

Executive Summary

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0.1 Changing Situation in the Persian Gulf Region

The substantial changes are taking place in the Persian Gulf countries that could alter their political, economic and cultural structures from the very foundations. These changes have the potential not only to affect political and economic developments in the Gulf states but also to greatly influence future relations between Japan and the Gulf states.

What should be cited first among the changes and events occurring in the Gulf region is the change of the political leadership under way in some countries. In Iran, where new President Mohammad Khatami took office in 1997, reformists won an overwhelming victory in parliamentary elections in 2000 making a significant shift in the tide of politics. In Saudi Arabia, Crown Prince Abdullah is assuming an increasingly greater role in place of ailing King Fahd.

At this juncture of time, Republican George W. Bush was elected new president of the United States after fighting a fierce election battle with Democratic candidate Al Gore, putting an end to eight years of the Democratic administration of President Bill Clinton. It is no exaggeration to say that the stability of the Persian Gulf region has been preserved by the U.S. presence since the Gulf War of 1991. The United States has played a significant role in stabilizing the Gulf region through the containment of Iran and Iraq. Now, the United States is having the new president, the Republican president who is taking over the administration from the Democratic president. Attention is now focusing on how the change of the U.S. political leadership is going to affect the situation of the Gulf region, particularly in Iran and Iraq.

Another important change is the sharp rise in crude oil prices since 1999. After the summer of 2000, oil prices soared to the highest levels in almost 10 years since the Gulf Crisis. The considerable rise in crude prices has been giving a major impact on the economies and politics of the Gulf

oil-producing countries where oil revenue has a great share in financial and economic affairs.

0.2 Japan's Ties with Gulf States over Oil

The sharp rise in crude oil prices has come to significantly affect the Japanese economy. Japan is deepening its dependence on the Gulf region for the supply of crude oil. In oil import statistics released by the Ministry of International Trade and Industry in November 2000, the Gulf region accounted for as much as 90.4% of crude oil imports into Japan. The fact that over 90% of Japan's imports of crude oil come from the Gulf region reminded us anew of the growing importance of the Persian Gulf region in the area of energy supply to Japan.

Just as Japan is raising its dependence on the Gulf region in the supply of oil, Arabian Oil Co. of Japan has lost oil production concession it had in Saudi Arabia. Arabian Oil has been pumping out oil for about 40 years in waters off the former Neutral Zone between Saudi Arabia and Kuwait. Prior to the scheduled lapse of the oil concession in Saudi Arabia on 27th February, 2000, the company tried but failed to renew the production concession. The loss of Arabian Oil's oil concession drove home anew the difficulties involved in oil development in the Gulf region.

However, in late October 2000, on the occasion of Iranian President Khatami's visit to Tokyo, Japan and Iran announced an agreement under which a Japanese oil company will be given the priority right of negotiation on the development of the Azadegan oil field in Iran. The accord was hailed as a feat that opened a new chapter in Japan's oil development in the Persian Gulf region.

At any rate, developments concerning crude oil in the past year heightened Japan's interest in the Gulf countries and oil problems at large.

0.3 Dual Containment of Iran, Iraq by the United States

The United States has taken the initiative in

stabilizing the Persian Gulf region after the Gulf War by its dual containment policy. Backed up by the military presence of the U.S. forces deployed in the Persian Gulf region, the dual containment policy is designed to rein in external activities of Iran and Iraq to contain the spread of their influence and put pressure on their domestic affairs as well, thereby ensuring the security of the Gulf region. The policy is founded on the perception that both Iran and Iraq pose a threat to the Gulf region and reconciliation with them is very difficult. The confrontation between Iran and the United States dates back to the Iranian Revolution of 1979, and the Gulf War rendered Iraq the key subject of the U.S. containment policy.

While the dual containment policy of the United States has greatly contributed to the stability of the Persian Gulf region, it has also proved to be an obstacle to the building of a regional relationship of cooperation and further economic development of the Gulf region, bringing about the present cramped-up situation. Both Iran and Iraq are major regional powers with big populations. Iran borders on Central Asia, while Iraq is linked to Europe by land routes via Syria or Turkey. In the long-term perspective, it is impossible to envision the economic future and security of the Gulf region with both Iran and Iraq left out.

Economically, there are some countries like Dubai that benefit from U.S. sanctions against Iran. To many other countries, however, the dual containment of Iran and Iraq is beginning to have a negative impact on their economic development. In diplomacy and security aspects, the dual containment policy of the United States is blocking exchanges among the Gulf states and hampering the creation of regional cooperation in a manner that includes both Iran and Iraq.

0.4 Emergence of New Leaders

The change of political leaders in Iran and other countries as well as the arrival of new U.S. President Bush may signal a major turning point

for the Gulf states by shaking up the cramped-up situation that shrouded the political, economic and diplomatic scenes of the region after the Gulf War.

Iran touched off the changes in the political arena. Since President Khatami was elected in 1997, Iran's domestic politics made a big change of course led by reformists. The trend has been intensified further after an overwhelming victory of the reformist camp in parliamentary elections in 2000. With President Khatami at the helm, Iran has been pursuing a moderate line of foreign policy, trying to improve relations with neighboring countries and European nations. Amid these changes on Iran's diplomatic front, there have also been new developments in the country's economic exchanges with other countries, including invitation to foreign investment in the oil sector. With a substantial amelioration in Iran's relations with Europe, Tehran's ties with the United States is drawing keen attention now.

In Iraq, there are no signs of change in the country's political leadership controlled by President Saddam Husayn. But its relationships with other countries have undergone profound change. After the Gulf War, Iraq has been isolated in the international community in the wake of sanctions by the United Nations. Recently, however, countries in the Arab world and many other nations have improved diplomatic relations with Iraq, paving the way gradually for Iraq's return to the international community. Among the Gulf Cooperation Council (GCC) states, only Kuwait and Saudi Arabia still maintain the stern attitude toward Iraq.

What is going to happen to the sanctions against Iraq will have a significant impact on the security and economic affairs of the Gulf region. Because of Iraq's huge oil reserves, there are many countries interested in Iraq for oil concession. Keeping an eye on a possible lifting of the sanctions against Iraq, it seems likely that a lot of countries are watching for a chance to get into the country's trade, construction and other markets.

In Saudi Arabia, Crown Prince Abdullah is strengthening his influence in place of ailing King

Fahd, who suffered a stroke in 1995. Under Crown Prince Abdullah, Saudi Arabia is turning its face more and more to Arab and Islamic countries. In particular, its substantially improved relations with Iran are contributing greatly to the regional stability. What should be watched closely in the future is how relations between Saudi Arabia and Iraq will develop.

0.5 New U.S. President Bush and the Gulf Region

The environment for the internal relations in the Persian Gulf region has been changing as reviewed above. If the United States should alter its policy toward the Gulf region, particularly the dual containment policy toward Iran and Iraq, it may change the situation in the Gulf region significantly. Hence, we are watching the new Bush administration's Gulf policy with a heightening interest.

A majority view has it that the U.S. policy toward the Gulf region under the new administration will not differ significantly from previous one. But the people in the Gulf states have growing expectations on Bush. A public opinion poll on the U.S. presidential election taken in Saudi Arabia in late November 2000 found that 90% of Saudi men favor George Bush as president over Al Gore because they believe Bush is fairer to the Arabs. It is likely that Gore's close ties with Israel affected their responses. At any rate, it is true that the Gulf states are taking an increasing interest in what policy the Republican administration of President Bush will come up toward the Middle East and the Gulf region.

Amid the profound change in Iran's political picture and the ongoing improvements in the relations between Iraq and the Gulf states, should the Bush administration make a volte-face in the containment policy toward Iran and Iraq, that would shake the static regional relations from the foundation, create a new framework of security as well as new streams of economic exchanges,

eventually leading to a momentous change in the political, economic and diplomatic landscape of the Persian Gulf region.

0.6 Sharp Rise in Oil Prices

From summer to autumn of 2000, crude oil prices rose to the highest levels in almost 10 years since the Gulf War. Dubai oil futures traded in Tokyo turned upward in March 1999 after slumping sometimes to break through \$10 per barrel in the period from late 1998 to early 1999. The price maintained the uptrend after climbing over \$20 in August 1999, topped \$30 in September 2000 and marked the highest of \$33 in November in the same year, about a threefold jump from the 1998 level.

The Gulf states' oil revenue has increased sharply as a result of the sharp rise in crude oil prices. In 2000, the growth of oil revenue was particularly steep because of the enhanced production level as well as the higher prices.

The definition of oil revenue differs among countries or among those who calculate it. Depending on how it is defined, it may be the case that oil revenue has not expanded so much. When oil revenue is the total sum of income the government earns as profit from the sale of crude oil, Saudi Arabia, for example, had the revenue of \$30 billion in fiscal 1998 and its revenue increased to an estimated \$60 billion in fiscal 2000. As the Saudi example shows, oil revenue of the oil-producing countries in the Gulf region is estimated to have effectively doubled in fiscal 2000 compared with the level of fiscal 1998 when oil prices plunged to their recent lows.

0.7 Economic Trends of the Gulf States

The sharp oil price rises described above are having a significant impact on the economies of the Persian Gulf states. While they vary in the degree of dependence on revenue from oil production, oil revenue, in effect, forms the core of the

economy of each of them.

Oil revenue is counted as fiscal revenue and is a main pillar of the oil-producing countries' fiscal resources. There are expectations that the sharp rise in oil revenue help them increase fiscal spending with a favorable effect on their economies. Up to now, however, the economies of the oil producing countries in the Gulf have not been so revitalized as had been expected.

There appear to be several reasons for that. First, the Gulf states are currently pushing for fiscal and economic reform, with tightening reins on expenditures. Also, many of them have massive cumulative debts. They are using the increased oil revenue to repay the cumulative debts, carving their fund and putting a brake on higher fiscal spending. And they had been obliged to maintain their spending at a certain level in the time of financial difficulties because of strong demand for current expenditure, which has weakened the effect of the sharp increase of oil revenue.

All in all, the Gulf oil-producing governments are holding fast to the conservative stance on increasing fiscal expenditure despite rising oil revenue. Therefore, even over one and a half years after oil prices began the steep ascent and massive oil revenue started flowing into their coffers, the economies of the Gulf states have not been reinvigorated as they should have been, with private consumption and infrastructure construction not growing so much.

Having said that, however, it is still true that the increased oil revenue is generating a favorable impact on their economies as a whole. Where are their economies heading in 2001, with the new fiscal year's budgetary expenditure being disbursed? After crude oil prices tumbled in late 2000 to make the oil market shrouded in growing uncertainties, developments in the economies of the Gulf states require close attention.

0.8 Economic Challenge: Industrialization

The common problems the Persian Gulf

states share are unemployment and responses to globalization. The unemployment problem stems from the sharp population increases after their economic development since the 1970s substantially improved the economic and social situation as a whole with better health and medical systems in place. The population of the Gulf states quickened the pace of increase in the latter half of the 1970s, and the number of working-age people is rising year by year. Creation of job opportunities for the young, therefore, is a major domestic policy issue confronting the Gulf governments. A recent report said the jobless rate in Saudi Arabia has reached 27% or 14% by another report. Not to mention Iraq subjected to the strict UN sanctions, unemployment problems are steadily growing serious in Iran and other Gulf countries as well.

The oil industry is a capital-intensive process industry. While requiring a massive amount of investment, an oil plant, once completed, is computer-driven and does not contribute much to creating fresh jobs. Therefore, it is becoming necessary to develop comprehensive industries, particularly non-oil industries, with the private sector being called upon to take up the challenge of fostering those industries in place of the governments gripped by fiscal constraints.

Moves toward the privatization of state-owned corporate entities and the introduction of foreign capital that have been gaining momentum in the Gulf states are designed to foster the private-sector economies and thereby solve unemployment problems. A success or failure of the efforts to foster private-sector industries is not simply an economic question but a crucial issue that can affect the domestic stability of the Gulf states.

0.9 Response to Globalization

How to respond to the globalization trend is also a major issue confronting the whole Gulf region. The three major powers of the region – Iran, Iraq and Saudi Arabia – have yet to join the World Trade Organization (WTO). This fact indi-

cates that the Gulf states have all sorts of problems to deal with and have not necessarily been responding to globalization adequately.

Iran and Iraq find it necessary first to get the sanctions lifted for their return to the international community. Saudi Arabia is confronted with the serious problem of how to harmonize its Islamic social system and culture with globalization.

The promotion of economic exchanges with foreign countries is considered to be beneficial to

the economic development of the Gulf states, and they have high expectations on the role Japan can play in this field. Already, a large number of Japanese companies have established their presence in Dubai, the United Arab Emirates. Many of these Japanese firms regard Dubai as the base of distribution. In the future, however, many Gulf states are likely to look to Japan increasingly for the establishment of manufacturing operations in their countries.

(Sadashi Fukuda)