 Asia is projected to overtake the US and Europe in terms of GDP, population size, military spending and technological investment. China's economy, worth more than \$10tn in 2014, will overtake the US as the largest global economy by 2017 in purchasing power parity (PPP) terms and by 2027 in market exchange rate terms<sup>13</sup>. With an average straight-line annual growth of 8.9 per cent, China is marching towards becoming the second biggest economy in the world by 2016 and will reach 19.8 per cent of global GDP by then, in contrast with Europe and the US, which will drop to 14.6 per cent and 14.5 per cent respectively.

India's economic growth has likewise been remarkable. Since 1991 it has been among the top 10 per cent of the world's countries in terms of economic growth and, according to the IMF, India will be the world's fastest growing large economy, streaming ahead to become the third "global economic giant" by 2030. The south Asian giant's economy is forecasted to expand by an average annual rate of 6.4 per cent from 2014 to 2020, growing faster than China after 2020 due to its "younger population and greater scope for catch-up growth". Thus, India's economy is expected to

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<sup>13</sup> National Intelligence Council, *Global Trends 2030: Alternatives World*, December 2012, <https://globaltrends2030.files.wordpress.com/2012/11/global-trends-2030-november2012.pdf>.

surge from \$7tn in 2014 to \$17tn in 2030 and \$42tn by 2050, claiming second place ahead of the United States' \$41tn and overtaking both the European Union and the United States in share of world GDP (in PPP terms) by 2044 and 2049 respectively<sup>14</sup>.

This "Global-Asian" era, also dubbed the "Asian Century", is challenging Western dominance of the global political economy since the mid-19<sup>th</sup> century. These profound structural changes in the global economic order and patterns of trade have initiated a dynamic shift of global power away from the unipolar world of 2000 – in which America had emerged at the end of the Cold War as the sole superpower – to a multipolar one, in which a number of major powers will influence global development, offering new opportunities for the Gulf monarchies.

## **The Gulf monarchies tilting towards Asia**

Substantial changes in global economic weights over the past decades, in particular the rise of China and India, combined with major shifts on the energy supply side – the US shale revolution – have increasingly shifted the Gulf countries' economic focus towards the Asian continent<sup>15</sup>.

There have been many shifts in geopolitical dynamics among the international powers, which have strategic interests in the Gulf region. Of the many factors creating such shifts, the growing importance of the two Asian powers – China and India – is the primary one that is leading the changes in geostrategic international relations in the region. In fact, the rise of China and, to a lesser degree, of India as superpowers in the making, encourages the Gulf monarchies to modify their foreign policy, with focus shifting from the traditional partnership with the West to a new one

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<sup>14</sup> A. Fensom, "China, India To Lead World By 2050, Asia's powerhouse economies are predicted to be dominant by mid-century", *The Diplomat*, 12 February 2015, <http://thediplomat.com/2015/02/china-india-to-lead-world-by-2050-says-pwc/>.

<sup>15</sup> K. Coates Ulrichsen, *The Gulf Goes Global: the evolving role of Gulf countries in the Middle East and North Africa and beyond*, FRIDE, Working Paper, 19 December 2013, [http://fride.org/descarga/WP\\_121\\_The\\_Gulf\\_Goes\\_Global.pdf](http://fride.org/descarga/WP_121_The_Gulf_Goes_Global.pdf).

with the Eastern powers. Firstly, the remarkable economic development of so-called 'Chindia' has earned considerable attention from the Gulf ruling elite. After his coronation as King of Saudi Arabia in 2005, King Abdullah bin Abdulaziz made the first overseas trip to Beijing and New Delhi, which can be perfectly explained by their increasing economic power<sup>16</sup>. The combined GDP of China and India stands at \$6.3tn, with a combined population of 2.5 billion and a combined average economic growth of 7.5 per cent. Furthermore, given that China and India will consume 26 per cent of Saudi oil by 2030, compared to 17 per cent for the United States, it is now much more logical for the Gulf countries to focus more on developing strong relations with the two Asian giants than it was before. The world-class military strength of China and India is another critical factor that the Gulf monarchies will also take into consideration.

Likewise, the Gulf region holds tremendous strategic interests for China and India for their industrialisation and economic development in general, as the two countries are heavily dependent on Gulf oil and gas. In addition, for China, the region is increasingly becoming an important source of capital for its financial institutions. For India, the GCC states have been crucial for the country's economy, as approximately six to seven million Indian migrants<sup>17</sup> are working in the region and the remittances that India received from the GCC countries in 2013 accounted for one-third of the total amount of \$69bn that the country received in 2013<sup>18</sup>, which makes the region the largest payer of Indian labourers abroad. These money transfers from the GCC states are still considered an important pillar sustaining the Indian economy in general.

Moreover, the GCC-Asia trade relationship, which was initially founded on the energy requirements of established and emerging Asian economies, is no longer limited to the issue of energy and

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<sup>16</sup> B. Wakefield, S.L. Levenstein (eds.), *China and the Persian Gulf: Implications for the United States*, Woodrow Wilson International Center for Scholars, Washington D.C., 2011.

<sup>17</sup> J. Hussein, "Key role of Indian labour in the Gulf", *The Peninsula*, 10 February 2015, <http://thepeninsulaqatar.com/qatar-perspective/dr-jassim-hussein/321085/key-role-of-indian-labour-in-the-gulf>.

<sup>18</sup> *Ibid.*

GCC hydrocarbon reserves. The change in emphasis of GCC trade patterns is clear and the focus of Gulf business is moving eastwards. A cursory glance at the region today would be enough to support this view.

Asia is now the GCC's most important trade partner, both in terms of its hydrocarbon exports as well as imports of machinery, manufactured goods and food. Intensified bilateral investment relations have also accompanied the GCC's growing trade ties with developing Asia. Migrant workers from Asia, especially from the Indian subcontinent, now account for more than half of the GCC's labour force, contributing significantly to economic prosperity and development in the Gulf monarchies.

This shift eastward is unsurprising, given the travails of developed Western economies. With the sluggish recovery from the financial crisis in the EU and the US, Gulf economies have had to seek trade elsewhere. China-GCC trade ties are strengthening at a faster rate than investments. By 2020 China will be the biggest export market for the GCC, and Chinese investment in the GCC is on the uptick, mostly in wholesale and retail trade, with a significant increase in Saudi Arabia. In contrast, Gulf companies have secured comparatively few refinery projects in China and portfolio investments have been limited<sup>19</sup>.

Accordingly, the global shift has led to a growing interdependence between the Gulf and Asia. The essence of this geostrategic shift is twofold. Firstly, the global demand for energy is increasingly coming from the East rather than the West, with China already becoming the world's largest net importer of oil and India being the third largest. Considering that two-thirds of Gulf oil went to Europe and the United States in 1980, declining to one-third by 2004<sup>20</sup>, the recent eastbound Gulf oil flow indicates that there will be noticeable changes in geostrategic considerations

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<sup>19</sup> N. al-Tamimi, *Asia-GCC Relations: Growing Interdependence*, Analysis no. 179, ISPI, Milano, June 2013,

[http://www.ispionline.it/sites/default/files/pubblicazioni/analysis\\_179\\_2013.pdf](http://www.ispionline.it/sites/default/files/pubblicazioni/analysis_179_2013.pdf).

<sup>20</sup> A. Echagüe, *Change or continuity? US policy towards the Middle East and its implications for EU policy*, FRIDE, Documentos de Trabajo, Working Paper no. 95, 2010, p. 1, [http://fride.org/download/WP95\\_US\\_UE\\_GCC\\_ENG\\_mar10.pdf](http://fride.org/download/WP95_US_UE_GCC_ENG_mar10.pdf).

among the concerned countries. Saudi Arabian King Abdullah's visits to India and China in 2006 prove this pivotal shift in the global energy market.

Thus, China is actively working on securing access to Middle East energy. China is trying to build a Maritime Silk Road<sup>21</sup> between Asia and Europe through the development of Oman's Sohar Port and Freezone, which is linked to the Arabian Peninsula and the Gulf countries. Beijing has also announced a \$46bn investment plan that will be heavily concentrated in the China-Pakistan Economic Corridor (CPEC)<sup>22</sup>, a combination of transport and energy projects and the development of a major deep-sea port providing direct access to the Indian Ocean and beyond. For the Chinese, this region has geostrategic significance because the corridor through Gwadar gives them the shortest access to the Middle East and Africa. In addition, China is investing in a number of ports in Asia, aiming to access sources of energy and increase its influence over maritime routes.

Similarly, India has become increasingly dependent on Middle East oil due to its extensive appetite for energy, with the region becoming the largest supplier for India's growing energy needs. To better access energy in the region, India has discussed the Iran-Oman-India pipeline<sup>23</sup> project for transporting natural gas. Previously, projects such as the envisioned India-Pakistan-Iran pipeline did not successfully progress due to the volatility of constructing and investing in such infrastructures in Pakistan, with its many tribal, lawless regions. However, there is another factor that contributes to the shift from the US side as well. The so-called 'shale revolution', which is also referred to as a game changer in the global energy market, has allowed the US to become less depend-

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<sup>21</sup> G. Knowler, "China focuses attention on Omani port of Sohar", *JOC.com*, 26 January 2015, [http://www.joc.com/port-news/china-focuses-attention-omani-port-sohar\\_20150126.html](http://www.joc.com/port-news/china-focuses-attention-omani-port-sohar_20150126.html).

<sup>22</sup> "Is China-Pakistan 'silk road' a game-changer?", *BBC News*, 22 April 2015, <http://www.bbc.com/news/world-asia-32400091>.

<sup>23</sup> K. Taneja, "India's Importance in the Middle East," *War on the Rocks*, 22 April 2014, <http://warontherocks.com/2014/04/indias-growing-strategic-importance-to-the-middle-east-and-persian-gulf/>.

ent on Gulf oil. Accordingly, this has diminished US interest and shrunk its role as the security guarantor of the region, since the cost for this now outweighs the possible benefit. Given the many complicated Middle Eastern conflicts and the strategic competition from China, US foreign policy seems to be pivoting toward the East, explaining the weakening motivation of the US to remain deeply involved in the Gulf region.

Secondly, the established strength of Chinese and Indian military power marks these countries as influential players in the global security order, which may provide the Gulf countries with a potential future option for their security insurance, helping to fill the power vacuum which the US, much like the British did in the past, looks likely to create. According to the Global Firepower Military Rankings 2015<sup>24</sup>, China and India rank as the third and the fourth largest world military powers respectively, after the US and Russia. In fact, China has been visibly engaging in military missions overseas, due to its increasing military strength. With the Chinese navy dispatched to Somali waters since 2008, China commenced a bilateral counter-piracy exercise<sup>25</sup> with the US in the Gulf of Aden and the Horn of Africa on 11 December 2014. In 2010, Chinese navy vessels docked in Iran and at Port Zayed in the UAE in order to participate in these counter-piracy operations<sup>26</sup>. China has initiated joint anti-piracy exercises<sup>27</sup> and naval visits to neighbouring countries and the Middle East region for the purpose of military diplomacy, as well as for its intent to protect strategic trade routes, building interim technical service stops in Djibouti, Oman, Saudi Arabia, and Sudan.

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<sup>24</sup> GFP, *The complete Global Firepower list puts the military powers of the world into full perspective*, Countries Ranked by Military Strength, 4 January 2015, <http://www.globalfirepower.com/countries-listing.asp>.

<sup>25</sup> T. Alston, E. Coffey, "US, China Conduct Anti-Piracy Exercise", *America's Navy*, NNS141212-06, 12 December 2014, [http://www.navy.mil/submit/display.asp?story\\_id=84858](http://www.navy.mil/submit/display.asp?story_id=84858).

<sup>26</sup> M. Singh, "China's Military Presence in the Gulf", *Wall Street Journal*, 26 September 2014, <http://blogs.wsj.com/washwire/2014/09/26/chinas-military-presence-in-the-gulf/>.

<sup>27</sup> D. Sun, "China's Soft Military Presence in the Middle East", *Middle East Institute*, 11 March 2015, <http://www.mei.edu/content/map/china%E2%80%99s-soft-military-presence-middle-east>.

Likewise, India has also been militarily active in the region<sup>28</sup>. In 2008, India and Qatar signed a defence agreement establishing the foundations for deeper Indian involvement in the region. Under the agreement, New Delhi has committed to protect Qatar from external threats. The deal with Qatar leads to the possibility of India providing military support in an event in which shipping lines get blocked and hamper the free-flow of oil and gas to the subcontinent's shores. India and Saudi Arabia signed a similar defence pact in 2014. This implies that China and India, while currently far from being global powers, are already playing a strategic role as reliable and capable international military powers, signalling that the GCC states' strengthening ties with these countries may prove to be an appropriate alternative to the US' dwindling influence in the region.

At present, the Gulf monarchies remain torn between their traditional Western allies and their newly emerging partners in the East, trying to figure out the best solution to today's changing geopolitical scene in the region. So far, one thing that is clear is that the long history of strategic partnership between the Gulf States and the US is shaking, and the role and presence of the US in the region will not remain the same due to shifting geopolitical interests on both sides. The rapidly growing economic power and military strength of China and India offers an opportunity for the Gulf monarchies to strengthen ties with them in order to rebalance global powers' interest. They fully understand that US security is currently inimitable by any other power, but they are hedging their bets by diversifying their relations. In doing so, the Gulf monarchies are also developing relations with European allies. This can be explained by the fact that the Eastern powers still have a relatively limited effectiveness in satisfying the needs of the Gulf monarchies compared to the Western partners with whom they share a longer and deeper history of strategic cooperation. Therefore, the Gulf monarchies' geostrategic relations in the future will be determined by the adjustment and calculation of all the powers concerned in the region.

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<sup>28</sup> K. Taneja (2014).

## Conclusion

The dynamics of the recent changes in global economics and politics have shaken the old established relationships between the Gulf monarchies and the West, leading to a conspicuous and growing trend in Gulf-Asia exchanges and relations. The rise of Asian economies – and especially those of China and India – have coincided with slow economic growth in the West and, combined with the shale energy revolution, shifted global energy demand towards the East. Increasing Gulf oil exports to the East have spurred further trade, economic, investment and political relations. Corresponding to this change, the US, which over the past four decades has guaranteed the Gulf region and oil supply security, appears to have lost some of its desire to continue, especially given the ongoing costs of staying engaged in such a turbulent region. Competition from Asia has also led to a reoriented US policy towards the East in order to confront China's rising power. This pivot in US policy, combined with some apparent disagreements with the Gulf monarchies over regional politics and especially its nuclear talks with Iran, their arch-enemy, has compelled the Gulf monarchies to diversify their economic and political relations. Taking into account the importance of Asia to their economic wellbeing and driven by their economic power and desire for diversification, they have begun to play a larger part in regional and international relations, especially in improving relations with China and India.

However, despite all the apparent indications that the Gulf monarchies are gradually tilting to the East, relations with the West will remain one of the main cornerstones of their policies. Although it is an undeniable fact that the rise of China and India is attracting the Gulf States eastwards whilst simultaneously loosening the traditional ties between the Gulf countries and the US, the two Asian powers will not fully replace the strategic role played by America or its other European allies in the short- or medium-term. Given the Gulf monarchies' faltering trust in the US as a reliable ally, the Gulf States are not likely to throw their lot in one direction or another. Their long tried and tested strategies of diversification and balancing will always prevail, especially consider-

ing their instinct for survival and their eternal quest for security. Global economic shifts and relative global power redistribution will increase and focus their attention on Asia's rise, but they will try to hedge their bets through pragmatic foreign policies, engaging with both old and rising powers. This is all the more so because of the nature of the multipolar world where no single country can dominate global economics and politics, in addition to the fact that currently there is no country that can replace the United States as the sole security guarantor of the region. The Gulf monarchies are learning how to manage multiple strategic relations and, besides cementing their relations with Asia, are also engaging with Europe, especially the UK and France. In fact, France is the country that is benefitting the most from these niche opportunities, having signed €15bn worth of weapons deals so far this year, which is almost double its €8.1bn record for the whole of 2014<sup>29</sup>. Also, the Gulf monarchies are not shying away from expressing their discontent with the Obama administration's decision to reach a nuclear deal with Iran, as the lifting of sanctions is deemed to only strengthen their regional rival. Through their purchase of French weapons, the Gulf monarchies have signalled to the US that they can opt for other partnerships for their defence deals. France seems to have followed suit with this gesture from the Gulf States by distancing itself from US policy in the region and by having its own voice over the Syrian issue, about which, for example, it criticized Syrian President Bashar al-Assad after his use of chemical weapons against opposition groups in 2013<sup>30</sup>.

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<sup>29</sup> M. Sailhan, "French courtship of Gulf monarchies is risky: experts", *Yahoo News*, 6 May 2015, <http://news.yahoo.com/french-courtship-gulf-monarchies-risky-experts-152941074.html>.

<sup>30</sup> A.J. Rubin, "Persian Gulf Breach With U.S. Creates Opportunities for France", *New York Times*, 13 May 2015, [http://www.nytimes.com/2015/05/14/world/europe/persian-gulf-breach-with-us-creates-opportunities-for-france.html?\\_r=0](http://www.nytimes.com/2015/05/14/world/europe/persian-gulf-breach-with-us-creates-opportunities-for-france.html?_r=0).



## **4. GCC Sovereign Wealth Funds: Aims and Motives**

*Sara Bazoobandi*

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Sovereign Wealth Funds (SWFs) have attracted a great deal of attention in the global financial system over the past decade. Although these investment institutions have been operating for more than five decades, the increase in scrutiny that they have received has been the result of a combination of factors such as: the increasing size of the assets under management by these funds, the opaque nature of fund operation and the information gap on their investment motives, and the rise in the numbers and size of the assets acquired by these investment organisations.

This chapter will focus on the commodity-based SWFs of the GCC countries. The GCC funds have come to the centre of global attention from analysts and policy makers over the past decade or so even though some of the GCC funds, including those owned by the Kuwaiti government, have been active institutional investors since the 1950s. The level of scrutiny which these institutions have received has increased significantly due to the factors that are mentioned above.

The rise of global energy prices in recent years has contributed to the historically large size of the assets managed by these funds. By late 2013, the GCC countries had 10 SWFs that in total managed \$1.7tn worth of assets. Since the total assets under management by SWFs (including commodity and non-commodity-based funds)

stand at around \$5.3tn, the GCC funds amount to approximately 30 per cent of the world's total assets managed by SWFs<sup>1</sup>.

The GCC sovereign wealth management institutes have come under heavy global scrutiny for their lack of operational transparency. The issues of ownership, governance and investment motives of these funds have remained relatively unknown to many observers and policy makers around the world. Various observers and policy makers have expressed their concerns about the information gap regarding the activities of these funds and demanded a greater level of transparency.

The Dubai Ports World controversy of 2005-2006 was an important incident provoked by the information gap on the operation and investment motives of the GCC-owned SWFs. The American legislature blocked the takeover of a British port management company by the Emirate's Dubai Ports World on the grounds that "it will make the country more vulnerable to terrorism"<sup>2</sup>. The deal had been approved by the Bush administration, but when it alarmed both Republicans and Democrats the Emirati company was forced to withdraw the offer<sup>3</sup>.

The question of the investment motives and the nature of investment strategies applied by these funds have remained relatively unknown. The Dubai Ports World incident and general anxiety about the non-commercial investment motives of these funds have encouraged these organisations to adopt a higher degree of transparency and information-sharing mechanisms. The introduction of the "Sovereign Wealth Funds. Generally Accepted Principles and Practices (GAPP)" – also known as the "Santiago Principles" – and the establishment of the International Working Group of SWFs (GAPP) have been useful initiatives towards more operational transparency of these funds, aimed at minimizing global concerns regarding the possible political motives of these funds.

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<sup>1</sup> S. Salacanian, "GCC Sovereign Wealth Funds manage over USD 1.7 trillion", *bq Doha*, 9 December 2013, <http://www.bqdoha.com/2013/12/gcc-sovereign-wealth-funds-manage-usd-1-7-trillion>.

<sup>2</sup> "US lawmakers criticize ports deal", *BBC News Online*, 21 February 2006, <http://news.bbc.co.uk/1/hi/world/americas/4734728.stm>.

<sup>3</sup> Ibid.

The international campaign for gathering a voluntary code of conduct for SWFs has not satisfied the global demand for clarifying the investment motives of these funds and the apprehensions over possible use of the SWFs as a foreign policy promotion tool by the sovereign owners have remained unanswered. In that context, this chapter will examine the investment strategy of the GCC SWFs over recent years in order to highlight possible practices of non-commercial investment strategy by these funds. It will explore some of the European countries' reactions to the investments of the SWFs as case studies to demonstrate some protectionist measures taken by host countries against the SWFs' potentially non-commercial investment interests.

### **SWFs, a socio-political sustainability strategy in the GCC?**

Each of the GCC sovereign wealth management funds has its own characteristics and individual strategy, which is relatively unique. However, the funds share a number of overarching goals including: diversification, inter-generational saving, protection against fluctuating hydrocarbon prices, and, finally, transferring knowledge and expertise to the owner countries of these funds.

The diversification of GCC oil-rich economies has remained a key challenge to policy-makers across the region. The possibility of the ultimate diminishing of hydrocarbon resources, fluctuation in price and demand, and the increase of non-conventional production capacities have confirmed that economic diversification needs to be prioritized by the policy makers in the GCC. In practice however, oil wealth has remained the dominant source of national income, the local non-oil sectors have remained under-developed, the labour force has continued to be significantly inefficient and therefore extremely reliant on foreign labour, and, finally, governments have remained the main economic players<sup>4</sup>.

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<sup>4</sup> M. Hvidt, *Economic diversification in GCC countries: Past record and future trends*, Research Paper no. 27, LSE Middle East Centre, London, 2013.

While economic diversification has received insufficient levels of attention from the GCC policy makers, the establishment of new SWFs and expansion of the already existing ones have become a regional trend. The GCC leaders have shown a great degree of enthusiasm and support for the regional SWFs. One can argue that such regional trends in support of expansion of the SWFs' economic power are convincing pieces of evidence proving the diversification of sources of wealth to various types of asset classes in which the SWFs invest. This argument is based on the assumption that, although the source of assets accumulated in these funds is currently surplus hydrocarbon export income, in the long-run the investment income of these funds can exceed hydrocarbon revenues. If such an assumption is valid and the regional leaders are indeed seeking to expand the economic power of SWFs globally in order to replace hydrocarbon revenue with the income generated from the SWFs' investments, the monopoly of the ruling elite over the single source of national income will remain unchanged. The regional leaders perhaps can see this as an economic sustainability strategy through which the system of distributing wealth from the state to the citizens remains unchanged and therefore a number of social, political and economic reforms can be avoided.

Inter-generational saving is another aim of the SWFs. This is indeed one of the aims of the GCC leaders' sovereign wealth management strategy. As noted above, the key to sustainability of the current economic, social and political systems across the region is in the social contract between the states and the citizens. Therefore, the SWFs can be perceived as a tool to maintain such social contracts throughout various generations of citizens and leaders across the region.

The protection of national economies against fluctuating hydrocarbon resources, prices and demand is certainly another core aim of the GCC sovereign wealth management strategy. Although the GCC policy makers have adopted their own independent sovereign wealth management strategies, stabilisation has been a key element of their strategies. In the case of Kuwait for example, the

Kuwait Investment Authority (KIA) – Kuwait's SWF – played an important role in rescuing the local bourse during the Souq al-Manakh stock market crisis of the 1980s<sup>5</sup>. In the 1990s also, the KIA played a critical role in supporting the exiled government of Kuwait and became a key source of financing the liberation operation and post-liberation reconstruction.

Saudi Arabia is another example of using sovereign wealth management as an economic stabilisation tool. With a large population and the government's heavy reliance on oil export revenue, Saudi policy makers have been conscious of the fluctuation of oil revenue and its impact on domestic consumption. As a result, the core element of Saudi sovereign wealth management has been focused on the ease of using sovereign wealth assets in order to keep government revenues inflowing smoothly at times of fluctuation in price, demand, or export levels. Until recently, the Saudi sovereign wealth management was mainly the responsibility of the Central Bank (SAMA, Saudi Arabian Monetary Agency) and focused heavily on liquid assets, particularly on US Treasury Bonds that are known to be low-interest-rate and low-risk assets.

Finally, the transfer of knowledge and expertise is another key aim of the SWFs in the GCC region. As previously stated, economic sustainability, formed around the current social contract, is a key priority for policy makers across the region. Traditionally, the GCC states have been in charge of providing services and resources to their citizens, who have developed high expectations for their standards of living (particularly over the past decade). Because of the relationship between the states and their citizens and the local populations' rising expectations, the region is facing challenges.

The GCC policy makers are under significant pressure to find solutions to energy, water and food consumption patterns across the region. If the current consumption patterns remain unchanged, the GCC states will find it increasingly difficult to provide these

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<sup>5</sup> I.A. Hijazi, "Kuwait in Bailout Effort After Market Collapses", *New York Times*, 25 December 1982, <http://www.nytimes.com/1982/12/25/business/kuwait-in-bailout-effort-after-market-collapses.html>.

resources. Therefore, the region needs to introduce “energy-efficiency measures; investing in clean fuel and renewable energy supplies; improving water efficiency; investing in new water desalination capacity; and buying or leasing agricultural land abroad”<sup>6</sup>. Redefining the social contract requires strong public policy implementation. While the GCC governments have failed to fully employ such policies, they have invested in various projects (both domestically and abroad) that are aiming to help overcome energy, water and food security challenges. A significant share of these investments has been financed by SWFs.

### **Global anxiety over the GCC funds’ non-commercial investment interests**

The potentially non-commercial investment motive of the SWFs has been the cause of anxiety in host economies. Since developed economies offered safer and higher rates of return for investments, they were the main focus of the GCC SWFs for a number of decades. Between the 1950s and 2000s, the GCC funds had heavily US dollar and/or British pound denominated investment portfolios.

During the 2000s, the GCC funds showed a great deal of interest in investing in trophy assets in the West. This was partly a result of a strong desire amongst the GCC monarchs for gaining new financial and political power. Indeed, profit maximisation and a significant increase of surplus oil export wealth due to high hydrocarbon prices motivated the GCC SWFs to invest in prestigious assets<sup>7</sup>.

An increasing sense of anxiety had been generated in the West about the funds’ investment motives, which peaked in 2005 during the P&O scandal<sup>8</sup>. The GCC funds, along with some Asian funds

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<sup>6</sup> Economist Intelligence Unit (EIU), *The GCC in 2020: Resources for the future*, 2010, [http://graphics.eiu.com/upload/cb/GCC\\_in\\_2020\\_Resources\\_WEB.pdf](http://graphics.eiu.com/upload/cb/GCC_in_2020_Resources_WEB.pdf).

<sup>7</sup> S. Bazoobandi, “Investment strategies of the sovereign wealth funds from the Gulf Cooperation Council in the Mediterranean: economic or political motivations?”, *Afkar*, no. 43, 21 September 2014.

<sup>8</sup> *BBC News Online* (2006).

(particularly China's), were seen as opaque investment vehicles driven more by strategic motives than commercial ones. As stated, the result was an intensifying sense of unease in the recipient West about the potential risk associated with investment of these funds in important national assets of the recipient countries. The financial crisis, however, brought about a change in Western perception of SWFs. Some of the large GCC funds provided a much-needed source of finance in the aftermath of the 2008 crisis for Western financial firms and it created a friendlier environment in the host economies<sup>9</sup>.

Although the liquidity provided by the GCC funds in the West was welcomed in the aftermath of the 2008 financial crisis, the question of the non-commercial investment interests of the funds has remained unsettled. As noted above, one key analysis for the GCC funds' investments in Western trophy assets has been backed by the regional ruling elites' aspirations for their respective countries. In this context, the 'non-commercial' investment interests of the funds have been rooted in the GCC countries' efforts in recent decades to re-brand themselves from small and insignificant nations to financial giants. With such re-branding efforts, the GCC ruling elite has not only been seeking to pave the way for attracting foreign investments into the region, particularly towards the non-oil sector, but they have also been aiming to use such global recognition as a tool for maintaining citizen-state relationships across the region. A study in Qatar, for example, showed that over 40 per cent of Qatari participants in a survey that measured various aspects of citizens' satisfaction with life, believed that the state is successfully representing their values<sup>10</sup>. Therefore, the use of SWFs' assets for investing in globally known and prestigious

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<sup>9</sup> "Sovereign funds discover gulf in values", *The Telegraph*, 23 March 2008, <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/2786831/Sovereign-funds-discover-gulf-in-values.html>.

<sup>10</sup> "Does Economic Satisfaction Really Cause Political Apathy in the Gulf?", Qatar University, The Social and Economic Survey Research Institute, 2013. [http://sesri.qu.edu.qa/sites/default/files/Common/Conferences/2013/Panel\\_3/Justin-Conference.Slides.pdf](http://sesri.qu.edu.qa/sites/default/files/Common/Conferences/2013/Panel_3/Justin-Conference.Slides.pdf).

assets can indeed contribute positively increasing citizens' confidence in the states across the GCC.

One of the relatively controversial cases of SWFs in the GCC with investment motives that are not driven by commercial interest is the Qatar Investment Authority (QIA) – Qatar's SWF. Over the past years the QIA invested heavily in a wide range of assets in Europe. A recent QIA investment in a French football club, for example, raised doubts about the Authority's investment motives. Qatar's official response to this highlighted a number of reasons for the investment including: improving the health of the Qatari population, strengthening relations between nations, and establishing Qatar as a global sports hub. None of which seem to have been convincing reasons for critics of the QIA's investment behaviour in this particular case.

A study by Danyel Reiche of the American University of Beirut<sup>11</sup>, asserts that boosting national identity and encouraging social cohesion through sport is not a relevant argument to justify the rationale behind the QIA investments in sport simply because the Qatari population, which forms roughly 11 per cent of the total population, is homogenous and a vast majority of Qataris are upper class Sunni Muslims. Therefore, as far as the Qatari government is concerned, there is no need to boost national pride, "since the state already provides the Qatari nationals with almost everything they need"<sup>12</sup> and in response the citizens have no major complaints. So, why is the Qatari government keen on naturalizing the foreign winning athletes who in many cases do not even speak Arabic? Reiche contends that in a society in which 89 per cent of the residents of Qatar are under no circumstances granted nationality and integrated into society, the use of sport as a tool to boost national pride and strengthen social cohesion is irrelevant. When it comes to encouraging social cohesion, the government of Qatar

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<sup>11</sup> D. Reiche, "Investing in sporting success as a domestic and foreign policy tool: the case study of Qatar", *International Journal of Sport Policy and Politics*, 10 December 2014, <http://www.aub.edu.lb/fas/pspa/politics-sports/Documents/Reiche-2014-Qatar-Sport%20Policy.pdf>.

<sup>12</sup> Ibid.

has a much longer way to go before using sport success. According to Reiche, “Philippine migrant workers even run their own basketball league instead of competing in Qatari sports clubs”<sup>13</sup>.

Therefore, if the citizens of Qatar “have a homogenous background, are happy with their life and there is no policy of integrating foreigners into society, there are no reasons to invest in sport-sporting success as a tool to unite, integrate people, and make those people proud”. Qatari SWF investments in the sports sector are likely to be more motivated towards gaining recognition globally. Indeed for Qatar, as Reiche states, sport success can bring Qatar a unique “opportunity to develop a profile and prestige” within the GCC. Using sport success as a tool for exercising soft power is a core element of Qatari defence and security doctrine. Since the country is unlikely to develop military capacity that is comparable to its neighbouring countries (Iran, 150 times larger in area, and Saudi Arabia, 200 times larger in area than Qatar) using soft power, which depends on sympathy, can contribute to the country’s overall security strategy. Last but not least, hosting mega sport events has put Qatar in the spotlight and turned the country into a fairly well recognized travel destination globally<sup>14</sup>.

## The GCC SWFs: the new financial giants

The GCC sovereign wealth investment institutions began to operate more than five decades ago. However, as average oil prices started to rise from \$20 to more than \$100 over the past decade, the funds available to these institutions also swelled significantly. Globally, SWFs have nearly \$5.3tn in assets under management (AUM) and the GCC funds control 30 per cent of this<sup>15</sup>. SWFs in

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<sup>13</sup> Ibid.

<sup>14</sup> J.S. Nye Jr., *The future of power*, NY Public Affairs, New York, 2011.

<sup>15</sup> V. Paprival et al., *Emerging Trends in the Sovereign Wealth Fund Landscape*, KPMG, Middle East, May 2013, [http://www.kpmg.com/AE/en/Documents/2013/Emerging\\_trends\\_in\\_the\\_regional\\_SWF\\_landscape.pdf](http://www.kpmg.com/AE/en/Documents/2013/Emerging_trends_in_the_regional_SWF_landscape.pdf).

the GCC control about “88 per cent of existing investable assets and 74 per cent of new assets”<sup>16</sup>.

As noted above, one of the aims of the SWFs in the GCC is to create a financial buffer that can be used for stabilisation purposes when it is required. There are various estimates for the size of the buffer that the GCC funds provide to their respective governments. According to Moody's, in Kuwait for example, the assets of the sovereign wealth investment institutions can cover government expenditures for 7.6 years and in Oman for about 1.2 years. Typically, the AUM of these funds in the GCC is several times larger than the size of government debts<sup>17</sup>.

By 2014, the GCC had 14 SWFs, which varied in the size of their assets under management from one country to another. For example, the Abu Dhabi Investment Authority (ADIA) with about \$627bn is amongst the largest SWFs in the region. There are smaller funds in the region including: the KIA with \$386bn worth of assets, the QIA with \$170bn. The UAE has the highest number of functioning investment institutions that are in charge of managing sovereign wealth. In addition to one of the largest funds of the region, ADIA, the country has a number of smaller funds including: Dubai's Investment Corporation with about \$70bn worth of assets, Abu Dhabi's International Petroleum Investment Company with \$65.3bn and the Mubadala Development Company with \$55.5bn<sup>18</sup>.

The energy price rise of the past decade allowed the GCC countries to amass substantial financial assets. Such an accumulation of assets has transformed the role of SWFs within the region and internationally. The resources under control of these funds have been used for variety of purposes over the past decades. To

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<sup>16</sup> S. Salacanian, “GCC Sovereign Wealth Funds”.

<sup>17</sup> B.D. Augustine, “GCC SWFs can absorb shocks from oil volatility. Not uncommon for these funds to invest locally in times of distress”, *Gulf News*, 15 March 2015, <http://gulfnews.com/business/sectors/banking/gcc-swfs-can-absorb-shocks-from-oil-volatility-1.1471950>.

<sup>18</sup> M. Morris, “SWFs in the Gulf reach new heights through oil reserves”, *World Finance*, 11 February 2014, <http://www.worldfinance.com/wealth-management/swfs-in-the-gulf-reach-new-heights-through-oil-reserves>.

cite only a few examples, in the 1990s the Kuwaiti SWF was the main source providing financial resources for liberation and post-liberation operations; in the beginning of the 2000s, the Emirati SWFs became active in acquiring trophy assets in Western markets, and more recently, the Qatari SWF has been active in utilizing the country's sovereign wealth in various ways. Many analysts see Qatar's sovereign wealth management strategy as a tool for achieving foreign policy aims. All in all, given the substantial size of these funds' AUM, and the small size of the domestic markets and populations of their respective countries, it is not surprising for the GCC funds to explore investment opportunities, with a diverse range of motives, at the global level.

### **What determines the GCC funds' investment strategy?**

In terms of investment strategy, the GCC funds have shifted their overall investment policies throughout the years of their operation. Traditionally, real estate and infrastructure where the yields are higher have been receiving a major share of the invested assets of these funds. Private equity investments have also been a large part of the GCC funds' investments.

One of the areas of change in investment behaviour of the GCC funds is indeed their attitude towards equity investments. For many decades, with some exceptions (including Mubadala of Abu Dhabi), the GCC funds had not shown much interest in getting involved in management of the companies in which they became shareholders. This is in fact contrary to the strategy of some of the other commodity SWFs, particularly the Norwegian. The standard practice of the Norwegian SWF in private equity investments is to acquire a certain degree of involvement in management of the companies in which it invests. Most of the GCC funds avoided close involvement in the decision-making process in the companies whose shareholders they became. They have been, however, under increasing global pressure to take a more responsible role in

managing the companies in which they invest and the response to such pressure seems to be assuming a much more active role<sup>19</sup>.

The GCC funds have traditionally had strong interest in investing in the Western world. Most of the funds have had offices in major Western financial centres like London and New York. Such interest has been reflected in the currency allocation of the investment portfolio of the funds. The weights of Western currencies in the investment portfolios of most of the GCC funds, particularly the US dollar and British pound, were significantly high for a number of decades.

This trend has begun to change over the past few years. Various global events have contributed to the geographic shift in the investment universe of these funds. The financial crisis of 2008, the global concerns over the future value of the US dollar, the Eurozone crisis, and the Arab uprisings in the MENA region have all been major events that have affected the investment allocation of these funds globally. As a result, in 2012 the share of the GCC funds' European investments decreased to 4 from 19 per cent in the previous year and the share of North American investments declined to 13 from 20 per cent in the previous financial year<sup>20</sup>.

The assets that are being diverted from Europe and North America have been mainly redirected to two areas: the GCC and the emerging markets. The concern that the Arab uprisings and the socio-political tension of the MENA region could reach the wealthy GCC nations has led to a substantial shift of investments by the GCC funds into the region. The GCC rulers who have been historically keen on maintaining the existing social contract, the very backbone of establishment of most of the GCC states, have responded rather quickly. In 2012 the GCC SWFs, which had not been active in regional investments, began to shift up to 56 per cent of their total AUM toward the GCC. It is worth mentioning that the share of the GCC funds' regional investments in the previous year (2011) was only 33 per cent<sup>21</sup>.

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<sup>19</sup> P. Paprival et al. (2013).

<sup>20</sup> S. Salacanian, "GCC Sovereign Wealth Funds".

<sup>21</sup> Ibid.

As stated earlier, the emerging markets have also received some of the assets the GCC funds diverted from developed Western economies. It is worth mentioning that this diversion of assets does not necessarily reflect GCC funds' divestments of their assets in the Western market. It is often the case that new investments by the funds are being directed towards new markets and this shift is mirrored in the proportional decline of the share of assets allocated to Western markets. The UAE, for example, signed \$19bn worth of contracts in 17 infrastructure projects in West Africa in 2014<sup>22</sup>. The QIA is also reportedly active in Asia. In 2014, the chief executive of the QIA, Ahmed al-Sayed, was reported by Reuters to have announced plans for investing up to one fifth of the fund's total AUM in Asia<sup>23</sup>.

The geographic shift of investments by the GCC funds has been combined with a change in their attitude towards risk. Most of the GCC SWFs upgraded their risk management strategy, acquired new in-house expertise, re-engineered their reporting system, and formalized their investment procedures to avoid unnecessary investment risks. As a result, such a shift in the investment universe of the funds is to obtain higher risk-adjusted investment returns. In addition, the diversification of these funds' portfolios can indeed be a safeguarding tactic against potentially cold future relations between the GCC and the West. In the next section, this chapter will briefly review some of the protectionist measures taken by European policy makers in response to the SWFs investments in their respective economies. Finally, in the context of 'non-commercial' investment interests, such a shift may well be in line with a longer-term political alignment tactic of the GCC's ruling elite, particularly in relation to major Asian economic powers.

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<sup>22</sup> C. Renwith, "UAE firms sign contracts worth \$19bn for West Africa", *Arabian Business*, 10 September 2014, <http://www.arabianbusiness.com/uae-firms-sign-contracts-worth-19bn-for-west-africa-564310.html>.

<sup>23</sup> "Qatar's wealth fund expands in China, eyes property and other investments", *Reuters*, 4 November 2014, <http://uk.reuters.com/article/2014/11/04/uk-qatar-china-sovereign-wealth-idUKKBN0IO0EF20141104>.

## **European protectionist strategy: a love-hate relationship with SWFs**

Most of the investment interest of the GCC SWFs on the European continent has been attracted to Europe's more powerful economies: Italy, Germany, and France. The Spanish economy had been host to some GCC investments particularly in the 1980s. The KIA had major investments in Spain, which ended with a disastrous scandal. In this section the focus will remain on Italy, Germany and France as in terms of the number and the size of investments these three countries have been the most successful economies on the Continent in attracting GCC sovereign wealth investments.

One main point to keep in mind when reviewing the European approach towards the SWFs' investments is that the attitude of more or less all the European economies towards the SWFs has been influenced by two key factors: the economic nationalism of Europe's economic powers and fear of a potential spread of influence by the state 'capitalist model'. Moreover, the structure of most of the European recipient economies for SWFs' investments is based on strong family-business owners, or state dominance, which have often limited the SWFs' activities.

In most of these economies, companies were traditionally closed to foreign investors. Historically, either family-business owners or state-owned banks and financial institutions heavily controlled the large businesses. As a result, the firms mainly relied on the state for investment capital instead of turning to equity markets for capital. Consequently, the stock markets of these countries have remained relatively small. In addition, foreign investment in most of the above-mentioned European economies is subject to government approval, which in many cases led to large-scale political debates over the best possible policy response by the host economies<sup>24</sup>.

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<sup>24</sup> M. Thatcher, *National policies towards sovereign wealth funds in Europe: A comparison of France, Germany and Italy*, Policy Brief 2, LSE Middle East Centre, London, 2013, <http://www.lse.ac.uk/middleEastCentre/kuwait/documents/National-policies-towards-sovereign-wealth-funds-in-Europe.pdf>.

All in all, despite the limitations and sometimes opposition to SWFs' investments, the European policy makers did provide a certain level of support for the funds' equity purchases in as far as allowing SWF investments in sensitive sectors such as nuclear energy and defence. That said, "the number of non-Western SWF equity investments (in European economies) remains small compared, for instance, with that in the UK" and stakes are limited<sup>25</sup>.

Determining the exact size of GCC SWFs' investments is difficult, mainly because they are not required to share information on their investments with the public and the details of their investment deals are often kept confidential. As stated, despite the structural limitations for SWFs' investments in Europe, many of the GCC funds have been active investors in the region both on the Continent and in the UK. This section will review some of the investments of the funds that have been made public.

The Qatar Investment Authority – the Qatar's SWF – although younger than the rest of the GCC funds, has been rather active on the European investment market. "Most of Qatar's investments in Europe are mainly concentrated in the UK and France"<sup>26</sup>. By 2013 out of 31 publically announced investment deals by Qatari government-owned investment institutions, 11 were in the UK, 12 in France while Germany, Switzerland and Spain hosted only two investments and Greece and Italy each signed 1 investment deal. The share of assets held by Qatar in its UK investments is the highest amongst the rest of the European host economies<sup>27</sup>.

In the UK alone, Qatari investments are estimated to be around \$30.6bn. Most of the QIA investments in the UK are located in the London area. Qatar announced plans to invest around \$15bn in "power plants, road projects, railways and the Thames Tunnel project"<sup>28</sup>.

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<sup>25</sup> Ibid.

<sup>26</sup> S. Salacanian, "Qatar investing heavily in Europe", *bq Doha*, 11 November 2013, <http://www.bqdoha.com/2013/11/qatar-investing-heavily-in-europe>.

<sup>27</sup> Ibid.

<sup>28</sup> Ibid.

France has been the second prime target of the Qatari SWF's investment. Qatar gained 'preferential investor treatment' in France, which exempts Qatar government-owned investment institutions from capital gains taxes on property in France. Such preferential treatment boosted Qatari investments in France to \$15bn between 2008 and 2013<sup>29</sup>.

Italy and Greece, both in demand for foreign investments after the European financial crisis, also welcomed Qatari investors and reportedly secured \$1bn investments by Qatari state-owned entities. Italy's strategic investment fund and Qatar Holding formed a joint-venture to invest in the "food, fashion and luxury goods, furniture and design, tourism and leisure"<sup>30</sup> sectors. By 2013 Qatar Holding also signalled plans to buy a 40 per cent stake in a business district in Milan estimated at about \$2.6bn. In Greece, Qatari government investments are mainly focused on the "banking, power, mining and real estate sectors"<sup>31</sup>.

Kuwait's SWF, the Kuwait Investment Authority, reported plans in 2015 for boosting its investments in European equities, following the quantitative easing program in Europe. Most of the KIA assets are invested in equities and to a lesser extent in fixed income<sup>32</sup>. As mentioned above, the KIA had been active in Spain in the late 1980s-early 1990s, which ended in a historic fraud scandal leading to a nearly \$5bn loss by the KIA. That experience however, did not permanently discourage Kuwaiti investments in Europe. Kuwait has continued to actively invest in Europe. In 2014, the KIA reportedly invested almost \$18bn in Germany alone. One of the major areas of investments for the Kuwaiti SWF in Germany has been the automotive industry<sup>33</sup>. Moreover, in 2014, the German utility company,

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<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> D. Saadi, "Kuwait sovereign fund turning its focus from US to EU investments", *The National*, 2 March 2015, <http://www.thenational.ae/business/economy/kuwait-sovereign-fund-turning-its-focus-from-us-to-eu-investments>.

<sup>33</sup> "Kuwait Investment Authority To Expand Germany Investments", *Gulf Business*, 18 September 2014, <http://gulfbusiness.com/2014/09/kuwait-investment-authority-expand-germany-investments/#.VYfxiSj0g7o>.

E.ON, sold its Spanish assets valued at \$3.1bn to an Australian company and Kuwait's SWF<sup>34</sup>. Infrastructure projects in Europe have also received attention from the Kuwaiti SWF<sup>35</sup>. The collapse of equity prices in response to the European debt crisis encouraged Kuwait's government-owned fund managers to acquire assets across Europe. According to the Kuwaiti Finance Minister, all sectors have been open for Kuwaiti investors and the investment decisions have been mainly made based on potential profits<sup>36</sup>.

The United Arab Emirates' SWFs have also followed more or less the same attitude as other GCC funds towards investments in Europe. One of the major areas of investment for UAE funds, similar to other GCC funds, has been the real estate sector. Similar to SWFs from other GCC countries, the UAE state-owned entities have been active in investments in the sports sector. In 2008 Abu Dhabi Holdings purchased a 90 per cent share in Manchester City estimated about \$330mn<sup>37</sup>. "In 2014 brands from the UAE spent \$163mn on shirt sponsorship"<sup>38</sup> in European football clubs. In 2013 "UAE investors bought almost \$1.3bn worth of commercial property in Europe"<sup>39</sup>. In 2015 ADIA, along with other GCC funds including KIA, was reported to be launching plans for boosting its presence on the European stock market in response to the quantitative easing of Europe.

Saudi Arabia's sovereign wealth strategy has been the most conservative amongst the GCC funds. Until recently, the country

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<sup>34</sup> C. Bjork, S. Raice, "Macquarie Group, Kuwait's Sovereign-Wealth Fund to Buy E.On's Spanish Assets", *The Wall Street Journal*, 27 November 2014, <http://www.wsj.com/articles/e-on-to-sell-spanish-assets-1417107498>.

<sup>35</sup> "Kuwait wealth fund eyes infrastructure projects in Europe and U.S.", *Al Arabiya News*, 26 January 2013, <http://english.alarabiya.net/articles/2013/01/26/262706.html>.

<sup>36</sup> Reuters, "Kuwait mulls investments in Europe, says official", *Arabian Business.com*, 22 October 2011, <http://www.arabianbusiness.com/kuwait-mulls-investments-in-europe-says-official-426504.html>.

<sup>37</sup> S. East, "Middle East millions fuelling European football", *CNN*, 12 January 2015, <http://edition.cnn.com/2015/01/12/football/qatar-uae-sponsor-football-europe/>.

<sup>38</sup> Ibid.

<sup>39</sup> C. Trenwith, "UAE investors splash cash on European property", *Arabian Business.com*, 3 March 2013, <http://www.arabianbusiness.com/uae-investors-splash-cash-on-european-property-report-491698.html>.

did not have an officially established institution with a sovereign wealth management mandate. The Saudi Central Bank – SAMA – has traditionally been managing a large share of the country’s surplus oil revenue. Being a central bank, SAMA has been a conservative investor which heavily invested in low risk adjusted return and liquid assets, particularly US Treasury bonds. In 2008, the Saudi government established a small SWF, Sanabil, with \$5bn or less worth of assets under management. SAMA has remained the main investment institution in the country that deals with oil wealth and its investment. SAMA’s investments are held “mainly in bonds and equities, rather than less liquid but more lucrative assets such as property”<sup>40</sup>.

## Conclusion

The question of understanding the investment motives of the GCC SWFs has proven to be a challenging one. For over a decade, since the global debate over this question was started, analysts and policy makers have been searching for an answer to whether or not the funds are used by the region’s ruling elite to pursue the non-commercial interests of their respective sovereign owners. Studying the investment behaviour of these institutions proves a number of points to answer a decade-long global debate about the investment aims of these multi-purpose institutional investors.

1. The sovereign owners of the GCC funds have benefited from a certain state-citizen relationship. Such a relationship forms a social contract that is based on a paternalistic role of the state in taking care of its citizens’ living standard expectations in exchange for legitimisation of power for the ruling elite. For the reasons explained above, the SWFs can serve the GCC policy makers as useful tools in maintaining this social contract.

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<sup>40</sup> “Oil-fuelled caution”, *The Economist*, 24 May 2014, <http://www.economist.com/news/finance-and-economics/21602731-kingdom-does-not-splash-cash-other-gulf-states-oil-fuelled-caution>.

2. Considering the size of the economies of the GCC countries and their populations, it is certainly financially reasonable for the SWFs to search for investment opportunities outside of their country of origin. Given the fast pace of global and regional events, particularly over the past decade during which the size of the AUM of the funds has increased significantly, the funds have become quick in their responses to shift between geographic zones, asset classes and currencies.
3. Like any complex organisation, the GCC SWFs have demonstrated the ability to receive information from the environments in which they operate, process the information and re-adjust themselves in response to their surrounding environment. Such a complex reaction mechanism is clear in their attitude towards risk, and prioritisation of domestic needs for investment *vis-à-vis* return maximisation overseas. It would therefore be unsurprising if the funds had re-adjusted their position within the global financial system from being passive profit-seeking organisations to those which pursue foreign policy goals.



## 5. **Saudi Oil Policy: To Swing or Not To Swing... That's the Problem**

*Naser al-Tamimi*

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Over the last four decades, the Kingdom of Saudi Arabia has emerged as the undisputed leader of the Organisation of the Petroleum Exporting Countries (OPEC) and the most important player in the global oil markets. Saudi Arabia derives much of its power from its important role as the 'swing producer' of the international oil market. Saudi Arabia's ability to single-handedly alter the price of oil gives the Kingdom significant geopolitical power. Saudi Arabia has used its ability to lower or increase its oil production to stabilize the global market and to its geopolitical advantage on many occasions. The International Monetary Fund (IMF) acknowledged the Kingdom's important role: "Saudi Arabia is a key player in the global oil market, accounting for more than 16 per cent of global proven reserves and significant spare capacity [...]. This enables Saudi Arabia to play a systemic and stabilising role in the global oil market and contribute positively to global economic stability and growth"<sup>1</sup>.

However, over the past year a new Saudi strategy has been emerging. In November, Saudi Arabia in an unprecedented move persuaded OPEC countries not to cut oil production. Daniel Yergin, the preeminent historian of the oil industry, described that decision eloquently: "What they did was historic [...]. They said: We resign. We quit. We're no longer going to be the manager of

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<sup>1</sup> IMF, *Saudi Arabia: Tackling Emerging Economic Challenges to Sustain Growth*, 18 March 2015, <https://www.imf.org/external/pubs/cat/longres.aspx?sk=42462.0>; IMF, *Saudi Arabia: 2014 Article IV Consultation-Staff Report*, 23 September 2014.

the market. Let the market manage the market”<sup>2</sup>. Then, in March 2015, Ali al-Naimi, the Saudi Petroleum Minister, clearly spelled out his country’s new policy during a speech at the German-Arab Friendship Association: “Today, it is not the role of Saudi Arabia, or certain other OPEC nations, to subsidize higher cost producers by ceding market share”<sup>3</sup>. Saudi Arabia reiterated its position again during OPEC’s last meeting on 5 June 2015.

This Saudi shift is accompanied by formidable challenges. First, a changing landscape in global oil markets with more competitors entering the scene is eroding Riyadh’s leading position as the sole swing producer. Secondly, the increase in supplies from countries such as the US, Canada, Russia, Iraq and possibly Iran may intensify the competition in the global oil markets (Asia in particular) in order to maintain market shares or attract new buyers. Last but not least, Saudi Arabia’s place in the world oil market is threatened by unrestrained domestic oil demand and fuel subsidies.

This chapter will examine key changes in Saudi Arabia’s oil strategy within a comprehensive strategic context, outlining implications whilst also exploring all alternative policy options available to the Kingdom. In doing so, the chapter seeks to answer the following questions: What are the real motives behind the shifts that have recently occurred in Saudi Arabia’s oil policy? What are the main challenges facing Riyadh’s oil policy? What are the Kingdom’s alternatives in dealing with these new developments? These are important questions that must be answered in order to understand the great change that is currently under way in the global oil market.

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<sup>2</sup> P. Waldman, “Saudi Arabia’s Plan to Extend the Age of Oil”, *Bloomberg*, 12 April 2015, <http://www.bloomberg.com/news/articles/2015-04-12/saudi-arabia-s-plan-to-extend-the-age-of-oil>.

<sup>3</sup> Full text of: “Saudi oil Minister’s remarks at the German-Arab Friendship Association”, Ali al-Naimi, Ministry of Petroleum, Berlin, 4 March 2015, <http://fingfx.thomsonreuters.com/2015/03/04/17345743f6.pdf>.

## The developing new Saudi oil policy

Saudi Arabia derives much of its power from its important role as the ‘swing producer’ or ‘central bank’ of the international oil market. Saudi Arabia’s ability to single-handedly alter the price of oil gives the Kingdom significant geopolitical power<sup>4</sup>. However, new developments in the world oil markets, especially the steady growth in shale oil in the US since 2008, combined with rising domestic oil demand in Saudi Arabia have and will continue to have a significant impact on its position as a swing producer.

### *US shale boom: changing oil market dynamics*

Since 2008 US production has increased dramatically, changing the dynamics of world oil markets and contributing to the sharp decline in oil prices. From a position of negative growth in 2008, US crude oil production growth turned positive in 2009 and has risen from 852,000 barrels per day (b/d) in 2012 to 968,000b/d in 2013, with a record growth of 1.246 million barrels per day (mb/d) in 2014 (Table 1). Meanwhile, US production jumped by 1.2mb/d in 2014, to 8.7mb/d. That was the biggest expansion in US crude since record-keeping began in 1900<sup>5</sup>.

Subsequently, by the end of 2014, oil production in the US was 80 per cent higher than it had been in 2008. The increase of 4.1mb/d was greater than the output of every single OPEC country but Saudi Arabia<sup>6</sup>. The latest data from the US Energy Information Administration (EIA), for the week to 29 May 2015, shows crude output hitting an all-time high of 9.586mb/d. That’s the highest

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<sup>4</sup> S. Fang, A.M. Jaffe, T. Temzelides, *New Alignments? The Geopolitics of Gas and Oil Cartels and the Changing Middle East*, 24 January 2012, James A. Baker III Institute for Public Policy, Rice University, <http://bakerinstitute.org/files/499/>.

<sup>5</sup> T. Randall, “These Charts Show Clearly Why Oil Prices Crashed”, *Bloomberg*, 30 March 2015, <http://www.bloomberg.com/news/articles/2015-03-30/these-charts-show-clearly-why-oil-prices-crashed>.

<sup>6</sup> D. Yergin, “Who Will Rule the Oil Market?”, *The New York Times*, 23 January 2015, [http://www.nytimes.com/2015/01/25/opinion/sunday/what-happened-to-the-price-of-oil.html?\\_r=0](http://www.nytimes.com/2015/01/25/opinion/sunday/what-happened-to-the-price-of-oil.html?_r=0).

level since 1983<sup>7</sup>. However, the EIA's May 2015 *Short-Term Energy Outlook (STEO)* forecasts that US crude oil production will be averaging 9.2mb/d in both 2015 and 2016, 40,000b/d (0.5%) and 100,000b/d (1.1%) lower than in last month's *STEO*, respectively. Yet well above the 2014 average level of 8.7mb/d by about 500,000b/d<sup>8</sup>.

TABLE 1 - US AND SAUDI CRUDE PRODUCTION  
AND OPEC BASKET PRICE

|                         | US production<br>(mb/d) | Saudi production<br>(mb/d) | OPEC basket price<br>(US\$) |
|-------------------------|-------------------------|----------------------------|-----------------------------|
| <b>2007</b>             | 5.07                    | 8.48                       | 69.08                       |
| <b>2008</b>             | 5.00                    | 8.90                       | 94.45                       |
| <b>2009</b>             | 5.35                    | 7.89                       | 61.06                       |
| <b>2010</b>             | 5.48                    | 8.13                       | 77.45                       |
| <b>2011</b>             | 5.64                    | 9.04                       | 107.46                      |
| <b>2012</b>             | 6.49                    | 9.51                       | 109.45                      |
| <b>2013</b>             | 7.46                    | 9.40                       | 105.87                      |
| <b>2014</b>             | 8.71                    | 9.53                       | 96.29                       |
| <b>2015<sup>1</sup></b> | 9.2                     | 9.83                       | 50.30                       |

(1) Forecast.

Source: Compiled from International Energy Agency (IEA), EIA, OPEC

As a result, the US' dependence on imported crude oil has declined drastically over the past seven years: from 9.8mb/d in 2008, to 7.3mb/d in 2014, and is expected to fall to 6.8mb/d in 2015<sup>9</sup>. Looking forward, US annual crude imports are expected to hit a

<sup>7</sup> B. Sharples, R. Rowling, "Oil Halts Advance as Saudis Pump at Record Before OPEC Meeting", *Bloomberg*, 1 June 2015, <http://www.bloomberg.com/news/articles/2015-05-31/oil-halts-advance-as-saudis-pump-at-record-before-OPEC-meeting>.

<sup>8</sup> Energy Information Administration (EIA), *Short-Term Energy Outlook*, May 2015, <http://www.eia.gov/forecasts/steo/archives/may15.pdf>

<sup>9</sup> J. Zou, "China to beat US as world's top crude importer in 2017", *ICIS News*, 25 May 2015, <http://www.icis.com/resources/news/2015/05/25/9888534/china-to-beat-us-as-world-s-top-crude-importer-in-2017/>.

new low slightly above 6mb/d by 2019<sup>10</sup>. The origin of imported crude oil has also changed. In 2008, OPEC supplied over 55 per cent of US crude oil imports. In 2014, this share declined to 40 per cent<sup>11</sup>. To be sure, US imports of oil and petroleum products from OPEC have fallen to a 28-year low since April 1987<sup>12</sup>. Within this context, it's not rocket science to understand why Saudi Arabia is refusing to cut its own production. The Kingdom seems to be trying to protect its market share in the US hoping that low oil prices will slow down investment in US shale oil, undermining future production growth. Or, as Rene Ortiz, the former Ecuadorean Oil Minister who also once served as OPEC's Secretary interestingly stated, "Today's OPEC [and Saudi Arabia] is thinking about market fundamentals rather than manipulating the market because it doesn't have the same power it once had"<sup>13</sup>.

### *Asian markets: competition is heating up*

The surge in US light tight oil (LTO) production has also forced a geographic shift in crude oil flows from North America to Asia. In a recent report titled *Saudi Arabia's crude dominance in Asia – A thing of the past?*, Wood Mackenzie points out that "The US has increased its heavy crude imports from Canada, backing off crude volumes from Latin America and the Middle East. Similarly, higher use of domestic tight oil resulted in the re-direction of West African crude supplies. As such, these suppliers have turned to Asia"<sup>14</sup>. To be sure, producers of lighter grades such as Nigeria, Algeria, Angola and Libya together have lost over 1.6mb/d of their market shares in the US since 2008 (Table 2). Additionally,

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<sup>10</sup> Ibid.

<sup>11</sup> EIA, "U.S. Imports by Country of Origin",

[http://www.eia.gov/dnav/pet/pet\\_move\\_impcus\\_a2\\_nus\\_epc0\\_im0\\_mbbldpd\\_a.htm](http://www.eia.gov/dnav/pet/pet_move_impcus_a2_nus_epc0_im0_mbbldpd_a.htm).

<sup>12</sup> T. Randall, "U.S. Oil Imports From OPEC Have Plunged to a 28-Year Low", *Bloomberg*, 1 April 2015, <http://www.bloomberg.com/news/articles/2015-04-01/u-s-oil-imports-from-OPEC-have-plunged-to-a-28-year-low>.

<sup>13</sup> C. Krauss, "New Balance of Power", *The New York Times*, 22 April 2015, <http://nyti.ms/1yTI7Yq>.

<sup>14</sup> "Saudi Arabia cannot command premium for its crude in Asia", Wood Mackenzie, 30 March 2015, [http://www.woodmac.com/public/media-centre/12527004?filter\\_type=all](http://www.woodmac.com/public/media-centre/12527004?filter_type=all).

the share of heavy-grade imports from Canada has increased from almost 20 per cent in 2008 to almost 40 per cent in 2014, displacing crude from countries such as Mexico and Venezuela and resulting in a competition of heavy oil exports from these two countries with oil exports from the Middle East<sup>15</sup>.

TABLE 2 - US CRUDE IMPORTS BY COUNTRY OF ORIGIN (000-B/D)

|                        | 2008  | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015 <sup>1</sup> |
|------------------------|-------|-------|-------|-------|-------|-------|-------|-------------------|
| <b>All Countries</b>   | 9,783 | 9,013 | 9,213 | 8,935 | 8,527 | 7,730 | 7,337 | 7,130             |
| <b>GCC<sup>2</sup></b> | 1,734 | 1,237 | 1,291 | 1,430 | 1,673 | 1,656 | 1,481 | 1,197             |
| <b>OPEC</b>            | 5,415 | 4,355 | 4,553 | 4,209 | 4,031 | 3,493 | 2,995 | 2,501             |
| <b>Libya</b>           | 68    | 61    | 43    | 9     | 56    | 43    | 5     | 8                 |
| <b>Algeria</b>         | 312   | 281   | 328   | 178   | 120   | 29    | 6     | 0                 |
| <b>Angola</b>          | 504   | 448   | 383   | 335   | 222   | 201   | 136   | 96                |
| <b>Iraq</b>            | 627   | 449   | 415   | 459   | 476   | 341   | 364   | 190               |
| <b>Nigeria</b>         | 922   | 776   | 983   | 767   | 406   | 239   | 59    | 40                |
| <b>Saudi Arabia</b>    | 1,503 | 980   | 1,082 | 1,186 | 1,361 | 1,325 | 1,159 | 915               |
| <b>Venezuela</b>       | 1,039 | 951   | 912   | 868   | 912   | 755   | 733   | 718               |
| <b>Non-OPEC</b>        | 4,369 | 4,658 | 4,661 | 4,727 | 4,495 | 4,237 | 4,342 | 4,776             |
| <b>Canada</b>          | 1,956 | 1,943 | 1,970 | 2,225 | 2,425 | 2,579 | 2,885 | 3,222             |

(1) Average of first quarter.

(2) GCC = Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE.

Source: EIA

In this context, Saudi Arabia's only option if it wanted to try to address the global glut would be to cut exports of its relatively small share of lighter crude production or make deep cuts in heavy grades. However, this would quickly be matched by an increase in heavy-grade production in Russia or South American countries and light oil output in OPEC member states such as Iran, Iraq and

<sup>15</sup> Y. Okada, H. Lee, "Latin America Challenges Saudi Oil Clout", *Bloomberg*, 20 April 2015, <http://www.businessweekme.com/Bloomberg/newsid/190/newsid/569>.

even Libya<sup>16</sup>. To add to the complications, the supply glut will further deepen, as Obama's administration eased a 40-year ban on oil exports and will now allow exports of up to one mb/d of US ultra-light oil to global markets<sup>17</sup>.

To put these developments in perspective, Saudi Arabia shipped 5.7 per cent less oil overseas in 2014, led by a decline in China. According to data from the Joint Organisations Data Initiative (JODI), Saudi crude exports averaged 7.11mb/d, down from an 11-year high of 7.54mb/d in 2013 and the lowest in three years<sup>18</sup>. In Asia the Kingdom is facing tough times in marketing more of its crude oil. Even Saudi crude exports to Japan, its top market in Asia, fell slightly to 1.137mb/d last year from 1.145mb/d 2013. Whilst China also cut imports of Saudi crude by 7.9 per cent, to 0.989mb/d last year from 1.078mb/d in 2013. India also decreased its oil imports from Saudi Arabia to 0.711mb/d from 0.787 for the same period (Table 3).

As a result, the Kingdom's share of Asia's oil market decreased from 26 per cent to nearly 24 and the Kingdom's market share in China dropped to 16 per cent last year from 19 per cent in 2013<sup>19</sup>. Russia and the Middle Eastern producers have been making steady inroads since 2010. Iraq has emerged as the largest competitor, as it has been most successful in increasing its share of Asian crude supply, with exports rising by 602,466b/d in a time period from 2010 to 2014. This is followed by Russia, whose sup-

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<sup>16</sup> D.H. Claes, A. Goldthau, D. Livingston, "Saudi Arabia and the Shifting Geoeconomics of Oil", Carnegie Endowment for International Peace, 21 May 2015, <http://carnegieendowment.org/2015/05/21/saudiarabiaandshiftinggeoeconomics/foi/i8vv>.

<sup>17</sup> F. Loo, J. Dennis, "Saudi Arabia asserts oil kingpin role; rejects output cut plea", *ICIS News*, 6 January 2015, <http://www.icis.com/resources/news/2015/01/06/9850065/saudi-arabia-asserts-oil-kingpin-role-rejects-output-cut-plea/>.

<sup>18</sup> W. Mahdi, "Saudi Arabia's Oil Exports Fell in 2014 in 'Tough Year'", *Bloomberg*, 18 February 2015, <http://www.bloomberg.com/news/articles/2015-02-18/saudi-arabia-s-oil-exports-fell-in-2014-in-tough-year->.

<sup>19</sup> "China's Record Russian Crude Imports Erode Saudi Market Share", *Bloomberg*, 23 January 2015, <http://www.bloomberg.com/news/2015-01-23/china-s-record-russian-crude-imports-erode-saudi-market-share.html>.

ply increased by 421,726b/d, and the UAE by 401,643b/d during the same period. In comparison, Saudi Arabia only increased its export volumes to Asia by 240,986b/d<sup>20</sup>. Most importantly, the Kingdom will progressively switch its crude exports from the US to Asia as rising Canadian heavy oil production is gaining new ground. Thus, this situation provided Saudi Arabia with strong incentives not to cut its crude production.

TABLE 3 - SAUDI CRUDE EXPORTS  
TO MAJOR MARKETS (2010-2014, 000B/D)

|                            | 2008  | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | Ranking<br>among<br>Saudi top<br>export<br>destinations<br>(2014) |
|----------------------------|-------|-------|-------|-------|-------|-------|-------|-------------------------------------------------------------------|
| <b>US</b>                  | 1,503 | 980   | 1,082 | 1,186 | 1,361 | 1,325 | 1,159 | <b>3</b>                                                          |
| <b>Japan*</b>              | 1,197 | 1,150 | 1,107 | 1,167 | 1,195 | 1,145 | 1,137 | <b>2</b>                                                          |
| <b>China*</b>              | 730   | 841   | 896   | 1,009 | 1,082 | 1,082 | 997   | <b>1</b>                                                          |
| <b>India*</b>              | 527   | 531   | 556   | 591   | 675   | 787   | 711   | <b>6</b>                                                          |
| <b>South<br/>Korea*</b>    | 791   | 754   | 800   | 835   | 863   | 830   | 844   | <b>5</b>                                                          |
| <b>EU</b>                  | 283   | 215   | 226   | 299   | 354   | 323   | 323   | <b>4</b>                                                          |
| <b>Taipei<br/>Chinese*</b> | 340   | 328   | 320   | 267   | 273   | 310   | 287   | <b>8</b>                                                          |
| <b>Singapore*</b>          | 342   | 248   | 256   | 283   | 240   | 171   | 188   | <b>7</b>                                                          |

\* Converted from tones, one tone = 7.33 barrels (BP, conversion calculator).

Source: Compiled from official data and IMF

Saudi Arabia has been forced to fight back, offering substantial discounts for Asian consumers and cutting its official selling price (OSP) to Asian customers six times in nine months<sup>21</sup>. For example, Saudi Aramco lowered its OSP for last March's delivery of its Arab Light crude to Asia by 90 cents. This was the lowest price

<sup>20</sup> Wood Mackenzie (2015).

<sup>21</sup> B. Aucon, S. Said, "Saudi Arabia Maneuvers to Retain Oil Crown", *The Wall Street Journal*, 10 April 2015, <http://www.wsj.com/articles/saudi-arabia-maneuvers-to-retain-oil-crown-1428707642>.

offered by Saudi Arabia in the past 14 years<sup>22</sup>. Above all, Saudi Arabia pumped 10.25mb/d last May, unchanged from April and matching the highest level in monthly survey data compiled by Bloomberg since 1989<sup>23</sup>. For Riyadh the long-term aim is clear: it is forsaking short-term financial revenues to help ensure its future market share<sup>24</sup>. Certainly if the Kingdom continues to maintain its current crude export volume of almost 4.56mb/d to Asia, by 2020 its market share will decline from around 24 per cent to 21 per cent<sup>25</sup>. More importantly, this would mean a lost market opportunity for Saudi Arabia in Asia's over 2.7mb/d of incremental crude oil import potential by 2020<sup>26</sup>.

### *The coming refining giant*

Saudi Arabia is also moving beyond its traditional role as a simple exporter of crude oil, as Aramco has been aggressively expanding its presence in the downstream sector. Over the past two years, the company has added 800,000b/d to Saudi Arabia's refining capacity through joint-ventures with Chinese Sinopec and French Total. The company has also begun work on the 400,000b/d Jazan refinery, which is expected to enter operation by 2018<sup>27</sup>. As a result, this year Saudi Arabia's nameplate refining capacity will grow to 2.9mb/d<sup>28</sup>, to hit nearly 3.3mb/d by 2018<sup>29</sup>. Saudi Arabia also has over 2.4mb/d of refining capacity overseas through joint and equi-

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<sup>22</sup> M. Chmaytelli, M.C. Smith, "OPEC Delegates Said to Ratify Oil Market Outlook for 2015", *Bloomberg*, 29 May 2015, <http://www.bloomberg.com/news/articles/2015-05-29/OPEC-delegates-said-to-ratify-oil-market-outlook-for-rest-of-15>.

<sup>23</sup> B. Sharples, R. Rowling (2015).

<sup>24</sup> A. Raval, "Saudi strategy to retain oil dominance", *FT.com*, 6 April 2015, <http://www.ft.com/intl/cms/s/2/451363c4-dc44-11e4-a6f7-00144feab7de.html#axzz3ee6gBVtU>.

<sup>25</sup> Wood Mackenzie (2015).

<sup>26</sup> *Ibid.*

<sup>27</sup> BMI Research, "Domestic Demand in Saudi Arabia to Decide Crude Production Growth", Business Monitor International, London, 27 May 2015.

<sup>28</sup> BMI Research, "Saudi Arabia Oil & Gas Report Q2 2015", Business Monitor International, London, 1 April 2015, p. 23.

<sup>29</sup> *Ibid.*

ty ventures in facilities in the US (in Louisiana and Texas, with Royal Dutch Shell owning three Motiva joint-venture refineries), China (in Fujian Province with ExxonMobil and Sinopec), South Korea (with S-Oil) and Japan (with Showa Shell)<sup>30</sup>. Overall, the growth puts Aramco's owned or equity stakes in refining at nearly 5.4mb/d, or at least 40 per cent above a decade ago<sup>31</sup> (Table 4).

TABLE 4 - SAUDI ARAMCO REFINING CAPACITY

|        | Wholly<br>owned<br>domestic | Domestic<br>joint<br>ventures | International<br>joint<br>ventures | Worldwide | Saudi<br>Aramco<br>share |
|--------|-----------------------------|-------------------------------|------------------------------------|-----------|--------------------------|
| Mn b/d | 1.006                       | 1.905                         | 2.464                              | 5.375     | 3.104                    |

Source: Aramco Annual Review, May 2015

Looking forward, Aramco has also set an ambitious target to become the world's largest oil as well as chemicals producer by the end of the current decade. Saudi Aramco said its downstream investments would exceed \$100bn over the next decade, targeting a refining capacity of 8-10mb/d, or more than a tenth of global capacity<sup>32</sup>. According to Aramco's *Annual Review 2014*: "These are major milestone projects in our goal to increase our participated refining capacity worldwide to 8-10mb/d, primarily in the Far East and Middle East and in other high-demand growth markets"<sup>33</sup>. Additionally, by building refineries at home and taking stakes in refineries overseas, "Saudi Arabia is on track to join the club of major oil product exporters", says the International Energy Agen-

<sup>30</sup> EIA, *Saudi Arabia*, Country Analysis Brief, 10 September 2014, [http://www.eia.gov/beta/international/analysis\\_includes/countries\\_long/Saudi\\_Arabia/saudi\\_arabia.pdf](http://www.eia.gov/beta/international/analysis_includes/countries_long/Saudi_Arabia/saudi_arabia.pdf).

<sup>31</sup> L. George, R. Bousso, "Saudi Arabia rewrites its oil game with refining might", *Reuters*, 22 May 2015, <http://www.reuters.com/article/2015/05/22/saudi-refining-evolution-idUSL5N0YC4AI20150522>.

<sup>32</sup> M. Cho, R. Shamseddine, "Saudi Arabia goes on refinery hiring spree in South Korea", *Reuters*, 28 May 2015, <http://www.reuters.com/article/2015/05/28/oil-southkorea-saudi-idUSL4N0XP1UA20150528>.

<sup>33</sup> Saudi Aramco, *Annual Review 2014*, 11 May 2015, <http://www.saudiARAMCO.com/en/home/news-media/publications/corporate-reports/annual-review-2014.html>.

cy, in its *Medium-Term Oil Market Report 2015*<sup>34</sup>. For Saudi Arabia, the goal is very simple: in the long-term, Riyadh hopes to find guaranteed markets for its crude. In the process, the increase in domestic demand and its refining capacity makes Saudi Arabia unable and less willing to reduce its oil production. Consequently, the Kingdom is gradually withdrawing from its traditional role as global swing supplier.

### *Oil strategy: the game of chicken*

Saudi Arabia is hoping that lower oil prices will slow down production growth in non-OPEC members, and stimulate economic growth and demand for its (and OPEC's) crude. Most importantly, the Kingdom has been positioning itself for tougher OPEC negotiations that lie ahead, particularly in the event of the return of Iranian oil to global markets<sup>35</sup>. Following the nuclear agreement reached in July 2015, Iran may be looking to increase its crude production once sanctions are lifted. The EIA estimates that, with a deal in place, Iran might start selling a stockpile of 30mb or more later this year and raise its output by perhaps 700,000b/d by the end of 2016<sup>36</sup>. Iranian officials are more optimistic as they say their country can add almost one million barrels to daily production within six months of sanctions being lifted. Iran produced 2.8mb/d of crude in May<sup>37</sup>. Meanwhile, Iraq's export plans signal all-time-high shipments as the country produced a record 3.87mb/d in May, according to data compiled by Bloomberg<sup>38</sup>.

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<sup>34</sup> A. Raval, "Saudi strategy to retain oil dominance".

<sup>35</sup> D. Yergin (2015); B. Fattouh, *Saudi Arabia's Oil Policy in Uncertain Times: A Shift in Paradigm?*, Oxford Institute for Energy Studies, 22 October 2014, <http://www.oxfordenergy.org/2014/10/saudi-arabias-oil-policy-in-uncertain-times-a-shift-in-paradigm/>.

<sup>36</sup> L. Denning, "Iran's Strategic Petroleum Reversal for Oil Markets", *The Wall Street Journal*, 9 April 2015, <http://www.wsj.com/articles/irans-strategic-petroleum-reversal-for-oil-markets-heard-on-the-street-1428599066>.

<sup>37</sup> A. Dipaola, G. Smith, "What's OPEC Going to Do With Ira's Million Barrels a Day?", *Bloomberg*, 3 June 2015, <http://www.bloomberg.com/news/articles/2015-06-02/iran-s-million-barrel-conundrum-brings-battle-back-inside-opec>.

<sup>38</sup> Ibid.

Ultimately, Riyadh may calculate that Iran, Iraq and even Russia will have to confront two hard choices. First, to pump more crude, thus increasing the risk of downward pressure on global oil prices, or cut their production individually or through collective agreement. Or, as Keith Johnson in a recent *Foreign Policy* article bluntly put it: “By staying the course, Saudi Arabia is playing a game of chicken with those other big oil producers inside OPEC, as well as Russia, rather than trying to wreck the US oil bonanza”<sup>39</sup>. With its sound fiscal fundamentals and large holdings of foreign reserves, Saudi Arabia can afford to wait. According to the latest data from the IMF’s Statistics, the stock of foreign exchange reserves held at the Saudi Arabian Monetary Agency (SAMA) was \$726.8bn in 2014. However, the IMF expects reserves to decline sharply in the next two years due to the slump in oil prices and decline in export revenues (Table 5). Regarding this, the Economist Intelligence Unit (EIU) estimates that at the current rate, it would still take a further 7-8 years before SAMA’s reserves are fully exhausted<sup>40</sup>.

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<sup>39</sup> K. Johnson, “Saudi Arabia Takes Out Its Energy Weapon”, *Foreign Policy*, 3 June 2015, <https://foreignpolicy.com/2015/06/03/saudi-arabia-takes-out-its-energy-weapon-OPEC-russia-putin-iran-oil/>.

<sup>40</sup> Economist Intelligence Unit (EIU), *Saudi Arabia: Reserves plummet in February and March*, 28 May 2015, <http://country.eiu.com/saudi-arabia>.

TABLE 5 - SAUDI ARABIA (SELECTED ECONOMIC DATA)

|                                                          | Average |       | Projections |       |       |       |
|----------------------------------------------------------|---------|-------|-------------|-------|-------|-------|
|                                                          | 2000-11 | 2012  | 2013        | 2014  | 2015  | 2016  |
| <b>Real GDP Growth (annual change; per cent)</b>         | 5.5     | 5.4   | 2.7         | 3.6   | 3.0   | 2.7   |
| <b>Nominal GDP (US\$bn)</b>                              | 358.6   | 734.0 | 744.3       | 752.5 | 649.0 | 705.7 |
| <b>Non-Oil Real GDP Growth</b>                           | 7.1     | 5.5   | 6.4         | 5.1   | 4.6   | 3.7   |
| <b>Oil Real GDP Growth</b>                               | 2.2     | 5.1   | -1.6        | 1.7   | 0.9   | 1.4   |
| <b>Crude Oil Production (mn b/d)</b>                     | 8.55    | 9.76  | 9.63        | 9.71  | 9.76  | 9.87  |
| <b>Crude Oil Exports (mn b/d)</b>                        | 6.63    | 7.58  | 7.57        | 7.13  | 6.96  | 6.91  |
| <b>Fiscal Breakeven Oil Price<sup>1</sup> (US\$/b)</b>   | ...     | 77.9  | 89.0        | 111.3 | 103.0 | 98.3  |
| <b>External Breakeven Oil Price<sup>2</sup> (US\$/b)</b> | ...     | 55.4  | 59.4        | 65.0  | 68.2  | 69.7  |
| <b>Exports of Goods and Services (US\$bn)</b>            | 191.2   | 399.4 | 387.6       | 371.5 | 247.5 | 279.8 |
| <b>Gross Official Reserves (US\$bn)</b>                  | 233.2   | 648.7 | 718.4       | 726.8 | 648.8 | 597.1 |
| <b>Total Government Gross Debt (per cent of GDP)</b>     | 45.1    | 3.6   | 2.2         | 1.6   | 1.8   | 1.7   |

(1) The oil price at which the fiscal balance is zero.

(2) The oil price at which the current account balance is zero.

Source: IMF, *Regional Economic Outlook Update Middle East and Central Asia*, May 2015

## Domestic and geopolitical challenges

Although Saudi Arabia's oil gambit seems logical, it will be associated with some risks in the short and long-term. The Kingdom's domestic dynamics and international geopolitical landscape could pose significant challenges for its oil policy. The first challenge stems from the rapid increase in US oil production and its impact on the future of US-Saudi relations. At the international level, the significance of the shale boom may, for the first time in history, give the US the chance to abandon its dependence on oil imports from Saudi Arabia once and for all. Regionally, a *détente* between Washington and Tehran could leave Saudi Arabia feeling more vulnerable and may give Tehran the opportunity to realize its regional ambitions. Finally, as Saudi Arabia takes domestic demands and the refining market into account, it will become more difficult for the Kingdom to play the role of swing producer. Ultimately, Saudi Arabia's 'special relationship' with the US may become 'less special', making alternative foreign policy choices more attractive.

The second challenge is that Saudi Arabia's place in the world oil market could be threatened by unrestrained domestic oil consumption. Saudi Arabia's ability to stabilize the international oil market by turning export volumes up or down would be damaged, with spare capacity used up to maintain export volumes. Saudi Arabia is now the largest oil-consuming country in the Middle East and the world's sixth-largest consumer, using more than a quarter of its output<sup>41</sup>. According to IEA estimates, Saudi Arabia consumed 3.22mb/d in 2014, compared with 3.02mb/d in 2013<sup>42</sup>. To add to the complications, energy subsidies (oil and electricity) in Saudi Arabia as share of GDP hit 8.3 per cent or \$62.1bn in 2013. This means that every person cost the Saudi government over \$2,155 per year<sup>43</sup>.

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<sup>41</sup> IEA, *Oil Market Report*, 13 May 2015,

<https://www.iea.org/media/omrreports/fullissues/2015-05-13.pdf>.

<sup>42</sup> Ibid.

<sup>43</sup> IEA, <http://www.iea.org/subsidy/>.

Looking forward, if Saudi Arabia's current domestic oil-consumption growth rate continues unabated, in the longer-term the Kingdom's spare oil production capacity will diminish<sup>44</sup>. Facts Global Energy (FGE) says in a recent report that Saudi Arabia's domestic consumption is forecast to grow by more than 870,000b/d to 2020<sup>45</sup>. Saudi officials are aware of the magnitude of the problem and are trying to speed up steps that contribute to energy efficiency. According to Prince Abdulaziz bin Salman, Saudi Arabia's deputy Petroleum Minister, the Kingdom seeks to cut its crude consumption by 1.5m/b of oil equivalent a day by 2030<sup>46</sup>. Whether it is a successful policy is yet to be seen.

TABLE 6 - SAUDI REFINING CAPACITY  
AND CONSUMPTION (SAUDI ARABIA 2014-2024)

|                                              | Forecast |       |       |       |       |       |       |
|----------------------------------------------|----------|-------|-------|-------|-------|-------|-------|
|                                              | 2014     | 2015  | 2016  | 2018  | 2020  | 2022  | 2024  |
| <b>Crude Oil Refining Capacity (mn b/d)</b>  | 2.505    | 2.905 | 2.905 | 3.305 | 3.305 | 3.305 | 3.305 |
| <b>Refined Products Consumption (mn b/d)</b> | 3.027    | 3.133 | 3.258 | 3.507 | 3.714 | 3.879 | 4.028 |

(1) BMI estimate.

Source: National Sources, EIA, BMI

Last but not least, the existence of OPEC itself is at stake. On 5 June 2015, the organisation reaffirmed the decision taken in last November to maintain production, which effectively means that member states are free to pump as much as they like. Ali al-Naimi, Saudi Petroleum Oil Minister, reiterated that OPEC's strategy is working. Yet the gambit has been costly for many OPEC produc-

<sup>44</sup> J. Krane, "A refined approach: Saudi Arabia moves beyond crude", *Energy Policy*, vol. 82, July 2015, p. 104.

<sup>45</sup> "Saudi Arabia Aims For Key Role In Global Products Supply With \$20bn Jazan Plans", *MEEs*, vol. 55. no. 9, 27 February 2015.

<sup>46</sup> W. Mahdi, "Saudi Prince Sees 'Excellent' Oil Market as Kingdom Pumps On", *Bloomberg*, 27 April 2015, <http://www.bloomberg.com/news/articles/2015-04-27/oil-market-is-in-excellent-condition-saudi-prince-abdulaziz>.

ers because they have already started to feel the heat. Countries such as Venezuela, Nigeria, Algeria, Iraq, and Iran need oil prices to be much higher to break even. The IMF warned recently that: “with a more constrained fiscal outlook over the next few years, oil exporting countries would need to adapt progressively to new realities”<sup>47</sup>. In short, pressure within OPEC to go back to the old system (quotas) will be significant. Prolonged low oil prices could test the organisation’s unity and Saudi Arabia’s staying power.

### Looking ahead: navigating uncertainty

More than ten months have passed since OPEC decided to keep its output ceiling unchanged, yet oil prices are lower by more than 50 per cent compared with a year ago. Looking ahead, a number of factors are likely to affect the baseline assumptions for global oil prices in the coming years, including changes to OPEC policy, the speed and strength of the global economic recovery, future oil production in the US, investments in the oil sector and geopolitical risks, in the Middle East in particular<sup>48</sup>. Although these factors mean there is considerable uncertainty about the global oil market outlook, most forecasts suggest that oil production in the US is going rise, which will subsequently lead to a decline in its oil imports from OPEC countries in the coming years.

The IEA in its May report said that supply was still outstripping demand and “It would thus be premature to suggest that OPEC has won the battle for market share [...] The battle, rather, has just started”<sup>49</sup>. More importantly, no one expected global oil

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<sup>47</sup> M. Ahmed, *Learning to Live with Cheaper Oil in the Middle East*, IMF, 22 January 2015, <http://blog-imfdirect.imf.org/2015/01/22/learning-to-live-with-cheaper-oil-in-the-middle-east/>;

<http://www.imf.org/external/pubs/ft/reo/2015/mcd/eng/mreo0115.htm>.

<sup>48</sup> IMF, *World Economic Outlook*, April 2015,

<http://www.imf.org/external/pubs/ft/weo/2015/01/>; IMF, *Saudi Arabia: Tackling Emerging Economic Challenges*.

<sup>49</sup> A. Raval, “Battle for oil market has only just started, says energy watchdog”, *Financial Times*, 13 May 2015, <http://www.ft.com/intl/cms/s/0/82de2a06-f943-11e4-be7b-00144feab7de.html#axzz3lRmzw83u>.

prices to return to the levels recorded in June 2014. OPEC Secretary General Abdallah Salem el-Badri acknowledged this new reality and said at a news conference during the organisation's last meeting in June: "The reality now is that we cannot have this \$100 (a barrel) anymore. This is a fact. We have less value for our barrels"<sup>50</sup>. *The Wall Street Journal* reported on 12 May 2015, OPEC predictions that oil prices will be about \$76 a barrel in 2025 in OPEC's most optimistic scenario<sup>51</sup>. Although the World Bank agrees with OPEC's pessimistic outlook in the short- and medium-term, it is more optimistic in the long-run.

Projections that US shale oil production would be wiped out by cheaper supplies was premature. Maria van der Hoeven, the former Executive Director of the IEA, said recently that the US shale industry may emerge even 'stronger' towards the end of the decade<sup>52</sup>. "Shale oil has changed the market [...] OPEC's move to let the market rebalance itself is a reflection of that fact [...] It may have effectively turned light tight oil into the new swing producer, but it will not drive it out of the market"<sup>53</sup>, she added. The IEA now sees oil supply from countries outside OPEC growing by 3.4mb/d from 2014 levels to 60mb/d in 2020, at an average of 570,000b/d per year<sup>54</sup>. Whilst total OPEC capacity is estimated to increase 1.22mb/d over the same period, representing an annual rate of around 200,000b/d per year<sup>55</sup>. Claudio Descalzi, CEO of Italy's major energy company, Eni, told *MEES* recently "that there are no short term solutions for OPEC. A production cut now to

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<sup>50</sup> S. Said, B. Spindle, B. Faucon, "OPEC Keeps Output Unchanged", *The Wall Street Journal*, 5 June 2015, <http://www.wsj.com/articles/opec-keeps-output-unchanged-1433504610>.

<sup>51</sup> B. Faucon, S. Said, "OPEC Sees Oil Price Below \$ 100 a Barrel in the Next Decade", *The Wall Street Journal*, 12 May 2015, <http://www.wsj.com/articles/opec-sees-oil-price-below-100-a-barrel-in-the-next-decade-1431347035>.

<sup>52</sup> A. Raval, "Crude falls as IEA says US shale oil output fall to be limited", *Financial Times*, 10 February 2015, <http://www.ft.com/intl/cms/s/0/979d5600-b07e-11e4-9b8e-00144feab7de.html#axzz3lRnNVbby>.

<sup>53</sup> Ibid.

<sup>54</sup> IEA, *Medium-Term Oil Market Report 2015*, February 2015, [http://www.iea.org/bookshop/702-Medium-Term\\_Oil\\_Market\\_Report\\_2015](http://www.iea.org/bookshop/702-Medium-Term_Oil_Market_Report_2015).

<sup>55</sup> Ibid.

sustain the oil price would quickly be replaced by new capacity coming from shale oil”<sup>56</sup>.

OPEC may face a few lean years ahead, but Saudi officials are optimistic in the long-run. Aramco in its annual report stated that Total Oil demand is forecast to increase by about 25 per cent over the next 25 years<sup>57</sup>. BP in the latest edition of its *Energy Outlook 2035* shares that optimism. BP sees global demand for oil (including bio-fuels and other liquids) rising by almost 20mb/d to 111mb/d by 2035<sup>58</sup>. Most importantly, the Middle East remains the world’s largest oil producing region; its share of global supply falls from 32 to 28 per cent over the next few years, but returns to 32 per cent by 2035<sup>59</sup>. Fatih Birol, the newly appointed Executive Director of the IEA, also spoke along the same lines: “The US will never be a major oil exporter. Their import needs are getting less but the US is not becoming Saudi Arabia [...] Its production growth is good to diversify the market but it will not solve the world’s oil problems”<sup>60</sup>. Other forecasts anticipate the same growth by 2040. The IEA estimated in 2013 that global consumption will reach 104mb/d, from 90mb/d. The EIA projected daily demand hitting 117.05mb/d, and OPEC forecast 111.1mb/d<sup>61</sup>.

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<sup>56</sup> “OPEC’s Market Strategy Shrinks Spare Capacity”, *MEEES*, vol. 58, no. 23, 5 June 2015.

<sup>57</sup> Saudi Aramco (2015).

<sup>58</sup> BP, *Energy Outlook 2035*, 17 February 2015, <http://www.bp.com/en/global/corporate/about-bp/energy-economics/energy-outlook.html>.

<sup>59</sup> Ibid.

<sup>60</sup> M. Khan, “United States will not become the 'new Saudi Arabia' of global energy”, *The Telegraph*, 26 February 2015, <http://www.telegraph.co.uk/finance/newsbysector/energy/oilandgas/11436337/United-States-will-not-become-the-new-Saudi-Arabia-of-global-energy.html>.

<sup>61</sup> I. Arnsdorf, “Falling Demand for Oil Is the Biggest Concern for Saudis”, *Bloomberg*, 26 January 2015, <http://www.bloomberg.com/news/articles/2015-01-26/for-saudis-falling-demand-for-oil-is-the-biggest-concern>.

TABLE 7 – PETROLEUM AND OTHER LIQUIDS CONSUMPTION<sup>1</sup>  
2013-2035 (REFERENCE CASE, MB/D)

|                      | 2013  | 2020  | 2025  | 2030  | 2035  |
|----------------------|-------|-------|-------|-------|-------|
| <b>US</b>            | 18.96 | 19.65 | 19.61 | 19.41 | 19.29 |
| <b>OECD Europe</b>   | 13.96 | 14.20 | 14.15 | 14.09 | 14.03 |
| <b>China</b>         | 10.67 | 13.13 | 14.75 | 17.03 | 18.92 |
| <b>Japan</b>         | 4.56  | 4.27  | 4.18  | 4.03  | 3.86  |
| <b>South Korea</b>   | 2.43  | 2.58  | 2.57  | 2.53  | 2.46  |
| <b>India</b>         | 3.70  | 4.30  | 4.89  | 5.52  | 6.13  |
| <b>Other Asia</b>    | 7.37  | 9.08  | 10.69 | 12.35 | 14.20 |
| <b>Global demand</b> | 90.7  | 98.4  | 102.9 | 108.8 | 114.7 |

(1) Includes crude oil, lease condensate, tight oil (shale oil), extra-heavy oil, and bitumen (oil sands).

Source: EIA, *The Annual Energy Outlook 2015*, April 2015

## Conclusion

Saudi Arabia's economic interests are the driving force behind its latest decision to reject calls to cut its (and OPEC's) production of crude oil. This chapter has shown that Saudi Arabia's objectives are framed around protecting its market share. Saudi Arabia's energy strategy is not a strategy to exclude shale oil, but rather a strategy to go where the market growth is. Or as then-CEO Khalid al-Falih said recently: "Supply and demand and the rules of economics will govern. It will take time for the current glut to be removed [...] Saudi Arabia will not single-handedly balance the market in a downturn"<sup>62</sup>.

In the short- and medium-terms, Saudi Arabia's motives are best understood in economical and not political terms. The Kingdom will pursue its core commercial objectives: 1) to maintain oil export levels and protect its market share; 2) to expand its foothold

<sup>62</sup> A. Dipaola, G. Carey, "Aramco Says Saudis Won't 'Singlehandedly' Balance Crude Market", *Bloomberg*, 28 January 2015, <http://www.bloomberg.com/news/articles/2015-01-27/saudi-aramco-capital-investment-to-drop-more-than-expected>.

in the refining sector, both at home and overseas; 3) to withdraw gradually from its traditional role as swing supplier, while maintaining significant spare production capacity<sup>63</sup>. In the long-run, Saudi Arabia will have no choice but to continue its policy of diversifying the economy away from its dependence on oil.

At the strategic level, maintaining good relations with the US remains Saudi Arabia's key foreign policy objective, given the long-standing economic and military ties between the two countries. But should the US put some distance between itself and Riyadh, or a rift develop between Saudi Arabia and the US, the Kingdom is likely to seriously consider parallel political-security arrangements in the longer-term.

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<sup>63</sup> BMI Research, "Domestic Demand in Saudi Arabia to Decide"

## **6. The Rising Gulf. What Implications for the EU?**

*Luigi Narbone, Valeria Talbot*

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This last chapter is aimed at assessing the implications for the EU of Gulf monarchies' assertiveness in the MENA region and of their shifting relations at the global level, as well as at identifying a common ground for cooperation on strategic issues.

In the aftermath of the Arab uprisings in 2011, the Gulf monarchies have taken centre stage in Middle East politics. Facing a set of challenges stemming from regional turmoil, these states have increased their geopolitical weight in the MENA region. They have played a significant role both in the Arab countries where regimes were overthrown and in regional crises and conflicts (i.e. Syria, Libya and Yemen), trying to reshape regional equilibrium and balances of power *vis-à-vis* Iran. In addition, relying on their oil wealth, the Gulf regimes have diversified their interests and extended relations and economic projections well beyond the MENA region, as witnessed by the intensification of trade, investments and energy flows with Asian countries, which have become the first destination of Gulf exports.

What are the implications for the EU of the change in the Gulf's position at the regional and international levels? How can the EU deal more effectively with these proactive actors? Looking at EU-Gulf relations, different dimensions have to be taken into account. While at the regional level, cooperation between the EU and the GCC has experienced ups and downs and remains below its potential, relations between single European states and Gulf monarchies have been flourishing in recent years in the economic and defence sectors, not to mention longstanding energy ties. This

has been reflected in an increase of commercial ties, defence contracts and business opportunities for European companies in Gulf markets. Furthermore, in the light of the economic difficulties, many European states have benefited from important Gulf investments in a wide range of sectors, resulting in a growing injection of Gulf capital into Europe.

Beyond deepening bilateral economic ties, the Gulf's activism in the MENA region deserves serious consideration by the EU. Indeed, whilst both share concerns regarding the evolution of regional security dynamics and an interest in the economic development of the Arab countries, EU and Gulf agendas do not seem to converge. In several respects, the Gulf monarchies are proving to have more leverage and economic assets than the EU in the MENA region. Furthermore, their involvement in regional affairs and ongoing crises – from Libya to Syria and Yemen – might have challenging consequences on Europe and its security, especially in the absence of a comprehensive EU foreign policy strategy towards the area.

### **The EU and the GCC: a relationship below its potential**

It is a well-recognised fact that the EU-GCC relationship has not developed to its full potential. In the past three decades the EU's international role has grown substantially and the Gulf countries have become increasingly important world economic and political actors. Nevertheless, the EU-GCC relationship remains rather shallow. Formal contacts between the two regional bodies take place regularly, both at a technical and at a political level, but the lack of concrete achievements feeds frustrations on both sides. Over the years there have been several calls for adoption of a more strategic approach and a few attempts to deepen the ties. But the results to date have been meagre and the opportunities for a more productive engagement have not been seized.

There are several reasons for this situation. Signed in 1988, the EU-GCC Cooperation Agreement reflected an EC policy of promoting regionalism in international relations, which prevailed in

the 1980s. This choice was never reviewed by the EU and explains an almost exclusive focus on a region-to-region relationship to the detriment of the bilateral relations between the EU and the six Gulf countries, which to date remain at an infant stage and even lack a legal framework.

The EU division of the MENA area into three separate sub-regions – North Africa, the Middle East and the Arabian Peninsula – has further complicated the interaction between the EU and the Gulf. Because of proximity and history, the EU has concentrated its efforts on the first two sub-regions. The Euro-Mediterranean dialogue, the Barcelona Process, the Neighbourhood Policy and the Union for the Mediterranean have all been designed as instruments to deal with the southern neighbourhood. But in designing the maps and tools for the region, the Gulf has been excluded. The EU has not yet been able to develop a broader Middle East policy and even the attempts to include the Gulf countries in triangular cooperation in the MENA region have not borne fruits.

On the other hand, the GCC was founded in 1981 with a significant stress on security and defence. Up to very recently it focused mainly on regional economic integration, looking at the EU as a source of inspiration. However, GCC integration has been slow and not immune from hiccups. This has reduced the pressure on the two sides to launch concrete cooperation initiatives. For instance, a Joint Action Programme encompassing several areas from trade to higher education, industry, money-laundering and culture, to mention just a few, was launched in 2010, but its implementation has been minimal and its renewal is under consideration.

More in general, the EU's soft-power vocation has not found ways to meaningfully shape relations with the Gulf countries, which traditionally put important stress on security and defence cooperation with their Western partners. While the stated objective of the 1988 agreement was to strengthen the stability of the Gulf and facilitate political and economic relations, the main emphasis has been on trade, investment, energy dialogue, research and technology. The bulk of efforts has gone to negotiate a Free Trade

Agreement (FTA), but in the conclusive phase of the negotiations differences between the two sides, mostly on the treatment of export duties, led to a suspension. The deadlock, which continues since 2008, has left bad feelings, particularly in the GCC camp.

The role of EU cooperation has been limited. In the framework of the Gulf countries' efforts in promoting economic diversification, modernisation and the creation of knowledge-based economies there is a high potential interest in the GCC for more exchanges with the EU in a number of areas. Also, the GCC countries have now realised that success in the reform process depends more on good implementation than on ambitious strategies that can be bought in the consultancy market place. The existing embryos of cooperation, for instance in the fields of research, technology, higher education, clean energy, small business development or trade facilitation, could be further developed. The main objectives should be to facilitate the transfers of know-how and to strengthen the links between the two regions. In this context, technical assistance and twinning programmes could be envisaged in a few domains such as public sector reform and modernisation. Furthermore, the two sides could benefit from joint initiatives combining Gulf capital and EU technology in specific areas such as, for instance, carbon capture and storage, alternative energy and environment. More people-to-people initiatives could be beneficial for the EU-GCC relationship, open the way to deeper business links and foster closer ties between the people of the two regions, which in turn could help building trust and mutual understanding.

However, by and large, EU development cooperation entails a donor-recipient relationship and is not geared to facilitate relations between peer partners. New forms of financing and project management would need to be found. The Gulf countries have failed to grasp the potential of joint cooperation initiatives and have shied away from investing money in and committing human resources to such projects. With the Gulf, the issue is not so much the funding of cooperation activities, but rather the interest and motivation of possible counterparts that could be increased

through successful pilot cases. Similarly, the EU should look at cooperation as a useful instrument to foster Europe's overall image and increase the competitive edge in the region.

As for the political aspects, human rights have been a divisive issue and there has been no progress in launching a EU-GCC dialogue in this and other related areas. On foreign policy and regional crises, from Syria to Iraq, the Islamic State and Libya, political dialogues to coordinate policy responses have been limited, the only exception being Yemen in 2011-12, where the EU subscribed to the GCC peace initiative and worked closely with it in its difficult (and now suspended) implementation. There have been repeated calls for enhanced political dialogue and coordination, but divergent views have often prevailed. For example, the Gulf countries have tried to get support for their strong anti-Iran stance and often manifested their discontent with their lack of involvement in the Iranian nuclear file negotiation.

## **Deepening bilateral economic ties**

The lack of progress in EU-GCC relations at the multilateral level does not mirror the reality of the existing economic bonds between Europe and the Gulf. Indeed, bilateral relations between some EU member states and the Gulf countries have historically been strong and have included an important security, defence and arms sales dimension. More recently, several European nations have invested in strengthening their ties with the region. The prolonged recession in Europe has pushed European businesses to aggressively seek opportunities in the fast-growing Gulf markets, which have become an arena for economic competition between European partners. The Gulf is now the 5<sup>th</sup> EU trade partner and an important destination for exports and investments, while the EU is the first trade partner for the GCC. In 2014 the two-way trade between the two regions reached €148bn, up from €100bn in 2010.

While prominence in oil and gas still figures high in making the region important for Europe, new elements of economic interest have emerged in recent years. Sustained growth rates, fed by a

prolonged cycle of high oil prices which lasted until recently, have made the combined six GCC countries the 11th largest economy in the world, with a GDP of \$1.63tn in 2013. Economic diversification away from hydrocarbons is proceeding more or less successfully in all six GCC countries. Growing integration into the global economy, the Gulf countries' strategic choice to turn the Arabian Peninsula into a major financial and East-West transport hub, the high-speed modernisation of many Gulf cities and, last but not least, the hosting of major sports events have created important investment opportunities for European companies. European businesses have established themselves successfully in infrastructure, mega-project development, services and retail. Europe is still a major technology and know-how partner for the Gulf. Similarly, the investment activities of the Gulf Sovereign Wealth Funds (SWFs) in Europe, responding to a need for diversifying investment destinations and to the buying opportunities created by the financial crisis, have also reinforced the economic links between Europe and the Gulf.

But the picture is far from static. The European business presence is challenged by fierce competition from Asia and by the ongoing re-direction of Gulf trade flows towards the East. The European countries have responded by intensifying bilateral contacts, but Europe as a whole would benefit from a strategy to ensure that current market shares, trade and investment prominence are maintained. For this purpose, a more coordinated effort to strengthen the EU's presence and increase its visibility in the Gulf would be important.

## **The Gulf's internal challenges and the EU**

On the Gulf side a number of challenges are looming, starting from the sudden fall of oil prices in 2014. The halving of the barrel price, due to a global supply glut, has opened a likely period of low hydrocarbon prices. The boom in US shale production has triggered a major transformation in the international oil and gas markets, with important consequences on Gulf countries' export

policies and a gradual abandonment of the role of swing supplier and provider of price stability played by the Kingdom of Saudi Arabia. But low oil prices will also bring into question the fiscal sustainability of current capital investments. Coupled with demographic challenges, energy inefficiencies, and oversized public sectors, there could be effects on future growth and diversification prospects. However, these countries have shown resilience in the past and a capacity to weather economic downturns. The need to move ahead on the modernisation and reform pattern is now well understood by the ruling elites and, in an era of low oil prices, economic diversification will become an even more pressing need. The new situation might indeed represent an opportunity to take difficult decisions that have been postponed so far, such as cutting wastes and subsidies and improving efficiencies. In other words, even without an oil bonanza, the Gulf region is likely to remain an important global economic pole.

On the political front, the Gulf countries are facing difficult challenges. Some of them are engrained in the polity of the region. For instance, Gulf societies have long felt the tension between tradition and conservatism on the one side and modernisation on the other. Conservative religious sectors play an important role in shaping political dynamics and have continued to challenge the gradual reform process that has accompanied, more or less effectively, the recent modernisation of these economies. The risk of a conservative recrudescence is always present. These dynamics have also created a fertile ground for radical Islamist groups, whose influence is based on strong stances against modernity and the corruption of the ruling elites and remains strong in some portions of society, continuing to pose an important security threat, particularly in Saudi Arabia. In addition, the intensification of regional geopolitical confrontations feeds the re-emergence of sub-regional and sectarian identities as divisive elements, with potential dangers for the stability of these countries.

But the strongest shock has come from the Arab Spring and its aftermath. The wave of change that swept the Arab world in 2011 has been also felt in the Gulf, although protest movements have

been limited and contained, with the exception of Bahrain where the crisis continues to date. Revolutionary change inspired by what was happening in other Arab countries has been seen as an existential threat for the authoritarian Gulf regimes and has provoked a number of domestic and international responses. Domestically, the immediate reaction of the Gulf monarchies has been a mix of fiscal measures aimed at buying public consensus. Such moves might be more difficult in the future, as the availability of fiscal surpluses diminish because of lower oil prices. Co-optation of new sections of the society and repression have also been part of the answer to the unrest. The Muslim Brotherhood (MB), an important force in some transitional Arab countries, has been strongly repressed in countries like the UAE, while Qatar's support for the movement led to a major intra-GCC rift, recently resolved with a low-profile policy undertaken by the Emirates and a re-compacting of the GCC.

One other consequence has been the acceleration of succession by a new, younger generation of royals. Contrary to the tradition that gives power to age and seniority, a new generation of young rulers has emerged. In Qatar, the new emir is in his 30s and is the youngest monarch in the world. Similarly, the recent succession in Saudi Arabia has opened the way to a subsequent move to the third generation in the al-Saud family. These unexpected changes are a clear sign of a willingness to be prepared for change and challenges, even if it requires a departure from tradition and entails risks. Contrary to what has been wrongly forecasted many times, the Gulf monarchies have proved to be resilient and these recent changes may be a sign of their adaptation capacity.

In dealing with the Gulf monarchies, the EU and the individual European states will have to take into account these economic and political changes and challenges, as they could affect Gulf domestic developments and stability in the medium and long-term. While the diversification of the Gulf economies may open further opportunities for business as well as deepen cooperation, the EU-Gulf relationship should not be limited to the economic field. The existing disconnect between the economic and the political dimen-

sion of the relationship should be addressed, as it might hinder the relation in the long-run. The Gulf search for international recognition needs to be acknowledged.

The EU would need to pursue an active political engagement with the region and continue encouraging gradual political opening. Dialogue in key political dimensions may prove difficult, as the EU has no leverage on sensitive issues such as political rights and civil freedoms. However, the Gulf States are important partners for the EU, and their political stability is a key element for Europe as a whole. The EU has a strong interest in the Gulf continuing in the reform path, albeit gradual, and “should be proactive and seek to encourage controlled and gradual reform to avoid greater future disruptions”<sup>1</sup>. Avoiding further deterioration of the Middle East environment and increasing the opportunities of co-operation aimed at reducing the current state of chaos in the region should be the paramount objectives.

## **The Gulf’s regional challenges and the EU**

The Gulf monarchies are acting in an increasingly volatile and unstable regional environment, characterized by spreading conflicts accompanied in some cases by the disintegration of state structures and borders, extremism and sectarianism. Gulf rulers have proven to be very active and assertive in pursuing their interests in the MENA region in the aftermath of the Arab uprisings. A mix of concern, pragmatism, aspirations for a more prestigious regional and international status, along with a push for regime change in some Arab countries or support for regime stability in the Arab monarchies, have characterized Gulf States’ agendas with mixed results. As a matter of fact, in recent years Gulf actions have significantly impacted to a great extent on regional dynamics. While

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<sup>1</sup> A. Echagüe, *Europe’s Gulf Dilemma*, FRIDE Policy Paper no. 160, June 2013, [http://fride.org/download/PB\\_160\\_Europe\\_Gulf\\_Dilemma.pdf](http://fride.org/download/PB_160_Europe_Gulf_Dilemma.pdf).

Gulf capital has been vital to struggling Arab economies<sup>2</sup>, it cannot be denied that their activism has also contributed to fuelling various ethnic, religious and political rivalries and conflicts in the region<sup>3</sup>.

From Libya to Syria and Yemen, the Gulf regimes, especially Saudi Arabia, Qatar and the UAE, have supported different conflicting parties and rebel groups in order to extend their influence as well as to counter Iran's penetration in the Middle East. Saudi-Iranian geopolitical and religious rivalry for pre-eminence in the Middle East has been reflected in diverse regional conflicts and crises. Saudi Arabia and the UAE, under the auspices of the GCC, intervened militarily to support the regime during the 2011 popular uprising in Bahrain with the stated objective of avoiding Iranian penetration in a country where the majority of the population is Shia. In Syria, Riyadh and Doha, along with Ankara, have supported a wide range of Sunni rebel groups with the aim of overthrowing the regime of Bashar al-Assad, Tehran's main regional ally. In Yemen, the Saudi monarchy took the leadership of a military intervention to reinstate the president after the Houthi forces seized major cities and took ground in the country.

However, it would be misleading to consider Gulf interventionism taking exclusively into account confrontation with Iran, although this is a key factor in Riyadh's calculations. In fact, Gulf policies toward the MENA region are the result of a number of factors: i.e. the survival of the Arab monarchies, status ambitions, regional equilibrium, strategic interests.

At the same time, as mentioned above, Gulf monarchies are far from being a monolithic bloc. Indeed, in spite of some convergence within the GCC framework, they have pursued different agendas on a number of issues. This has been particularly evident in the diverging approaches towards the MB and the emergence of

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<sup>2</sup> Since 2011 the GCC states have increased their FDI in the Mediterranean countries, surpassing the EU as main investor in 2013. See [www.animaweb.org](http://www.animaweb.org). According to ANIMA figures, Gulf FDI amounted to \$11.125bn – up from \$3.8bn in 2010, but far from the \$19bn in 2006 – while the EU ranked second with \$8.750bn.

<sup>3</sup> C. Koch, C.P. Hanelts, *A Gulf Conference for security and Cooperation Could Bring Peace and Greater Security in the Middle East*, GRC Gulf Papers, July 2015.

political Islam in the Arab countries carried out by Qatar, on the one hand, and Saudi Arabia and the UAE, on the other, as well as in support for different fighting factions in regional conflicts and crises. While Doha has acted as the main regional sponsor of the MB, Riyadh and Abu Dhabi have carried out hard campaigns against the movement in order to arrest the spread of its political affirmation, which they see as a threat for their regimes. In this respect, the most significant case is Egypt, which since the overthrow of Muslim Brotherhood President Morsi has received huge economic and financial support from the Gulf. Soon after Abd al-Fattah al-Sisi's takeover, Saudi Arabia, Kuwait and the UAE allocated \$14bn to support the 'new Egyptian course', replacing Qatari capital, while in March 2015 they pledged \$12.5bn in aid to stimulate the Egyptian economy<sup>4</sup>.

Divergences within the GCC states have appeared more evident in Libya's civil war where the Gulf monarchies have backed opposing militias. The country has been considered an arena of confrontation in the wider battle over the role of Islamists<sup>5</sup>. While Qatar has backed the Islamist government based in Tripoli (although it decreased its support during the last year) the UAE has aligned – along with Egypt – with the internationally recognised regime in Tobruk. Indeed, in this context Gulf action has not facilitated the international attempts, carried out under UN auspices, at a diplomatic and political solution of the Libyan conflict.

As a matter of fact, in a turbulent MENA region, it is not surprising that Gulf monarchies' actions are "contributing to the cycle of state breakdown, conflict, terrorism, and migratory flows – all of which increasingly threaten European interests"<sup>6</sup>. In such an environment, although it lacks a comprehensive strategy for the MENA region as a whole, the EU, along with its member states, should engage with the Gulf actors in finding common ground for

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<sup>4</sup> "Gulf states offer \$12.5 billion aid to Egypt", *Al Arabiya*, 13 March 2015, <http://english.alarabiya.net/en/business/economy/2015/03/13/Saudi-announces-4-billion-aid-package-to-Egypt.html>.

<sup>5</sup> J. Barnes-Dacey, *Responding to an Assertive Gulf*, ECFR Policy Brief, June 2015.

<sup>6</sup> Ibid.

cooperation in facing shared challenges and threats, reaching political solutions to regional crises and facilitating post-crisis reconstruction. The case of EU-US-GCC co-operation on the Yemen's crisis in 2011-12 is a good example.

Furthermore, the launch of a regional political dialogue, leveraging on the EU's role as a mediator, might dispel fears about the Iran nuclear deal and prepare the ground for a new peaceful Middle East setting. In this context, the EU and the Gulf monarchies should engage in building trust and increasing mutual understanding, which represent essential prerequisites for setting up any regional security framework.

Finally, geopolitical and socio-economic dynamics in the MENA region are increasingly intertwined, in dealing with this area the EU should consider developing a comprehensive strategy, which overcomes the longstanding fragmentation of its action and policies towards North Africa, the Middle East and the Arabian Peninsula. In this framework, the review of the European Neighbourhood Policy<sup>7</sup> might provide the opportunity to broaden the thinking about EU external action and policy in this part of the world.

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<sup>7</sup> In March 2015 the EU Commission launched a consultation on the future of its relations with neighbouring countries, including Southern Mediterranean neighbours. The European Neighbourhood Policy (ENP) is the main policy that frames relations between the EU and Mediterranean partners on a bilateral basis.

## About the Authors

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*The opinions expressed in chapter 6 are only those of the author.*

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