

**Geopolitical Risks in the Middle East
after the Emergence of *Islamic State* and
the Impact on the Energy Supply in Asia**

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ISBN 978-4-931482-55-5

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FOREWORD

Under the Asia-Pacific Economic Cooperation's mission of promoting economic prosperity in sustainable ways, this research document proposes a policy framework for understanding the major factors involved in oil & gas supply to the APEC region.

Oil accounted for the second largest share of primary energy demand in the APEC region in 2013 and will likely remain the top energy source in the long term. The external sources for oil are dominated by suppliers in the Persian Gulf region, where the states' stability has faced challenges from the spread of extremism, especially by the threat of Islamic State, or ISIS/ISIL. This report presents a wide range of analysis to evaluate the impact of non-state actors' behavior towards energy resources that are of paramount importance for APEC member economies

This report is the work of the Asia Pacific Energy Research Centre. It is an independent study, and does not necessarily reflect the view of or policies of the APEC Energy Working Group or individual member economies.

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Executive Summary

This research looks at the impacts on the political, fiscal and social stability of the oil- and natural gas-producing countries in the Middle East of terrorist attacks perpetrated not only by Islamic State, which, since its emergence in June 2014, has become a threat to Syria, which is in the midst of civil war, and Iraq, where political turmoil is still continuing, but also by other extremist organizations that profess themselves to be the branches of Islamic State spread throughout the Middle East, North Africa, South Asia and Southeast Asia, while bearing in mind the impact on the energy security of energy-consuming countries in the Asia-Pacific region, and tracking and analyzing the latest events from a geopolitical perspective. For this purpose, this research attempts to estimate the damage to the production systems of energy-exporting countries in the Middle East on the basis of the ideological genealogy and behavioral patterns of Islamic State and measure the size of fiscal burdens associated with the procurement of war expenses for the military operations against Islamic State and the strengthening of the domestic security structure of the relevant countries, the mounting momentum for drastic reform of the economic structure stemming from the recent declines in crude oil prices, and the potential impact of the rise of the new political and military forces on the regional situation.

The Arab Spring that raged across the Middle East and North Africa and the ensuing turmoil are still continuing. One of the symbolic events among these developments is the declaration of the establishment of Islamic State by ISIS/ISIL, a discriminatory extremist group. The international terrorist organization that split from al-Qaeda is an unusual group that boasts of its control of its territories and involves itself in the management of resources in the territories that it controls to secure funding sources. For its brutal acts against heretics and minorities and its very existence, ISIS/ISIL drew keen attention in the international community and also succeeded in attracting a large number of sympathizers (fighters) from outside the Middle East. Its ideology and ideas have spread to Europe and the United States, far from the Middle East, accompanied by the emergence of home-grown terrorists who have carried out relentless attacks that have resulted in many casualties. ISIS/ISIL is believed to be trying to amplify social unrest by inducing sectarian conflicts with their attacks on Shiite Muslims and other minorities.

Spawned from the turmoil that spread after the end of the Iraq War, ISIS/ISIL is ideologically close to al-Qaeda, a Sunni terrorist organization. Claiming to be the descendants of the family branch of Prophet Muhammad, ISIS/ISIL asserts the legitimacy of its rule and actions by declaring jihad (holy war) against the visionary occupation by the Christian crusaders and the defeat of the Assad government in Syria which the group regards as heretical. ISIS/ISIL, known for its brutal treatment of enemies, makes excellent use of a media strategy that differs from that of al-Qaeda and distributes its messages in multiple languages in cyberspace. The strategy is proving quite effective in attracting foreign sympathizers. With its control over oilfields, ISIS/ISIL has succeeded in becoming the wealthiest terrorist organization in history. The influence of its ideology has spread beyond the Middle East all over the world, giving rise to shocking terrorist attacks.

Among the oil- and natural gas-producing countries in the Middle East, Iran has made the most vociferous appeal for the need for the international community to counter the threat of ISIS/ISIL, but the country has suffered an economic blow partly due to the delay in the lifting of Western economic sanctions. Foreign capital, which holds the key to expanding crude oil production, is not forthcoming because of lingering concern over the long-term investment climate, and the outlook is not bright either regarding the country's feud with Saudi Arabia. Iraq, which seeks the annihilation of Islamic State, is facing more severe political and social challenges following public protests against the country's economic conditions and corruption. Prime Minister al-Abadi's pledges of reform and a cabinet reshuffle have now become empty promises. Moreover, he finds himself caught in a vicious cycle, further alienating the Sunni population by relying on Shiite Muslims and Kurdish militias for ISIS/ISIL cleanup operations. Both Iran and Iraq are suffering from tight fiscal conditions and the loss of opportunities due to falling oil prices, and Iraq is planning to tide over the fiscal crisis by securing lending from the International Monetary Fund (IMF).

With its sights set on the looming issue of royal succession, Saudi Arabia has been proactively carrying out the reorganization of government ministries and the reshuffling of top government officials, with young Deputy Crown Prince Mohammed, the son of King Salman, given a number of prominent posts in the government. While deepening its rivalry with the Shiite state of Iran in the Yemeni civil war, Saudi Arabia has embarked on an ambitious economic reform program with a view to 2030, including the initial public offering (IPO) of Saudi Aramco. However, there remain a host of problems

that need to be resolved before achieving a Saudi economy that is not dependent on oil revenues, and the understanding and self-help efforts on the part of its people seem essential. With the country facing threats from ISIS/ISIL and al-Qaeda in the Arabian Peninsula, the common occurrence of terrorist attacks targeting Shiite Muslims and security organizations suggest the need for caution.

Unlike the past, Kuwait is now witnessing a divide running through its society, particularly with its Shiite community. Terrorist attacks by ISIS/ISIL aimed at Shiite Muslims are also occurring, helping raise the sectarian tensions. The walkouts staged by oil workers during the period of fiscal austerity resulting from declining oil prices are an indication that Kuwait's fiscal conditions are more severe than first anticipated. In the UAE, where Crown Prince Mohammed is effectively running the government, the reorganization of ministries and agencies has been carried out, accompanied by a change of personnel. Although the country has not yet experienced any large-scale terrorist attacks, it is continuing to suppress the Muslim Brotherhood, crack down on associates of Lebanon-based Shiite armed group Hezbollah and stay alert to ISIS/ISIL. In Qatar, following Emir Tamim's succession to the throne, efforts to reintroduce conservative policy initiatives are under way, thus reigning in the open policy introduced by his predecessor. All the Gulf Cooperation Council (GCC) countries, except Oman, have joined the military intervention in the Yemeni civil war despite their dire fiscal conditions, with the UAE and Saudi Arabia seeing no small number of soldiers killed in action.

The Middle East countries are under pressure to enhance their economic resilience against declining oil prices while adopting countermeasures against ISIS/ISIL both at home and overseas. As they are being forced to record fiscal deficits due to lower oil prices, these oil producers are seeking to maximize immediate revenues from oil exports, making no major changes in their oil production policies. The confrontation between Saudi Arabia and Iran is also preventing the Organization of Petroleum Exporting Countries (OPEC) members from forming consensus. As a consequence, the OPEC member states are maintaining the current high levels of crude oil production.

The cases of terrorist attacks causing physical disruptions in the oil production system have been so far limited to Libya in civil war, resulting in a drop in exports of around 1 million b/d. The decline has already been quantitatively covered by Iraq's increased production and Saudi Arabia's utilization of its surplus output capacity.

ISIS/ISIL has recently begun launching attacks against oil facilities in Libya, but has yet to gain control of any oilfields.

As a whole, the spillover of the direct threat of ISIS/ISIL into the oilfields and natural gas fields can be contained to a certain degree. This is good news for the energy security of Asia. Nevertheless, it must be noted that ISIS/ISIL, al-Qaeda and other terrorist organizations are plotting to indirectly destabilize the governments of the Middle East countries by spreading an atmosphere of restlessness by conducting terrorist attacks. Under these circumstances, all the relevant countries are being called upon to understand that terrorist organizations might try to take advantage of the sectarian conflict to their advantage, and then with that understanding, to adopt policy measures to avoid such a situation. Over the long term, attention must be paid to the possible occurrence of an incident in Syria that would require the re-demarcation of international borders. If the ripple effects reach the other Arab countries, it would certainly heighten the uncertainties over the supply of energy in Asia.

1. Overall Situation since the Emergence of *Islamic State*

1-1 On the Eve of the Emergence of *Islamic State*

The importance of the Middle East in the global economy, particularly the region's overwhelming performance as the supply center of energy and its vast reserves of conventional energy resources, is unparalleled. Many Asian countries also procure fossil fuels from the Middle East, and this relationship between the two regions presumably leaves only limited leeway for any major change even in terms of the medium- to long-term.

In the Middle East, most countries have been subject to the dominance and rule of the authoritarian regimes for long periods of time. Other than some disturbing movements that came to the surface on the occasions of generational transitions or successions of semi-autocratic leaders, the long-reigning governments have stably run their respective countries for many years. However, the so-called "Arab Spring" jolted this long period of superficial peace and tranquility, and a number of countries experienced the emergence of grass-roots movements for the very first time. In general, the countries caught in this wave saw their stability undermined, and in the worst cases, became mired in civil war.

Regarding energy security, which is important from an Asian perspective, contrary to initial concerns, the "Arab Spring" fortunately did not result in any serious loss of opportunity. This was because any physical disruption of oil production and exports was largely limited to a single country, namely Libya in North Africa. During the same period, Iraq began to increase production, while Saudi Arabia, with the spare capacity to increase oil production, boosted output to more than make up for the production loss in Libya. These worked to minimize the Libyan impact on the global oil market.

However, a new type of discriminatory extremism emerged amid the instability that ensued, and oil consuming countries in Asia and other regions had to once again calculate the extent and depth of the impact on energy procurement. The extremist group mentioned here is ISIS/ISIL, which split from the international terrorist organization al-Qaeda. The name "ISIS/ISIL" will hold a special place in the pages of history as it declared the establishment of *Islamic State* in June 2014. While it is not common for a terrorist group to have control over specific territories, what is worthy of much greater interest than that is the fact that ISIS/ISIL has gained control over oilfields within Syria and also occupied oil refineries in Iraq.

1-2 Resources Management by *Islamic State*

Since the simultaneous terrorist attacks against the United States in September 2001, there has been a constant need to work out terrorist threats, focusing on the movements and thinking of al-Qaeda, which has established itself as an international terrorist organization. After al-Qaeda attempted to attack Saudi Arabia's Byqaiq oil installation, it goes without saying that oil-producing countries in the Middle East were put on an increased level of alert against physical attacks. The occupation of oilfields in Syria and the control of Iraq's Baiji oil refinery, in tandem with the establishment of *Islamic State*, made clear that ISIS/ISIL's activities were not limited to destruction, and instead included the use of energy resources as a way to establish its economic and fiscal foundations, revealing an unexpected side to this terrorist group descended from al-Qaeda.

ISIS/ISIL, which operates *Islamic State*, has been refining crude oil produced at oil fields under its control and selling oil products outside its territories as an important source of revenues for the organization. For a period of time, the group was reported to have earned US\$1.5 million per day from these operations and became known as the world's wealthiest terrorist organization.

The oilfields ISIS/ISIL controls and from which it produces crude oil are exclusively in Syria, with most located in Deir ez-Zor Governorate in eastern Syria adjoining Iraq. Since the establishment of *Islamic State*, the group is believed to have continued to produce around 25,000 barrels per day within Syria. Since autumn 2015, however, it would be reasonable to assume that oil production by ISIS/ISIL has declined after being targeted by separate air raids by the forces of the coalition of the willing and the Russian forces, and that the supply of oil products has also dropped due to the incremental destruction of its mobile refining facilities. With the global slump in crude oil prices coinciding with these developments, it is presumed that ISIS/ISIL's oil revenues have significantly declined from the earlier levels.

Many points remain unclear about the level of technical capability of ISIS/ISIL, the group of combatants committing acts of terrorism, in terms of managing oil wells and maintaining and repairing the oil refineries. Many believe that officials of the former Iraqi Ba'ath Party are providing the necessary technologies and services. Even by a conservative estimate, however, it would be entirely impossible to repair and restore the

oil facilities at a rate that would keep pace with their destruction by air raids. Thus, it is not difficult to imagine the revenue sources of ISIS/ISIL dwindling over time. Furthermore, as there have been a plenty of press reports that the territories under the control of ISIS/ISIL in Syria and Iraq have been shrinking in 2016, there should be an increasing number of cases where the group has been losing control over the oilfields themselves. In fact, in January 2016, the People's Protection Units (YPG), Kurdish resistance forces on the offensive in northern Syria, seized the al-Jabsah oilfield from ISIS/ISIL.¹ Since the Syrian Democratic Forces (SDF), with the YPG at its core, is continuing to make advances amid the continuous air raids, it is likely that ISIS/ISIL will continue to lose more of its territories in the oil-producing areas in Syria going forward.

This raises the concern that ISIS/ISIL, when forced to retreat, may resort to sabotage, such as by setting oilfields on fire, similar to former Iraqi President Saddam Hussein, when he was defeated in the Gulf War. *Islamic State*, which embraces Islamic rule, is said to have adopted the same interpretation of underground resources as al-Qaeda and adhered to the judgment that destruction of oilfields is an un-Islamic act and impermissible. While the extent to which this “discipline” is observed in actual scenes of fighting is a gray area, the fact that the ISIS/ISIL “branch” in far-removed Libya did attack oil facilities but refrained from destroying the oilfields, suggests that the risk of ISIS/ISIL destroying the oilfields in Syria is presumably not very high. In addition, Syria’s oil production itself is limited and it is somewhat comforting to know that Syria’s oil reserves are not large enough to have a major impact on the world market.

1-3 Impact of ISIS/ISIL on Oil-Producing and Natural Gas-Producing Countries in the Middle East

The propagation of the ISIS/ISIL “ideology” not only in the Middle East but also beyond the region constitutes a new threat that the international community must respond to in a comprehensive manner. The group’s self-righteous and exclusive values, the active use of outright violence to realize those values, and the ingenious public relations strategy to propagate its messages underline that the nature of *Islamic State* problem is not something that is restricted to only Syria and Iraq. Already, a string of lone-wolf attacks by home-grown terrorists have occurred in France and the United States, and the killing of foreign noncombatants has also been committed in Bangladesh and elsewhere. This requires the consideration of what impacts they would have on

¹ Financial Times, “Inside Isis Inc: The journey of a barrel of oil,” February 29, 2016.

energy suppliers in the Middle East as well as the areas expected to be impacted and the depth of such impacts.

First of all, it is essential to know the targets of attacks by subsidiary organizations and “branches” of ISIS/ISIL as well as by individuals influenced by the group’s extremism. What has become clear by its public statements and actions in the past is that ISIS/ISIL recognizes the so-called “near enemies” as the priority targets of its attacks. The ideological grounds for this will be addressed in Chapter 2, while the list of assumed targets is discussed below. At the top of the list are the Shiite Muslims considered by ISIS/ISIL as heterodox, followed by Christians and others who believe in other religions. Second in line are “un-Islamic” royals and emirs, who are seen as “corrupt leaders.”

In light of such patterns of thinking and actions by ISIS/ISIL, it naturally follows that Iraq, Bahrain and Iran, where Shiites comprise the majority of the population, loom large on the “order” of attacks. The next highly probable targets are countries and specific regions with Shiite communities of a certain size, including Saudi Arabia, Lebanon and Kuwait. This hypothesis is validated by reports of actual terrorist attacks that have already taken place in most of these countries. States in the Middle East governed by kingdoms and emirates include the six member states of the GCC, as well as Jordan and Morocco. The reason why ISIS/ISIL considers these countries to be subject to un-Islamic rule is not only due to the fact that they are kingdoms or emirates, but also because the belief and livelihood of Sunni Muslims in these countries are seen as threatened.

Therefore, it has to be considered that the targets of potential attacks by ISIS/ISIL and terrorists linked to the group exist almost anywhere. Still, if the focus is placed on countries and regions related to energy production, then Iraq, Iran, Bahrain, Kuwait and the Eastern Province of Saudi Arabia would be at the top of the list of potential targets. However, up to now, ISIS/ISIL has failed to seize control of even the critical oilfields in Iraq and has not succeeded in doing serious harm to oil facilities in countries other than Libya. The matter of major concern is that ISIS/ISIL could foment social anxiety by launching terrorist attacks on Shiite residents in the Persian Gulf states and set the stage for an escalation of sectarian conflicts that could divide their societies. As a rule of thumb, when a sectarian conflict flares up, one must be prepared for the outbreak of civil war as the worst case scenario. Moreover, bringing such a civil war to an end will

surely be a formidable challenge.

1-4 Deterioration of Fiscal Conditions due to Falling Oil Prices

The slumping crude oil prices are believed to have directly hit the smuggling of crude oil and oil products that has provided ISIS/ISIL with a key source of revenues. At the same time, however, they also seem to have brought about the severe conditions faced by oil-producing and natural gas-producing countries in the Middle East, which are also being forced to confront extremism at home and abroad, as seen in the fact that all of these countries have slipped into fiscal deficits for two consecutive years. What should not be forgotten is that the governments of these countries, which have provided public services to their citizens and residents, have been expanding fiscal spending, almost without exception, in a bid to placate their peoples since the Arab Spring of 2011. Furthermore, the subsequent fighting against *Islamic State* and terrorism, as well as the intervention in the civil war in Syria and Yemen, has increased their fiscal burdens further. In particular, as the military intervention in the civil war in Yemen is showing signs of becoming protracted, contrary to initial expectations, these countries have to procure an ever-increasing amount of funds to finance the intervention. In this regard, from 2015 to 2016, starting with the formulation of deficit budgets from the outset, the commencement of “reforms” that would force the people to bear the brunt of the pain as well is becoming an important challenge these countries cannot avoid.

Though these reforms have been considered necessary for a long time, these countries have been hesitant to take action against the backdrop of budget surpluses, the benefits of constantly high oil prices, and also for fear of public backlash, with the implementation of reforms being pushed back as a consequence. For example, the ambitious Saudi Vision 2030 announced by Saudi Arabia is designed to fundamentally transform the country’s economic and social structure. That the vision has been prepared with the generational transition in the House of Saud in mind is apparent, as Deputy Crown Prince Mohammed bin Salman is responsible for both its formulation and implementation. Presumably, Saudi Arabia has been able take this bold course of action based on the powerful incentive to set the stage for an unusual succession to the throne, in which the deputy crown prince could be skipping Crown Prince Mohammed bin Nayef, a scenario often rumored about inside and outside the kingdom.

However, whether it be the decisive carrying out of reforms or the succession to the throne, either could serve as the catalyst for an outburst of discontent that has been built

up in domestic society. Thus, it would be desirable for Saudi Arabia to proceed with a certain measure of caution, with its sights set on the possibility of an unexpected situation occurring to shake up what appears to be a rock-solid governing regime.

2. The Genealogy of *Islamic State* and the Spread of Its Influence

Islamic State is the terrorist organization that declared the establishment of an Islamic caliphate in Mosul in western Iraq in late June 2014. While its name includes the word “state,” it is not a “nation” that is recognized by the international community but generally perceived as a self-appellation by the terrorist group.

Thus, in Arabic mainstream media, for example, *Islamic State* is called “DĀ‘ISH” by taking the Arabic acronyms of the group’s name “al-Dawla al-Islāmīya,” or called “Tanẓīm al-Dawla al-Islāmīya,” meaning “Islamic State organization,” by inserting the Arabic word “Tanẓīm,” meaning “organization” ahead of the group’s name. In English-language media as well, in order to avoid misunderstanding, instead of *Islamic State*, the abbreviated name of “IS,” or “ISIS” (Islamic State of Iraq and al-Shām) and “ISIL” (Islamic State of Iraq and Levant), both the abbreviated names before the name change, are often used. In Japan, as well as in the United States and at the United Nations for that matter, “ISIS” and/or “ISIL” are frequently used. This article uses the nominal designation of ISIS/ISIL.

At present, ISIS/ISIL has bases of operations in Iraq and Syria and claims to have branches called “provinces” across the world. The group has also gone beyond these “provinces,” perpetrating terrorist attacks in Europe and the United States, posing a threat to the entire world that rivals or surpasses that of al-Qaeda, which perpetrated the simultaneous terrorist attacks in the United States in September 2001.

2-1 Origins of ISIS/ISIL

The origin of ISIS can be traced directly back to “tawhid” (meaning the uniqueness of God in Arabic) and “Jamā‘a al-Tawḥīd wa al-Jihād” of Abū Muṣ‘ab al-Zarqāwī, a Jordanian terrorist operating in Iraq. The group pledged allegiance to Osama bin Laden of al-Qaeda in 2004, and renamed itself as “Tanẓīm Qā‘ida al-Jihād fī Bilād al-Rāfidayn” becoming “al-Qaeda in Iraq” (AQI).²

During the U.S. occupation of Iraq, AQI not only attacked the U.S. forces and its “puppet” Iraqi government but was also feared for its brutal tactics, such as the abduction of foreigners residing in Iraq and the uploading of videos showing their

² Immediately before the Iraq War of 2003, the United States alleged that Zarqawi’s group was part of al-Qaeda and was colluding with the Saddam Hussein government, and cited this allegation as one of the reasons for justifying the U.S. invasion of Iraq. However, his group actually only became part of al-Qaeda after the U.S. forces began its occupation of Iraq.

beheading on the Internet. The group terrorized not only the U.S. troops and the Shiite Iraqi government, the primary targets of its attacks, but also ordinary Iraqis and other Sunni Muslim groups that have similar ideologies, and were thus regarded as the most powerful and most appalling terrorist groups in U.S.-occupied Iraq.

After the repeated confrontations and alignments with a mob of jihadist groups in Iraq, AQI formed *Majlis Shūrā al-Mujāhidīn fī al-‘Irāq* (Mujahidin Shura Council in Iraq (abbreviated as “MSCI” hereinafter)) by gathering several organizations together in January 2006. However, the new group’s leader was not Zarqawi but Abd Allāh b. Rashīd al-Baghdādī.

After Zarqawi was killed in an attack by the U.S. forces in June 2006, AQI called an emergency meeting and appointed Abū Ḥamza al-Muhājir as Zarqawi’s successor. However, Muhajir was merely a commander of AQI and MSCI was still positioned as an umbrella organization of AQI.

In October 2006, MSCI brought together the heads of several tribes and formed a new federation, “Ḥilf al-Muṭayyabīn,”³ which means “the alliance of fragrant groups.” A few days after the announcement of the alliance, however, MSCI declared the founding of *Dawla al-‘Irāq al-Islāmīya* (Islamic State of Iraq (abbreviated as “ISI” hereinafter)). Incidentally, ISI at the time called on all of the Mujahid, ulama, tribal heads and Sunni people to pledge allegiance to its leader, Abū ‘Umar al-Baghdādī, as “Amīr al-Mu’minīn,” which means the leader of the believers.⁴

It is all the more important that ISI brought up the title of “Amīr al-Mu’minīn.” This is the title that is said to have been used by the second caliph of Islam, Umar, or Omar. Since Umar, “Amīr al-Mu’minīn” is taken to effectively mean the caliph.⁵ In other words, ISI is believed to have been precisely laying the groundwork for the caliphate of *Islamic State* to be established later.

Furthermore, beginning with the statement of December 2006, Abū ‘Umar

³ The alliance formed by branch tribes of the pre-Islamic Quraysh tribe. The alliance was so named because the participants in the alliance pledged allegiance by dipping their hands in containers of perfumed water and dried them on the walls of the Ka’aba Temple.

⁴ The name was changed from Abd Allāh b. Rashīd al-Baghdādī, who was the MSCI leader, to Abū ‘Umar al-Baghdādī. However, both men are generally believed to be the same person.

⁵ However, there are cases where this title is used without identifying the holder of the title as the caliph. In the modern age, the King of Morocco used said title. Mullah Omar, who led the Taliban movement of Afghanistan, and his successor also used the title of “Amīr al-Mu’minīn.”

al-Baghdādī called himself “Abū ‘Umar al-Ḥusaynī al-Qurashī al-Baghdādī.” Needless to say, “al-Ḥusaynī” means the descendant of Hussein, the son of Ali, the fourth caliph and the husband of the daughter of Muhammad the Prophet, while “al-Qurashī” means that the person is a descendant from the Quraysh tribe. According to a clause in a classical text of Islamic jurisprudence, one of the qualifications of the caliph is being the descendant from the Quraysh tribe, and it is believed that Abū ‘Umar used the title to claim that he satisfies that requirement in advance. Thus, the fact that MSCI called itself a “state,” however illusionary it was, the fact that Abū ‘Umar used the title of “Amīr al-Mu’minīn” and the fact that he called himself “al-Qurashī,” can be described as strategic moves for the coming declaration of the establishment of the caliphate.

Another important point is that Abū Ḥamza al-Muhājir is believed to have disbanded AQI. AQI, which used to be one of the groups that constitute MSCI, was absorbed by ISI as a military unit.

Meanwhile, Abū ‘Umar openly called upon officers of the former Iraqi forces to join the ISI forces. The members of the former Saddam Hussein government are generally said to have joined ISI in large numbers during this period.

2-2 Ideology of ISI

The ideology of ISI was articulated as follows in a statement publicized in 2007. According to the statement, the targets of ISI attacks are “shirk” who practice polytheism, and the statement particularly denounced the Shiites as “rāfiḍa” (rejecters) who are a sect of polytheism and ridda (apostasy). The statement also says the goal of ISI is to establish a system of “governance in accordance with the Law of Allah through the Islamic Courts,” and terms forms of secularism such as nationalism, communism and Baathist faith “blatant unbelief.” Democracy is included as part of this concept of “secularism,” meaning that every single person who participated in the Iraqi political process after the end of the Iraq War is the enemy of ISI. Therefore, political parties linked to the Muslim Brotherhood, despite also being Sunnis, are regarded as unbelievers.

ISI also believes that the jihad to liberate not only Iraq but also other Muslim territories occupied by heretics and unbelievers is the obligation of all Muslims. The occupied Muslim territories are not limited to Iraq and Afghanistan, which are actually occupied or were previously occupied by the Western forces, but also include other

independent Islamic states. ISI asserts that the rule to govern the entire land of Islam is the rule and law of disavowing the Icon. It regards all of the policymakers of these countries as unbelievers and renegades, and claims that fighting against them is an even greater obligation than fighting against the Christian crusader occupiers.

The extension of these ideas would mean that ISI regards everyone except itself as the enemy. At this point, it is assumed that the theoretical groundwork has already been prepared to turn the entire world against itself.

2-3 Rise of New Leader Abu Bakr

In part due to the formation of the Awakening Council, or *Majlis al-Şaĥwa*, involving the American forces, the activities of ISI in Iraq has rapidly muted down since 2007, with the number of terrorist attacks and the number of deaths both decreasing sharply. In this context, the two ISI leaders, *Baghdādī* and *Muhājir*, were killed by the American forces in April 2010. In the following month, ISI announced that *Abū Bakr al-Baghdādī al-Ĥusaynī al-Qurashī* had become its new leader. It also announced that ISI had appointed *Abū ‘Abdullāh al-Ĥasanī al-Qurashī* as lieutenant and *Abū Sulaymān al-Nāşir li Dīnillāh* as the minister of war.

At the time, however, ISI’s activities in Iraq had stagnated. Since terrorist activities per se had died down in Iraq, there was growing belief that administration by a Shiite government would become firmly established in Iraq. In fact, even after the U.S. troops were pulled out at the end of 2011, the Iraqi situation remained relatively stable. Iraq also maintained its system even when the autocratic regimes in the Middle East collapsed one after another amid the “Arab Spring” that started in late 2010.

On the other hand, from around the summer of 2011, the situation in Syria deteriorated in almost an instant, and the country fell into a state of civil war. Once the extremely easy-to-understand dichotomy between the Syrian government of President *Basshar al-Assad*, an Alawite, supported by Shiite Iran and Russia, and the Sunni armed insurgents fighting the Assad regime, was established, the Sunni armed forces that viewed the Assad regime as a target of their jihad came to Syria seemingly attracted by the cause of a new jihad, turning the battlegrounds of Syria into the bases of a new jihad. This was precisely when ISI enjoyed a revival.

2-4 Emergence in the Syrian Civil War

In January 2012, the video entitled “al-Shām of the Jihad” was posted on the Internet [al-Jawlānī, Jihād al-Shām 2012]. This marked the declaration of the establishment of Jabha al-Nuṣra, or the al-Nusra Front. By his name, its leader, Abu Mohammad al-Jawlani, is believed to have been born in the Golan Heights occupied by Israel, but it is not clear whether this is true or false. Based on press reports, al-Jawlani entered Iraq after the war ended and became an aide of Zarqawi there.⁶ Subsequently, al-Jawlani steadily advanced his career and became an operational commander in the town of Mosul in western Iraq. Thereafter, when Syria fell into civil war, he headed for Syria with support from Baghdādī. This marked the origins of the al-Nusra Front.

In April 2013, however, Abu Bakr Baghdādī made an abrupt announcement that ISI would merge with the al-Nusra Front, which was engaged in the armed fight against the Assad government, change the group’s name to Islamic State of Iraq and Syria (ISIS/ISIL) and unify its flag with the flag of ISIS/ISIL. However, the al-Nusra Front rejected the proposed merger with ISIS/ISIL.

Al-Zawahiri, al-Qaeda’s leader, intervened, but ISIS/ISIL rejected his intervention, and al-Qaeda and ISIS/ISIL broke off their relations. Meanwhile, the al-Nusra Front pledged allegiance to al-Zawahiri and is now operating as the Syrian branch of al-Qaeda.

2-5 Establishment of *Islamic State*

On June 29, 2014, ISIS/ISIL’s official spokesman Abu Muhammad al-Adnani, in an audio statement posted on the Internet, announced that *Islamic State*, as represented by “the People who Loosen and Bind,” established the Islamic caliphate (khilāfa) and that the group had decided to pledge allegiance to Ibrāhīm ‘Awwād Ibrāhīm bin ‘Ali bin Muḥammad al-Badrī al-Qurashī al-Hāshimī al-Ḥusaynī al-Sāmarrā’ī as the caliph of all Muslims.

Needless to say, “al-Sāmarrā’ī” refers to Abu Bakr Baghdādī, the leader of ISIS/ISIL, who accepted the pledges of allegiance and became the imam and caliph of Muslims around the world. In tandem with this, the geographic names of “Iraq and al-Shām” were dropped from the name of ISIS/ISIL and the group’s official name became

⁶ Al-Jawlani was arrested there by the U.S. forces and detained at Camp Bucca. Abu Bakr Baghdādī was reportedly detained at Camp Bucca as well. Thus, it is possible that the two men met there.

“al-Dawla al-Islāmīya,” or *Islamic State*.

Baghdādī is said to be an Iraqi who was born in Samarra in 1971. According to biographies found on the Internet, he was born into a religious family belonging to the al-Būbadrī (or Badrī) tribe. Baghdādī identifies himself as al-Qurashī (a person from the Quraysh tribe) and al-Ḥusaynī (a descendant of Hussein, the son of Ali, the fourth caliph). This is not necessarily false, as the Būbadrī tribe is said to share the same genealogy as the Quraysh tribe.

Baghdādī is said to have graduated from the Jāmi'a Ṣaddām Ḥusayn li al-'Ulūm al-Islāmīya (or the Saddam Hussein University for Islamic Studies). The university was the first Islamic university established during the Saddam era, and its name has been changed to the Al Iraqia University (or the Iraqi University). Baghdādī reportedly earned a master's degree and a doctoral degree at the university.

Upon graduation, Baghdādī preached as a cleric at the Imam Ahmad ibn Hanbal Mosque in Samarra, but after the Iraq war, he is said to have engaged in anti-American military operations. As he graduated from a religious university during the secular era under the rule of President Saddam Hussein, Baghdādī may have had a very strong religious mind since those years. Information on the Internet has it that he had already been involved in jihadist activities in those years. There also is information that he had been active as an imam or preacher at Qubaisi Mosque in Baghdad and Fallujah Mosque.

However, some say Baghdādī embraced extremism after he was arrested by the U.S. forces and detained at Camp Bucca. He then founded the militant group, Jama'at Jaysh Ahl al-Sunnah wa-l-Jama'ah, in which he served as a member of the shari'a committee. In 2006, Baghdādī and his group joined the Mujahideen Shura Council (Iraq).⁷ After serving as a member of the shari'a committee of ISI, he was chosen as the leader of Islamic State of Iraq following the death of Abu Umar al-Baghdadi.

There is information that Abu Bakr al-Baghdādī was a former member of the Muslim Brotherhood.⁸ This information was provided in an article of the Saudi Arabic newspaper, Al-Sharq al-Awsat, which quoted Yusuf al-Qaradawi, a noted Islamic cleric

⁷ However, he joined the Mujahideen Shura Council (Iraq) somewhat later than the founding members.

⁸ The establishment of a caliphate has an important place in the ideologies of the Muslim Brotherhood in Iraq, but it has always been regarded as the long-term goal [Sabri 2012].

living in Qatar, who is said to have close ties with the Muslim Brotherhood.

2-6 Policies of ISIS/ISIL

ISIS/ISIL probably differs significantly from al-Qaeda and other jihadist terrorist organizations in terms of “governance.” Unlike other groups, ISIS/ISIL asserts that it governs its territories based on what it believes Islam to be. The establishment of the caliphate is exactly part of that. ISIS/ISIL has also set forth several characteristic policies. Effectiveness aside, these include the revival of slavery, destruction of mausoleums, introduction of the capitation tax and introduction of gold, silver and copper currencies.

Meanwhile, the group’s atrocious tactics, as represented by carrying out decapitations, have become synonymous with ISIS/ISIL. These tactics became common in Iraq during the years of activities by Zarqawi. Zarqawi and others took to the practice of having Westerners taken hostage dress in orange and beheading them with knives after making them plead for their lives. Orange is the color of the inmate uniforms in the United States put on Muslims detained at Guantanamo base. It is clear that ISIS/ISIL’s intention is a kind of retribution against that.

From the perspective of ISIS/ISIL, decapitation as a means of killing is not something that is disapproved of. This is because classical Islamic law generally provides that the following five options for the treatment of prisoners are acceptable: kill them by beheading; enslave them; exchange them with enemy prisoners; release them for ransom; or treat them leniently and release them.

On the other hand, execution by burning is generally believed to be impermissible, as it is said to be regarded as the destruction of dead bodies in Islam, or a punishment that is the sole prerogative of Allah. However, ISIS/ISIL has brought forward the principle of *lex talionis*, or an eye for an eye and a tooth for a tooth, and believes that if enemies kill Muslims with the use of fire, they are allowed to put enemies to death with the use of fire.

2-7 Skilled Media Strategy

It has often been pointed out that ISIS/ISIL has a highly skilled media strategy. Al-Qaeda and AQI had already developed their own media strategy using the Internet, but ISIS/ISIL can be described as having expanded this strategy and making it more

sophisticated. The media distribution department Fajl and the media production organization al-Furqan Media are the most important media departments of ISIS/ISIL that have existed since the days when it was called AQI, and a new organization, Mu'assasa al-I'tiṣām is also becoming prominent.

From the years as AQI to the years as ISI, Arabic Internet bulletin boards were the main vehicle of propaganda. In recent years, however, the main platform for their propaganda operation has shifted toward Twitter and other forms of social media. In addition, the group has more recently been using Telegram and other applications. In the years of ISIS/ISIL, a new media department, al-Hayat Media Center, has also emerged. The main platform on which the department is carrying out its operations is also social media, but, unlike al-Itisam Media or al-Furqan, al-Hayat Media Center is mainly in charge of public relations in English. At present, ISIS/ISIL is publishing various non-Arabic journals online, including Dabiq in English, Dār al-Islām in French, Konstantiniyye in Turkish and Istok in Russian (Dabiq is also offered in multiple other languages, such as Indonesian Bahasa and Bosnian).

Other than the above, the daily bulletin called al-Bayan can be accessed online, and al-Naba, which reports on the results of fighting, and Ajnād, which distributes songs a cappella inciting the jihad, is popular as well. Maktaba al-Himma, which publishes pamphlet-type guides on individual themes, is also an interesting medium.

Another important development is an inflow of a large number of foreign mujahideen into the territories controlled by *Islamic State*. By numbers, the large amounts of Tunisians and Saudi Arabians stand out, but a significant number of people have also come from non-Arab countries, including Turkey, France and Russia. The simultaneous terrorist attacks in Paris in November 2015 vividly illustrated the horrifying nature of attacks perpetrated by those fighters who returned to their home countries from Syria and Iraq.

2-8 Funding Sources of ISIS/ISIL

Not much is known about the funding sources of ISIS/ISIL. Cited as the key funding sources from the beginning include donations from the Persian Gulf states, spoils of war from the territories occupied, smuggling of looted cultural assets, capitation tax from the People of the Book, trafficking of crude oil and oil products from the oilfields ISIS/ISIL took control of, spoils and ransom money for hostages detained. In actual fact,

however, there is insufficient evidence to support the veracity of many of these funding sources.

The media often labels ISIS/ISIL as the “most affluent terrorist organization,” and the main factor for this is largely oil. Since the summer of 2014, however, the U.S.-led coalition forces started air raids in Syria and destroyed the oilfields and refineries controlled by ISIS/ISIL. Thus, its oil production is likely to have declined considerably. Further to that, crude oil prices dropped significantly, and this alone most certainly has dealt a severe blow to ISIS/ISIL. In addition, ISIS/ISIL also faces technical problems. For example, much of the crude oil produced from the oilfields believed to be under control of ISIS/ISIL is heavy oil, which requires a fairly high technological capability to turn it into useful oil products. It is hard to assume that ISIS/ISIL possesses the technological prowess sufficient to produce and refine crude oil.

Not much can be expected from funds that can be raised within the territories, including the capitation tax, as many Christians have now left Syria or been enslaved. Smuggling of cultural assets has its limits, and the looting of houses of people who left Syria and seizures of their assets cannot be described as a sustainable source of funds. In that sense, and based on the process of elimination, the reasonable conclusion would be that an inflow of funds from external sources is supporting the finances of ISIS/ISIL.

2-9 Territories of *Islamic State* and Its Expansion into Asia

At the end of 2015, it was widely reported that the territories controlled by ISIS/ISIL were gradually dwindling. However, among the territories governed by ISIS/ISIL, those that can be deemed “areas” have been limited from the very beginning and many of its territories are only dots and lines. In the case of Iraq, ISIS/ISIL has consolidated its control mostly in regions with large Sunni populations in the western and central parts of the country. In Syria, its sphere of influence includes regions near the border with Iraq in the east, Aleppo in the north, Palmyra in the middle and the suburbs of Damascus. ISIS/ISIL claims that it governs these regions by dividing them into administrative districts known as “provinces,” but the control asserted by the group there perhaps is nothing more than nominal control.

After the establishment of the caliphate was declared, a chorus of pledges of allegiance to Baghdādī, the “caliph,” was heard from jihadist organizations and jihadist individuals all over the world. Up to now, however, the regions whose pledges of

allegiance ISIS/ISIL itself has actually endorsed are limited to those in Libya, Algeria, Saudi Arabia, the Sinai Peninsula, Yemen, Afghanistan, the Caucasus and Nigeria. Of them, the regions in Libya, Saudi Arabia, Yemen and the Caucasus are divided into smaller “provinces,” and it is common practice that when allegiant fighters make terrorist attacks in their regions, they claim responsibility for them in their respective names.

When the coalition forces, comprised mainly of the United States and Arab states, launched military operations targeting ISIS/ISIL in response to the expansion of its sphere of influence, ISIS/ISIL resorted to the tactic of killing Western journalists and others detained as hostages. The killing of two Japanese nationals by ISIS/ISIL in 2015 as part of the group’s hostage tactics is still fresh in the minds of the Japanese.

Meanwhile, in Iraq and Syria, the offensives against ISIS/ISIL by the Iraqi and Syrian governments as well as the coalition forces and the Russian forces have intensified since 2016, with ISIS/ISIL rapidly losing its territories. However, the shrinkage of the controlled “territories” and the “ideological erosion” are not necessarily the same thing. Going forward, it is still highly likely that terrorist attacks by ISIS/ISIL or those radicalized by the influence of the ISIS/ISIL ideology will take place anywhere in the world. Terrorist attacks by ISIS/ISIL have already extended beyond the boundaries of Iraq and Syria and into Europe, the United States and further into South Asia and Southeast Asia. In the December 2015 statement, Baghdādī lashed out at Saudi Arabia and the Christian crusaders and called for attacks against them, referring to such countries and regions as Somalia, the Philippines, Indonesia, Bangladesh and Turkestan. As if responding to his call, a terrorist attack occurred in Jakarta in January 2016, and ISIS/ISIL immediately claimed responsibility for the incident.

Intermittent pledges of allegiance have been heard from the Philippines as well. In January 2016, Isnilon Hapilon, leader of Abu Sayyaf in Basilan; Abu Anas al-Muhajir, leader of the Ansar al-Sharia battalion; and Abu Harith al-Filipini, a delegate from Marakah al Ansar battalion in Sur posted a video pledging their allegiance anew to ISIS/ISIL on the official channel of ISIS/ISIL. Furthermore, in April 2016, ISIS/ISIL released its official statement on incidents in the Philippines for the first time. At the moment, neither Indonesia nor the Philippines has been designated as a “province” of *Islamic State*. If ISIS/ISIL is to lose further ground in Iraq and Syria, the possibility cannot be entirely ruled out of the group giving greater priority to Southeast Asia.

The number of fighters from Southeast Asia fighting in Iraq and Syria is estimated to be at least 600. There also are many cases where potential fighters were arrested before reaching Iraq or Syria. Including those returning from Iraq and Syria, how to handle those influenced by jihadist ideology will become a major challenge going forward. It is entirely conceivable that any mishandling or insufficient responses would lead to the spreading of terrorist threats.

3. Developments in Major Middle East Oil Producers and Counterterrorism

3-1 Iran

3-1-1 Political and Social Situation in Iran

The agreement on the Joint Comprehensive Plan of Action (JCPOA) in July 2015 and the lifting of sanctions in January 2016 based on JCPOA came as significantly bright news to Iran. A rush of visits to Iran by economic delegations from many countries that started immediately after the tentative nuclear agreement between Iran and the six powers led by the United States in November 2013 continued through 2015 and into the spring of 2016, with a host of business negotiations taking place with post-sanctions Iran in mind.

Iranian President Hassan Rouhani, who was elected in 2013 on the platform of the “settling of an agreement on nuclear development and the ensuing lifting of sanctions,” was able to attain widespread domestic support by actually concluding the nuclear agreement with the major Western countries. In the parliamentary elections (and the election of the Assembly of Experts) held in February 2016, candidates backing the Rouhani government made a strong showing, constituting a significant force in the 10th Parliament. In the fifth election of the Assembly of Experts, former President Hashemi Rafsanjani, who has provided firm support for the Rouhani government, won the largest number of votes.

However, there exist political forces in Iran that are wary of rapid changes that might be brought on by the nuclear agreement and the ensuing lifting of the sanctions. These forces, which can be labeled as hardline conservatives, despite the crushing defeat they suffered in the February 2016 elections, constitute a key element of the support base of Supreme Leader Ayatollah Ali Khamenei, and maintain a measure of say within the ruling regime. These forces expanded their economic interests during the years of the government of President Mahmoud Ahmadinejad (2005–2013) when the economic sanctions against Iran were tightened, and as such they feel that the process leading to the lifting of the sanctions itself could threaten those interests.

Heading the list of such forces is the Islamic Revolutionary Guards Corps (IRGC), the military force of the Islamic Republic of Iran. Established soon after the 1979 revolution, the IRGC has defended the Islamic Republic of Iran system at home and overseas and regards the defense of the framework of Iran’s “revolutionary regime” as its mission. In order to fulfill its mission, the IRGC has attempted to contain the

reformist forces that sometimes dare to raise an objection even to the framework of the regime at home, while externally maintaining ties with “resistance forces” around the world to hold any military attack on Iran in check.

In Iran, the expectations that things will get better in the wake of the lifting of the sanctions are still maintained, forestalling a situation in which social discontent would increase. During the years when the economic sanctions against Iran were being tightened, nonpayment of salaries for government employees increased and the unemployment rate rose in Iran. Expectations are high that the revitalization of the economy in the wake of the lifting of the sanctions will improve these situations.

Under these circumstances, Sunni extremist forces that emerged from the protracted civil war in Syria, as represented by ISIS/ISIL, can be cited as a potential external threat to Iran’s security. These forces take a hostile view of the Shiites who make up the majority of the Iranian population, and have at times moved closer to the Iraqi side of the Iranian border.

3-1-2 Responses to Extremism Represented by ISIS/ISIL

ISIS/ISIL, which declared the establishment of the “caliphate” in Mosul, northern Iraq, poses a threat to Iran that borders on the eastern part of Iraq. Iran also has amicable relations with the Shiite-led central government of Iraq, established after the collapse of the government of former President Saddam Hussein. Thus, Iran has been cooperating in the operations to mop up ISIS/ISIL fighters in Iraq. Iran is even reported to sometimes be conducting “joint operations” with the U.S. forces, albeit indirectly. Major General Qasem Soleimani, commander of the Quds Force, the IRGC special forces unit responsible for extraterritorial operations, is reportedly directing the fighting against ISIS/ISIL, performing well in such efforts.

Syria is another country in which Iran is deepening its involvement under the pretext of “ISIS/ISIL cleanup.” In Syria, since the spread of the impact of the Arab Spring to the country in March 2011, antigovernment movements and their suppression have developed into violent skirmishes, resulting in the civil war today. Amid these developments, Iran initially supported the Syrian government of President Assad for the cause of the “protection of the Shiite shrines” in Syria. Iran came to the aid of the Assad government because it is invaluable to Iran as a bridge with Hezbollah, the armed anti-Israel resistance group in southern Lebanon. Iran was deeply involved in the

establishment of Hezbollah in the first half of the 1980s and has been providing support to it since.

Later, Iran's fighting in Syria has been designated as the fight against Salafi jihadism, represented by ISIS/ISIL as well as the fight to defend Shiite shrines. Iran continued the fight against the anti-Assad forces by dispatching former IRGC officers to Syria as "military advisers" and also sending Shiite believers of Afghanistan and Pakistan to Syria as fighters. From around when Russia began air raids in Syria on the side of the Assad government in September 2015, the number of Iranians killed in the fighting in Syria (called the martyrs, or shahid, in Iran) increased sharply. Despite this, the Iranian leadership regards the fighting in Syria as the fight against ISIS/ISIL, and has justified the military intervention by reasoning that "unless Iran fights against ISIS/ISIL in Syria, ISIS/ISIL could threaten to advance on Iran as early as tomorrow."

The rise of ISIS/ISIL and other extremist forces is in part a phenomenon brought about by the prolonged civil war in Syria. However, Iran, like Russia, does not have an option to "pull the plug" on the Assad government, and is continuing to fight against the anti-Assad forces by also mobilizing Hezbollah fighters from Lebanon. Iran is continuing to emphasize the necessity of rooting out Sunni extremism as embodied by ISIS/ISIL and the al-Nusra Front. In response, Saudi Arabia and other Sunni states argue that Hezbollah, "lends a helping hand to the oppression of the Syrian people by the Assad government" and Iran, which supports it, are in fact the terrorists. There is no sign of such verbal exchanges quieting down.

3-1-3 Economic Impact of Falling Oil Prices

Iran has been forced to continue the fighting against ISIS/ISIL amid the tightened sanctions on the country and the continuing fall of crude oil prices. Since the boycott of Iranian crude oil that commenced in July 2012 when oil prices stayed high, Iran's economic conditions have never been favorable.

To begin with, since the 1980s, the Iranian economy has been burdened with such structural problems as high inflation, high unemployment, the inefficiency and low productivity of state enterprises and the maintenance of standards of living through the doling out of subsidies. During the period when the sanctions against Iran were tightened, these problems uniformly worsened. That said, the government's mismanagement also contributed to making the situation even worse.

Looking at the impact of the tighter sanctions first, the United States strengthened financial sanctions against Iran by forcing financial institutions across the world to choose between the United States and Iran. This pushed up Iran's costs of imports, resulting in an acceleration of inflation. The sluggish imports also gave rise to a shortage of intermediate goods indispensable for Iran's manufacturing sector, causing the operating rate of factories to decline and employment to rise.

With respect to the government's policy mismanagement, the previous government of former President Ahmadinejad, which sought "the realization of social justice" through "the distribution of oil wealth," aggravated inflation by implementing a series of policies cynically described as "throwing money around" on the pretext of relieving the poor in particular. The series of policies carried out by former President Ahmadinejad, such as the lowering of interest rates, the lending scheme for very small companies and bulk orders for public works, all worked to expand the money supply, which ultimately turned into inflationary pressure.

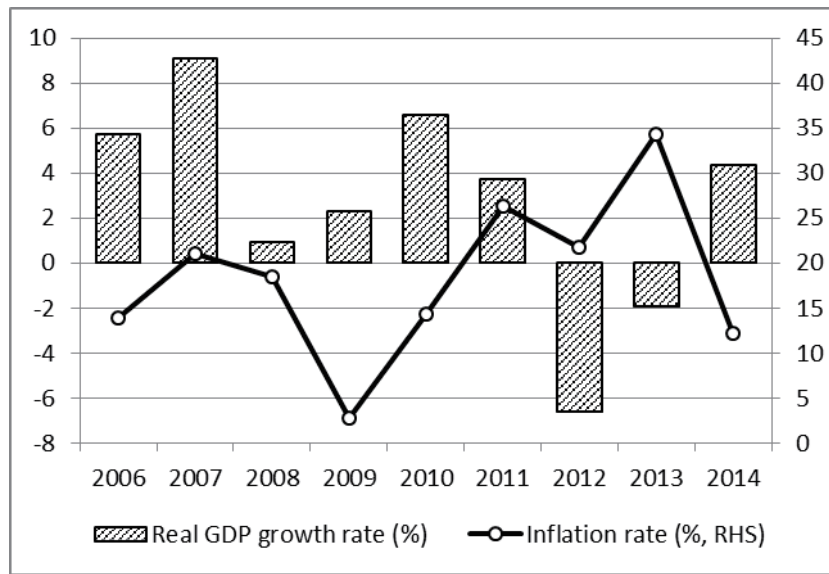
While the privatization of state enterprises promoted by the Ahmadinejad government helped expand the economic interests of what are called charity foundations and IRGC-related semiofficial organizations, the initiative did not lead to the realization of economic growth through enhanced production efficiency, the longstanding issue for the Iranian economy. The Ahmadinejad government's reform of the country's subsidization policy further squeezed the government finances as it was implemented in combination with the policy for cash benefits.

The government of President Rouhani, which was inaugurated in August 2013 and inherited the above-described economic conditions, focused on the nuclear talks with the major Western countries in order to realize an early lifting of the economic sanctions and also sought to bring down the inflation rate as a matter of urgency. As a result, as shown in the figure below, the inflation rate, which stood at 35% when President Rouhani assumed office in 2013, declined to below 15% in 2014. The achievement of the economic recovery was delayed, however.

One of the reasons behind this can be traced to the slumping oil prices. Following the lifting of the sanctions in January 2016, the Rouhani government intended to give a boost to an economic recovery with an increase in oil revenues by expanding exports of

crude oil. However, it was not easy to regain the lost market share amid the continuing oversupply, and due to the falling oil prices, Iran finds itself in a situation where oil export revenues do not increase while volumes of oil exports rise.

Figure 1: Iran’s Real GDP Growth Rate and Inflation Rate



Source: World Bank, World Development Indicators

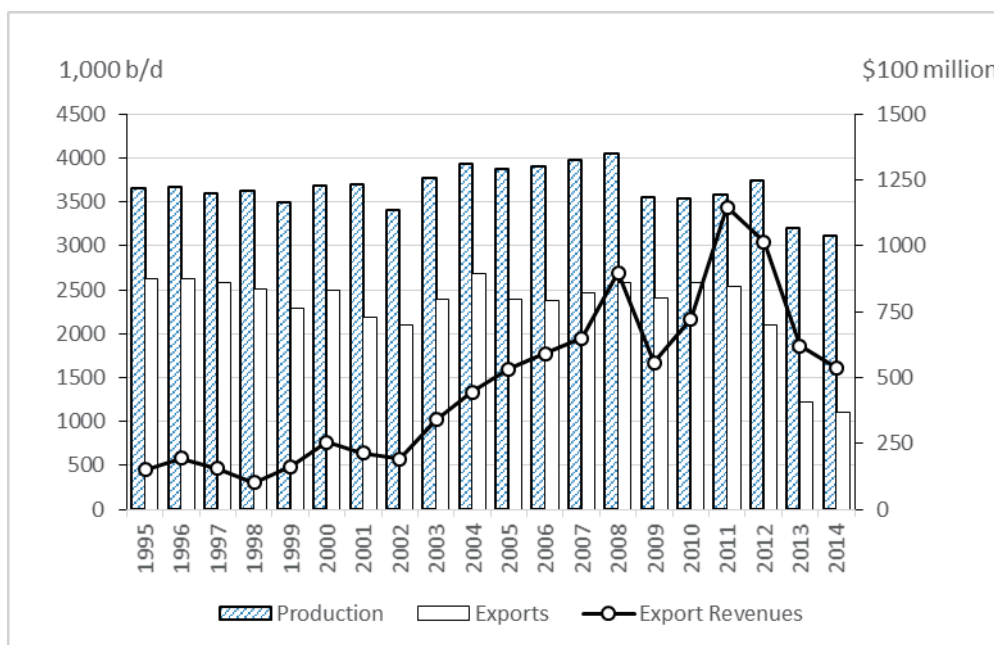
3-1-4 Oil and Natural Gas Production

As shown in the figure below, Iran’s exports of crude oil, which stood at around 2.5 million barrels per day (b/d) before the tightening of sanctions, plunged by about 60% to around 1 million b/d by 2013 following the boycott of Iranian oil by the United States and the European Union, accompanied by sharp decreases in revenues from crude oil exports. As Iran lost the export markets for its crude oil by the boycott, the country was compelled to cut back on production, and crude oil production decreased to 3 million b/d in 2013 from over 4 million b/d in 2008.

Iran had pronounced a plan to boost crude oil production as much as possible upon the lifting of the sanctions. During the period of tighter sanctions against Iran, however, Iranian crude oil was replaced by crude oil produced in Saudi Arabia or Iraq, and it was no easy task for Iran to recover the lost export markets. As oil prices fell, every oil-producing country was trying desperately to protect its export market. As such, no country came forward to “hand over” its market to Iran.

Furthermore, Iranian oilfields, most of which had been developed in the beginning of the 20th century, are rapidly becoming decrepit, and there is the view that the recovery of crude oil production in Iran is unlikely to be achieved as smoothly as desired by the government. Iran hopes to increase production by applying the enhanced oil recovery (EOR) method to aging oilfields and also proceeding with the development of new oilfields. However, the prospect of the smooth development of new oilfields is far from certain. While the Rouhani government intends to push forward with the development of the oil sector with the participation of foreign capital, the hard-line conservatives in Iran still retain their deep-rooted distrust in “foreign capital.”

Figure 2: Iran’s Crude Oil Production, Exports and Export Revenues



Source: OPEC statistics

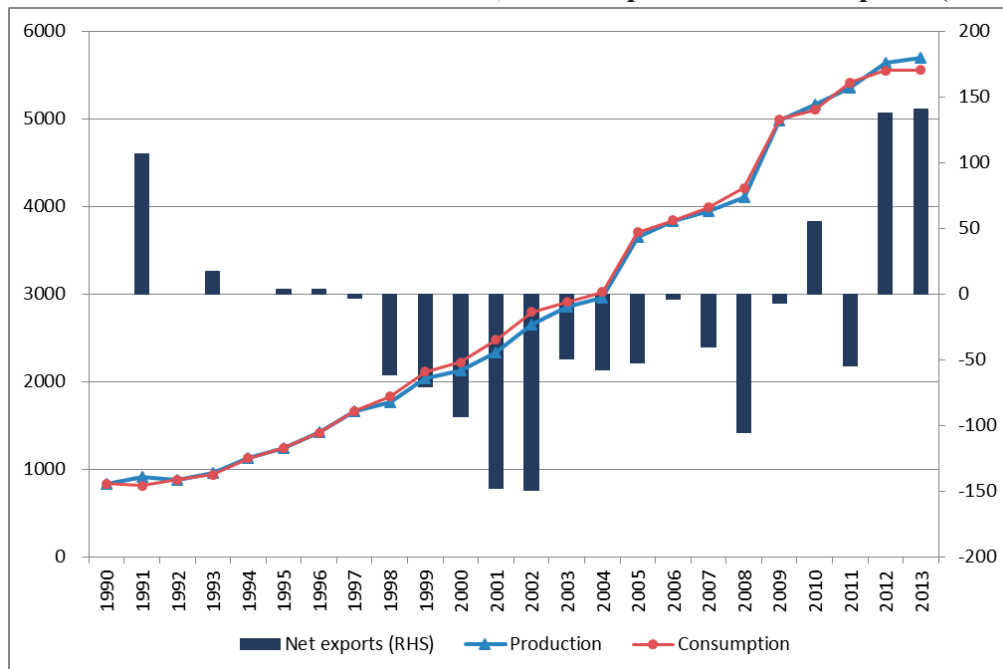
Under the constitution enacted immediately after the 1979 revolution, Iran was prohibited from giving foreign companies any stake in underground mineral resources. However, as it became evident that the technologies and funds of foreign companies are essential for the development of its oil and natural gas sectors, in the mid-1990s Iran came up with the idea of “buy-back” service contracts that allow the entry of foreign capital in a manner that does not constitute a violation of the constitution.

As the buy-back contract formula proved quite unpopular among foreign companies, however, the Rouhani government, soon after its inauguration, hurriedly developed a

new framework for introducing foreign capital, the Iran Petroleum Contract (IPC) as a “form of contract that is more attractive to foreign capital.” However, the IPC was criticized for being “excessively favorable to foreign capital,” and has yet to be approved in Iran. As a consequence, the entry of foreign capital into Iran’s oil sector has not become a reality even after the lifting of the sanctions in January 2016.

The situation is much the same in the natural gas sector. Even under economic sanctions, Iran’s natural gas production has been increasing somewhat in recent years, as Iranian companies filled the gaps left by the departure of foreign companies to develop the South Pars gas field, the country’s largest, and other gas fields, though on a very limited scale. However, as the development of Qatar’s North Field gas field, which is located to the south of the South Pars gas field and has much the same structure as the Iranian gas field, proceeds smoothly with the cooperation of foreign capital, the need for Iran to quickly develop its own gas fields has been repeatedly pointed out. At the same time, the entry of foreign capital into Iran’s natural gas sector has yet to be realized either, due to a delay in the IPC approval.

Figure 3: Iran’s Natural Gas Production, Consumption and Net Exports (unit: bcf)



Source: Prepared based on data from the U.S. Energy Information Administration (EIA)

There are a variety of uncertain factors making foreign companies reluctant to

committing to long-term investment in Iran, which can be said to explain the slow entry of foreign capital into Iran, even after the lifting of the sanctions. First of all, of the economic sanctions against Iran, the sanctions related to the nuclear development issue have already been lifted, but a string of other sanctions still remain in force. Because of this, international financial institutions, particularly those making dollar transactions, have to be cautious about doing business with Iran. As such, there have been successive cases in which business contracts cannot be finalized as no banks come forward for the job of settling transactions with Iran.

Secondly, the outcome of the U.S. presidential election is another source of concern. In particular, Donald Trump, the Republican Party's presidential candidate, publicly stated that he would "tear up" the nuclear agreement with Iran in the event of his assuming the presidency. For the time being, foreign companies are in no mood to make final decisions on Iranian investment until it becomes clear who the next U.S. president will be.

The lifting of the sanctions against Iran in January 2016 by itself does not promise any dramatic increases in Iran's production of crude oil and natural gas. Still, it can be said that the realization of the lifting of the sanctions has enabled Iran to take at least one step forward on the path to increased crude oil production. As long as the nuclear agreement remains intact, Iran's oil production can be expected to continue increasing going forward, though the advance may only be a little at a time.

3-2 Iraq

3-2-1 Political and Economic Situation in Iraq

The Iraqi government of Prime Minister Haider al-Abadi was inaugurated in the autumn of 2014, and, as with the preceding Iraqi governments, is a nationally united government. However, all key posts are occupied by those from Shiite parties, in part because the Shiite parties together obtained the majority of seats in the parliamentary elections held in April 2014. Prime Minister Abadi steered the administration in the direction of national conciliation by improving relationships with the Sunni parties and Kurdish parties, which had become strained under the previous government of Prime Minister Nouri al-Maliki, but has not been able to make any bold policy shift because of opposition from within the Shiite parties, his support base.

Thus, the prisoner amnesty bill and the bill for the establishment of the national guards, which the Sunni parties demanded be enacted at the time of the formation of the cabinet, have ultimately been shelved, though deliberations on the bills took place in parliament. The amnesty bill is designed to deal with the problem of a large number of citizens who were arrested by the Iraqi security forces in counterterrorism operations still being detained without trial. Many of the detainees are Sunni residents. The national guards bill is for the creation of national guards in each governorate, public security units comprised of residents from each governorate, and for the partial devolution of the public security enforcement powers with the authority to direct the national guards bestowed to the governors of each governorate. In view of the situation in which the Shiite-led security forces pose a threat to citizens, particularly in the governorates with large Sunni populations, the bill was devised with the assumption that the maintenance of public order is put in the hands of local residents after driving out the ISIS/ISIL fighters. However, there is no prospect of the bill being enacted as the decentralization measure has raised deep concerns that it may lead to the division of Iraq as a state.

Under normal circumstances, politicians should be discussing the shift in policy, including decentralization, for the stable governance of Iraq after driving *Islamic State* out of Iraq. In reality, however, military responses to ISIS/ISIL, the “founders” of *Islamic State*, are superseding any other problems as the top priority. As a consequence, the Popular Mobilization Unit (PMU), led by Shiite militias active on the battlefronts, is stepping up its presence and enjoys a stronger voice along with the Shiite parties. Conversely, the positions of the Sunni parties have been weakened considerably in

Iraq's national political arena, with their ties to local voters having been severed as they have been forced to flee by *Islamic State*.

Regarding the Kurdish problem, meanwhile, the pending agreement on exports of crude oil and budget allocation was concluded between the Iraqi government and the Kurdistan Regional Government (KRG) in late 2014. However, both sides could not overcome their mutual distrust, and the agreement fell apart in about half a year. Since then, KRG has been maintained its course of action to seek to establish fiscal independence through exports of crude oil on its own. Top KRG officials very frequently speak of eventual independence from Iraq.

Prime Minister Abadi is steering his government while trying to balance these various political forces, but his support base is far from solid. Under these circumstances, the prime minister began moving to strengthen unifying force under the banner of reform against the backdrop of discontent among citizens.

When popular demonstrations, triggered by power shortages amid record heat levels in the summer of 2015, spread to denounce corruption within the government and the reduction of public services, Prime Minister Abadi announced a comprehensive package of reforms. Backed by the support of the Shiite clergy, he took the decisive actions of cutting the salaries of high-ranking government officials, consolidating government ministries and agencies and reducing the number of cabinet ministers. Parliament initially supported the prime minister's reform program, but adopted a resolution requiring the prime minister to obtain parliamentary approval of any reform measures to be enforced in the future after the spread of popular demonstrations protesting the plan announced by the government in October to cut the salaries of high-ranking government employees without any detailed design. With respect to the measures to combat corruption, an arrest warrant was issued against Trade Minister Malas Abdulkarim al-Kasnazani in October 2015. However, given that his political importance is relatively low among the cabinet ministers, the incident does not necessarily mean that Prime Minister Abadi has been cutting into vested interests in his fight against corruption.

As illustrated above, Prime Minister Abadi's reform program began to lose momentum within several months after its launch. Under these circumstances, another turning point resulting in an entirely new situation came in the form of the reinvigoration of protest movements from around February 2016 that drew several tens

of thousands of demonstrators. The central figure that helped mobilize the demonstrators was Muqtada al-Sadr, the Shiite cleric and political leader. He has a strong support base in Sadr City in the eastern part of Baghdad with a large low-income population, and thus is capable of mobilizing a large number of citizens. In addition to organizing demonstrations, his supporters joined a sit-in protest in front of the Green Zone in the central part of Baghdad in mid-March and Muqtada al-Sadr himself began the symbolic sit-in protest within the Green Zone in late March in a gesture to press for the reform.

Seizing this opportunity, Prime Minister Abadi, who was discussing the cabinet reshuffle with various political parties, submitted a list of the new cabinet ministers to Parliament on March 31. While retaining the prime minister, the defense minister and the interior minister leading the fighting against *Islamic State*, the list of the 14-member cabinet, mainly comprised of technocrats, including scholars and bureaucrats handpicked by the prime minister himself, was premised on the reduction of the ministerial posts by 7 through the consolidation of government ministries and agencies. However, many political parties wishing to keep their vested interests intact raised fierce objections, putting a halt to the cabinet reshuffle. As a result, there is now no firm prospect of a cabinet reshuffle taking place, one of the key items in the prime minister's reform program.

At a time when the fight against *Islamic State* is moving ahead, the credibility of the Abadi government is declining rapidly.

3-2-2 Progress in Military Operations against *Islamic State*

By the middle of 2014, *Islamic State* came to rule the majority of central Iraq, including Mosul. Two months later, the extremist group launched a large-scale offensive into the northwestern part of the country and also usurped a portion of territories under the control of KRG.

Subsequently, the U.S.-led coalition forces began air raids, and the security forces of the Iraqi government reinforced the defenses of the capital city of Baghdad and the southern part of the country while pushing ahead with its military operations northward from the capital. Furthermore, Peshmerga, the military forces of KRG, is joining the cleanup operations against *Islamic State*, moving southward from its stronghold in the north.

As a result, by April 2015, the cities in Diyala Governorate bordering the Iranian border, Babil Governorate located to the south of Baghdad Governorate and Salah ad Din Governorate along the Tigris to the north of Baghdad Governorate were all but liberated. *Islamic State* newly took over Ramadi in Anbar Governorate in May 2015, dealing a heavy blow to the Iraqi government, which, however, regained control of Ramadi by the end of 2015. Summing up the situation in January 2016, Steve Warren, the spokesman for the coalition forces, said that *Islamic State* has now lost 40% of its territories compared to peak levels.

Figure 4: Distribution of Iraqi Areas under Control of Various Forces (as of February 2016)



Source: Institute for the Study of War

The biggest focus in the fight against *Islamic State* going forward will be the recapturing of Mosul, regarded by the extremist group as its capital. In January 2016, Prime Minister Abadi gave his blessing to the retaking of Ramadi and pronounced his

intention to make 2016 a year of an ultimate victory by driving *Islamic State* out of Iraq. However, Mosul is located some 200 kilometers north of Baiji on the northern tip of the territories currently under the control of the Iraqi government. Scattered in between the two cities are Sharqat, Hawija and other towns, which *Islamic State*, and its predecessor organizations, had used as their strongholds in the past several years.

Furthermore, the realities are that while the Iraqi government forces have yet to be fully reconstructed, the troops fighting on the frontlines in the battle to recapture Ramadi and other major battles are limited to counterterrorism units, which are a small cadre of elite troops within the Iraqi government forces. There is no doubt that these elite units will get involved in the operations to retake Mosul, but it would be difficult to liberate Mosul, the second largest city in Iraq, through these units alone.

Therefore, the liberation of Mosul will inevitably involve a variety of actors, including Peshmerga from the Kurdistan region, the Mosul Brigades, made up of local youths commanded by the former governor of Ninawa Governorate, now being trained in the Kurdistan region, the Turkish forces that support them, PMU standing on the frontlines against *Islamic State* alongside the Iraqi government forces, the IRGC providing military assistance to PMU, and the U.S. forces supporting the Iraqi government forces and Peshmerga with air raids. Since they are each acting with their own individual ulterior motives, it would be no easy task to coordinate and align their actions, which is essential for successful operations. What is making things more complicated is the mutual distrust among these actors. IRGC and PMU hold deep suspicions about the U.S. forces and the U.S. government, while the Iraqi government has strong objections to the Turkish troops deployed in the Kurdistan region without its permission. Peshmerga, for its part, is very vigilant about PMU, which is likely to become its next enemy after the desired defeat of *Islamic State*.

As described above, while *Islamic State* is the common enemy for all the actors involved, each of them regard the other actors as a potential threat to itself. Thus, along with the military advances, the coordination of their respective political interests is indispensable for the successful recapturing of Mosul. However, that would certainly require some creative thinking.

3-2-3 Economic Impact of Falling Oil Prices

The Iraqi economy, due to its very high dependence on crude oil, has been heavily

affected by falling oil prices since 2014. Oil revenues have dropped by 42% from \$84.2 billion in 2014 to \$49.2 billion in 2015. The 2016 government budget was adopted on the assumptions of the crude oil price of \$45 per barrel and oil exports of 3.6 million b/d (excluding 550,000 b/d to be handed over by KRG, oil exports from the southern part of the country are estimated at 3.05 million b/d). However, the export price in January, at \$22 per barrel, had fallen to just half of the assumed price. When oil revenues account for over 85% of the budgeted revenues, the impact of oil price falls is extremely large. Without the accumulation of past oil revenues as those held by the Persian Gulf oil producers, a decline in oil revenues would directly lead to a fall in expenditures. In order to make up for the budget deficits, Iraq has to rely on international financial institutions like the World Bank and the IMF. The Iraqi government considered the issuance of government bonds in 2015. As the proposed government bonds were given low ratings by financial institutions and carried very high interest rates of 11.5%, however, Iraq gave up on the idea of issuing the government bonds in October 2015. The Iraqi government still hopes to issue government bonds in 2016 by enhancing its creditworthiness by concluding a standby credit agreement with the IMF.

As the government was unable to work out funds for development spending, new projects were at a near-standstill in 2015. In 2016, Iraq now finds itself in a situation where it has to consider trimming down current expenditures as well. In Iraq, which does not have a viable private sector, however, the ratio of government employees is high in the labor market and the reduction in salaries of government employees has become a very politically sensitive issue.

The fiscal conditions of KRG are much graver than the Iraqi government's. In late 2014, the Iraqi government and KRG concluded an oil export agreement, under which KRG would deliver 550,000 b/d of crude oil to the Iraqi government and the Iraqi government for its part would provide funds equivalent to 17% of KRG's budget. However, with both sides raising issues concerning the shortfalls in remittances and crude oil deliveries, the agreement fell apart in about half a year. As a result, the Iraqi government has suspended the budget allocation to KRG, dealing a major fiscal blow to KRG. KRG is independently exporting around 600,000 b/d of crude oil through a Turkey-bound pipeline. However, KRG is being compelled to export its oil at a deep discount to market prices as the Iraqi government regards KRG's oil exports as contraband trade, another factor that squeezes its finances. KRG has already been in arrears for public employee salaries for about five months. In February 2016, at a

cabinet meeting KRG decided to slash salaries of high-ranking government employees by 75% and also cut salaries of other public employees by 10-20%.

Under these circumstances, KRG is seeking to obtain fiscal support directly from the international community, instead of reviving an oil export agreement based on a relationship of trust with the Iraqi government. KRG wants a certain proportion of the assistance that the Iraqi government would obtain from the IMF and the international community to be directed at the Kurdistan region. Until now, however, the Iraqi government has not assented to KRG's demand.

3-2-4 Oil Production

Since the fighting with *Islamic State* is largely limited to areas north of Baghdad, the oil-producing region in southern Iraq with huge oilfields is not directly affected by the deteriorating security situation. This is a much better situation than initially feared. As many international oil companies have been engaged in oilfield development and oil production in Iraq since 2009, Iraq's production and exports of crude oil expanded significantly over the past several years. The average volume of oil exports in 2015 came to 3.005 million b/d, an increase of nearly 20% over 2.517 million b/d in 2014.

On the other hand, falling oil prices are keeping limiting new investment. Oil field development contracts in Iraq take the form of service contracts, under which the Iraqi government refunds development costs to international oil companies and pays them specified amounts of reward for each barrel of increased production. These arrangements affect the Iraqi government more directly than international oil companies when oil prices decline. The Iraqi government made clear its intention to review these contracts more than once, but no companies have yet to agree to renegotiate the contracts. As the Iraqi government has been urging international oil companies to reduce development costs as much as possible while maintaining production levels, not surprisingly, no or little new investment has been made since the second half of 2014. International oil companies operating in Iraq are also growing disgruntled about arrears of development cost refunds.

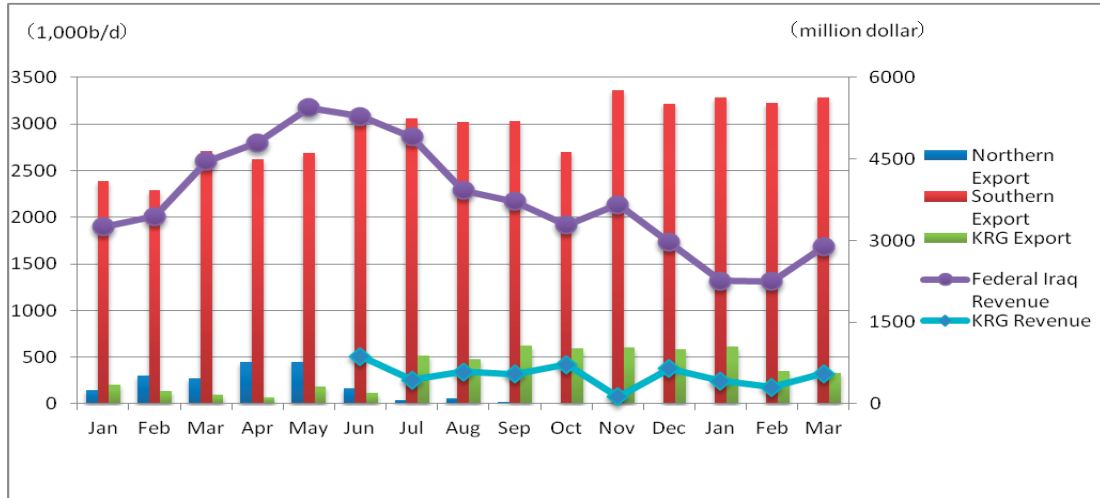
In the country report released in January 2016, the IMF forecast that Iraq's crude oil production will rise to 5.7 million b/d and oil exports to 4.4 million b/d in 2020 on the assumption that crude oil prices hover around \$60 per barrel in 2018-2020. Because of falling oil prices and the resultant limited new investments over the past two years or so,

however, Iraq is not in a position to significantly expand oil exports in the near future. In order to expand the country's oil exports by over one million b/d over the coming four years, as forecast by the IMF, a recovery in oil prices is absolutely imperative.

Following the collapse of the oil export agreement with KRG, the Iraqi government in March 2016 suspended the deliveries of crude oil produced in Kirkuk to the Kurdistan region. The Iraqi action was prompted by the fact that the Kirkuk oil it had been shipping is blended with crude oil that KRG is exporting independently as a source of revenues for KRG. On the other hand, as the Iraqi government's northbound pipeline for oil exports cannot be used from being under threat from *Islamic State*, around 70,000 b/d of the Kirkuk crude oil, which has nowhere else to go, is being shipped to oil refineries and power plants after associated gas is taken out, with the remaining quantity of around 100,000 b/d being injected back into the oilfields. The lack of an appropriate political agreement is preventing the effective utilization of some of oil resources.

Falling oil prices are having no small impact on KRG's oilfield development as well, keeping the pace of production increases slow. KRG's crude oil production stood at around 600,000 b/d in early 2016. As of March 2016, the Middle East Economic Survey (MEES) estimated KRG's production capacity at the end of 2016 at around 660,000 b/d. While the Iraqi government does not recognize the legitimacy of KRG's independent oil exports, KRG has succeeded in finding willing buyers for its crude oil, mostly in Europe. Israel, Turkey, Thailand, Singapore and Japan are among the countries that are also importing crude oil from KRG.

Figure 5: Iraq's Oil Exports and Export Revenues in January 2015-March 2016



Source: Ministry of Oil of Iraq, Ministry of Natural Resources of KRG

3-3 Saudi Arabia

3-3-1 Political and Social Situation in Saudi Arabia

In the wake of the demise of King Abdullah bin Abdulaziz Al Saud in the early hours of January 23, 2015, Crown Prince Salman bin Abdulaziz Al Saud assumed the throne and Deputy Crown Prince Muqrin bin Abdulaziz Al Saud became Crown Prince. On the same day, King Salman appointed Interior Minister Mohammad bin Nayef, his nephew, as Deputy Crown Prince. However, on April 29, 2015, King Salman dismissed Crown Prince Muqrin, promoted Deputy Crown Prince Mohammad as Crown Prince, and appointed Defense Minister Mohammad bin Salman, his son, as Deputy Crown Prince.

The impetuous change of personnel caused controversy, and in particular, the appointment of Defense Minister Mohammad as Deputy Crown Prince caused a ripple within the Saud royal family. In Saudi Arabia, when a new crown prince or a deputy crown prince is nominated by the king, the Allegiance Council, which comprises representatives who are the descendants of the founder of the kingdom, King Abdulaziz ibn Saud, is to approve the king's choice and pledge allegiance. With respect to the appointment of Defense Minister Mohammad as Deputy Crown Prince, 28 out of the 34 representatives voted in favor and 4 against, with 2 representatives abstaining (for the rate of confidence of 82%). The confidence rate was higher than 75% shown for the appointment of Prince Muqrin as Deputy Crown Prince in February 2014, but the fact that 4 representatives on the Allegiance Council voted against the nomination of Deputy Crown Prince Mohammad is of great significance.

King Salman also significantly changed the governing structure under former King Abdullah. First of all, King Salman abolished a string of organizations that existed under King Abdullah (including the National Security Council, the Supreme Council for Petroleum and Minerals, the Supreme Council for Islamic Affairs and the Supreme Economic Council), and newly established two councils, the Council of Political and Security Affairs and the Council of Economic and Development Affairs. The Council of Political and Security Affairs is chaired by Crown Prince Mohammad, while the Council of Economic and Development Affairs is chaired by Deputy Crown Prince Mohammad.

On May 7, 2016, King Salman issued a decree for an even larger-scale reorganization of government ministries and agencies and a cabinet reshuffle. Of particular importance

in the restructuring of government ministries and agencies are the reorganization of the Ministry of Petroleum and Mineral Resources into the Ministry of Energy, Industry and Mineral Resources, the reorganization of the Ministry of Commerce and Industry into the Ministry of Commerce and Investment, the abolition of the Ministry of Water and Electricity, and the reorganization of the Ministry of Agriculture into the Ministry of Environment, Water and Agriculture. Of particular interest in the cabinet reshuffle is the dismissal of Oil Minister Ali al-Naimi, and the appointment of Health Minister Khalid al-Falih as Energy Minister. The reorganization of the government and the cabinet reshuffle were carried out apparently to lay out the framework for implementing Saudi Arabia's ambitious economic reform program, Vision 2030, which is discussed below.

Since the enthronement of King Salman in 2015, Saudi Arabia increasingly made its presence conspicuous with its proactive foreign policy. For example, in March 2015, Saudi Arabia took the initiative in forming a coalition of the willing to launch air strikes against the Houthis, an armed religious-political movement, in neighboring Yemen. Saudi Arabia also sent the Peninsula Shield Force of the GCC to Bahrain during the years of former King Abdullah, but the kingdom's proactive military and foreign policies since the enthronement of King Salman are particularly remarkable.

For Saudi Arabia, meanwhile, the relationship with the United States, its traditional security partner, remains important. When the kingdom made its military intervention in Yemen, the U.S. cooperation in terms of logistics and intelligence was indispensable. In the Syrian civil war, Saudi Arabia shares the ultimate goal of removing President Assad with the United States, despite some grievances it has against the U.S. stance.

On the other hand, Saudi Arabia's intervention in Yemen is at a crossroads. In January 2016, some parts of the media, based on a leaked report of the U.N. panel of experts, reported that the Saudi-led coalition of the willing undertaking military operations in Yemen was conducting air raids against civilians broadly and systematically. In addition, massive spending on Yemeni operations has been squeezing the kingdom's coffers much more than anticipated beforehand. Under these circumstances, Saudi Arabia, having second thoughts about the continuation of the military operation and beginning to consider ceasing the military intervention, began exploring ways for a political settlement of the Yemeni civil war. In early March 2016, Saudi Arabia and the Houthis in Yemen conducted an exchange of prisoners of war.

While Saudi Arabia was skeptical about the nuclear talks with Iran, U.S. President Barack Obama visited Saudi Arabia on January 27, 2015, and met with King Salman soon after his accession to the throne. When the foreign ministers of “P5+1” countries and Iran announced a “framework agreement” on the final solution to Iran’s nuclear development problem in Lausanne, Switzerland, on April 2, 2015, President Obama called King Salman to explain the details of the agreement. After the Joint Comprehensive Plan of Action (JCPOA) was worked out in July 2015, King Salman was swayed to support it as the result of strong persuasion by the United States.

In addition, the United States showed its readiness to cooperate with Saudi Arabia militarily. On May 5, 2015, U.S. Secretary of State John Kerry said the United States would cooperate with the Persian Gulf states in their defense against Iran’s ballistic missiles. Also at the U.S.-GCC summit meeting held at Camp David on May 14, President Obama expressed U.S. intentions to support the GCC countries in emergency situations, including military actions. The series of these U.S.’ display of commitment apparently worked to ensure Saudi Arabia’s “endorsement” of the nuclear accord with Iran.

While it supported, albeit grudgingly, the nuclear agreement with Iran, Saudi Arabia remained strongly wary of the possibility of Iran stepping up its involvement in Arab states, including Syria, Lebanon, Iraq and Yemen, by regaining its economic strength following the lifting of the sanctions. Thus, the Saudi government indicated its policy to resolutely reject Iran’s presence and involvement in Arab states as “interference in domestic affairs.” In the context of these developments, Saudi Arabia executed prominent Shiite cleric Nimr al-Nimr on January 2, 2016.

On January 3, 2016, following the day of the execution of Nimr al-Nimr, in Iran, the Saudi embassy in Tehran and the Saudi consulate in Mashhad were attacked, providing Saudi Arabia with an excellent excuse to denounce Iran. Saudi Arabia immediately broke off diplomatic relations with Iran and pressured other Arab Islamic states to join the criticism against its government. In response, Bahrain, Sudan, Djibouti and Somalia severed diplomatic ties with Iran, while Kuwait and Qatar recalled their ambassadors from Tehran and the United Arab Emirates (UAE) downgraded the diplomatic relations to the level of charge d’affaires. The Arab League and the Organization for Islamic Cooperation (OIC) also issued their respective statements to denounce Iran. The string of these events brought about heightening tension over Iran in the region. Some voiced

concern over the adverse market impact of a possible emergency situation.

3-3-2 Measures to Deal with Extremism

During 2015, Saudi Arabia saw frequent occurrences of attacks against Shiite Muslims by ISIS/ISIL. In particular, the suicide bombing attack on May 22 on the Shiite Imam Ali ibn Abi Talib Mosque located in Qudaih village of Qatif city in Eastern Province that claimed 21 lives drew keen attention not only for the large number of casualties but also because it was the first terrorist attack perpetrated by ISIS/ISIL in Saudi Arabia. In the following week, on May 29, another Shiite mosque, Imam Hussein Mosque in Anud in the city of Damman in the same Eastern Province, became the target of the suicide bombing attack, which killed four people. As with the attack in the preceding week, the Damman attacker targeted the Friday prayers.

Almost simultaneously with these incidents, ISIS/ISIL issued a video entitled “Drive Rāfiḍa out of the Peninsula of Mohammed,” calling upon its supporters and sympathizers to attack rāfiḍa (the derogatory Arabic term used by Sunni extremists to refer to Shiite Muslims) as the primary target. In addition, ISIS/ISIL cited the Saudi royal family and the Saudi forces as targets alongside Shiite Muslims.

On August 6, 2015, a mosque for the Saudi rapid deployment unit in Abha in southern Saudi Arabia was attacked by a suicide bomber during the prayer hours. The attack claimed 15 lives, of which 11 were members of the unit. Another terrorist attack by ISIS/ISIL targeting Shiite Muslims occurred again in Eastern Province in October 2015.

In February 2016, a series of terrorist attacks aimed at Saudi military officials occurred. On February 8, a vehicle owned by a military official was blown up in the capital city of Riyadh, and Amaq News Agency, which has close ties to ISIS/ISIL, reported that ISIS/ISIL claimed responsibility for the incident. On February 15, a retired Saudi military officer was killed in Jazan in southern Saudi Arabia, and ISIS/ISIL officially claimed responsibility for the murder.

Furthermore, a number of Saudi men who pledged allegiance to ISIS/ISIL killed a relative who was a soldier in the rapid deployment unit and uploaded a video of the murder scene on the Internet on February 26. The Saudi Ministry of the Interior put six suspects on the wanted list, and the security forces killed all the suspects in an exchange

of fire on March 11.

The Saudi authorities have been stepping up counterterrorism measures. For example, a long wall is being constructed on the border with Iraq in order to keep out ISIS/ISIL fighters from Iraq. In February 2014, the Saudi government enacted a new anti-terrorism law, which imposes jail terms of 3 to 20 years on those who participate in fighting overseas, join terrorist organizations and propagate terrorist ideologies. Subsequently, Saudi Arabia designated al-Qaeda, AQAP, ISIS/ISIL, the al-Nusra Front, Hezbollah, the Muslim Brotherhood and the Houthis as terrorist organizations. The Saudi authorities arrested a large number of suspects for each occurrence of terrorist incidents.

In recent years, much importance is given to the rehabilitation of terrorists and suspected terrorists, but this approach has not necessarily proven effective. For example, the Mohammed bin Nayef Counseling and Care Center, the core institution to help de-radicalize potential extremists under the jurisdiction of the Interior Ministry, offers a variety of programs for overcoming the influences of extremism, al-Qaeda ideology and ISIS/ISIL ideology with the cooperation of clerics and psychologists as well as members of the security service. According to some press reports, however, 334 former Saudi terrorists who were released from prisons or completed rehabilitation programs at the Mohammed bin Nayef Counseling and Care Center subsequently rejoined terrorist organizations.⁹

In December 2015, Saudi Arabia announced the formation of the Islamic Military Alliance to Fight Terrorism, bringing together a total of 34 Arab Islamic states. On January 2, 2016, Saudi Arabia also executed a total of 47 “terrorists.” These included prominent Shiite cleric Nimr al-Nimr, while 43 were linked to al-Qaeda. By executing the well-known Shiite cleric together with those linked to al-Qaeda and widely recognized as “terrorists,” the Saudi government apparently wanted to disseminate the idea that anti-establishment Shiite clerics are “terrorists,” just as those linked to al-Qaeda.

On March 2, 2016, the GCC governments designated Hezbollah, a Shiite armed political group based in Lebanon, as a terrorist organization, and the Arab League followed suit on March 11 with the designation of Hezbollah as a terrorist organization.

⁹ *Makkah al-Mukarrama*, 12 October 2014.

Thereafter, on March 13, the Saudi Interior Ministry announced that severe punishment would be imposed on Hezbollah members as well as supporters, sympathizers and funders of Hezbollah and those who sheltered Hezbollah members.

As seen above, the Saudi government has been implementing counterterrorism measures in rapid succession, particularly in view of the terrorist attacks that occurred on Saudi soil. At the same time, the Saudi government is also taking a number of measures to forestall an expansion of the influence of Iran, its archrival in the Middle East, through Shiite organizations.

3-3-3 Economic Impact of Falling Oil Prices

Saudi Arabia recorded a fiscal deficit of \$98 billion in 2015 under the influence of falling crude oil prices and is expected to suffer a fiscal deficit of \$87 billion on a budget basis in 2016 as well. Under these circumstances, the kingdom resumed issuance of government bonds in July 2015 for the first time in eight years. Principal buyers of the government bonds are domestic commercial banks, but their capacity to absorb government paper is gradually diminishing in the face of the growing balance of outstanding government bonds. Thus, it is evident that at some stage, the Saudi government will be compelled to find willing purchasers of its debt overseas as well as within the kingdom.

The ratio of outstanding government bonds to GDP was low at around 3% before the resumption of issuance in July 2015, but it is estimated to be edging up in tandem with the placement in recent years. The IMF forecast that the debt-to-GDP ratio will rise up to 33% by 2020. In the wake of the deteriorating debt ratio, since October 2015, U.S. rating agency Standard & Poor's (S&P) lowered the rating of Saudi Arabian government bonds by three notches from AA minus to A minus. Moody's Investors Service is also expected to take similar rating action soon.

Aside from the issuance of government bonds, Saudi Arabia is also trying to procure funds through international loans. The Saudi government has not raised funds on the overseas markets for more than 10 years. In March 2016, the Saudi Ministry of Finance asked foreign banks to submit loan proposals. In response, the two foreign banks came up with the prospective lending amount of \$6 billion to \$8 billion. However, the Saudi government, citing the strength of lending interest, raised the amount of borrowings to up to \$10 billion in April 2016.

Until now, Saudi Arabia has not levied any tax on its people, in principle. In the face of falling crude oil prices, however, the Saudi government is moving to introduce a value-added tax (VAT), which is now expected to be enforced by 2018. Saudi Arabia is also looking elsewhere to find fiscal resources, including reductions in subsidies for gasoline, electricity and water. Saudi Arabia had maintained the world's lowest energy prices for long years, but in late December 2015, took the bold course of raising prices of gasoline and gas oil by 50-73%. In addition, the Saudi government raised prices for natural gas and water (for industrial use). The government is expected to gradually cut back on subsidies going forward.

3-3-4 Economic Reform Plan

King Salman, in his speech before the Shura Council in December 2015, underscored the necessity of economic reform to reduce the kingdom's reliance on oil in the face of declining crude oil prices. In 2016, Deputy Crown Prince Mohammad bin Salman, chairman of the Council of Economic and Development Affairs, began talking about Saudi Arabia's economic reform plan in interviews with a number of media organizations. In an interview with the Economist magazine in January 2016, he referred to an IPO of Saudi Aramco, and in an interview with Bloomberg in April 2016, he discussed a plan to enlarge the size of the Public Investment Fund (PIF), a Saudi sovereign wealth fund (SWF).

Then, on April 25, 2016, under the leadership of Deputy Crown Prince Mohammad, the Saudi cabinet approved Saudi Vision 2030, which maps out the economic reform program up to 2030. Vision 2030 lists a broad range of objectives, including, among others, the increase in the size of assets of the PIF from 600 billion Saudi riyals (SR; US\$160 billion) to SR7 trillion (US\$1.86 trillion), the raising of the ratio of the private sector to GDP from 40% to 65%, the increase in annual non-oil revenues from SR163 billion (US\$43.4 billion) to SR1 trillion (US\$267 billion), and the reduction in the unemployment rate from 11.6% to 7%, all by 2030.

The key pillars of the Vision 2030 are Saudi Aramco's IPO and the expansion of the asset size of the PIF. Saudi Arabia plans to list up to 5% of its equity shares on the Saudi stock market in 2017-2018. Saudi Aramco is a "public corporation" with one of the world's largest asset values, bestowed with 266.5 billion barrels of crude oil reserves. Even with the floating of only 5% of the company's outstanding shares, Saudi Aramco's

IPO is going to have no small impact on the stock market. The remaining 95% of shares not offered to the public are set to be transferred to the PIF, which is estimated to bring the size of the fund's assets to approximately US\$2 trillion. Saudi Arabia is thinking of using the PIF to secure income from investments and diversify the kingdom's industries.

Another pillar of Vision 2030 is the promotion of non-oil industries and the expansion of employment opportunities. As non-oil industries that can be expected to contribute to increasing GDP and expanding employment opportunities, Deputy Crown Prince Mohammad is deeply interested in tourism and the development of mineral resources. As for tourism, the plan is to increase the number of Muslims making lesser pilgrimage, or Umrah, to Makkah or Mecca, from 8 million at present to 30 million by 2030. With regard to the development of mineral resources, the plan calls for the development of bauxite, phosphorus, gold, copper and uranium and the creation of 90,000 jobs by 2020.

Going forward, in order to push forward with Vision 2030, which aims for the diversification of the kingdom's industries and an expansion of employment opportunities, Saudi Arabia will clarify the roles and responsibilities of respective government organizations and then formulate the National Transformation Program 2020 (NTP).

3-4 Kuwait

3-4-1 Political and Social Situation in Kuwait

Kuwait is a monarchy ruled by the House of Sabah, and the current emir is Sheikh Sabah. Sheikh Sabah and Crown Prince Sheikh Nawaf are both elderly, at 87 years old and 79 years old respectively. However, there has been no mention of any serious health problems experienced by the two thus far. Alongside Crown Prince Nawaf, former Prime Minister Nasser Mohammed and former Deputy Prime Minister Ahmed Fahad have been cited as potential heirs.

Amid the rivalry between Saudi Arabia and Iran that further intensified in January 2016, the Shiite minority is coming under increasing pressure in Kuwait, where the relationship between Sunni and Shiite Muslims has traditionally not been very negative. On January 13, 2016, all the nine Shiite members of the National Assembly absented themselves from both the general and in-camera sessions in a gesture to protest the imprisonment or death sentences handed down by the Kuwaiti authorities against Shiite Muslims who had contacts with Iran. Saleh Ashour, one of the absentee members of the National Assembly, commented that he resented the fact that Shiite Muslims in Kuwait had been labeled as “agents of Iran and members of Hezbollah.”

Another Shiite member of the National Assembly, Abdul Hamid Dashti, appeared on a program of Ikhbariyah TV, a Syrian television station close to the Assad regime, on February 24, 2016, and said that Saudi Arabia was sponsoring terrorism and should be bombed. The Saudi ambassador to Kuwait reported his statements to the Kuwaiti Foreign Ministry, and the National Assembly on March 15 approved a request from the government to deprive Dashti of immunity privileges. The divide over Iran and the Shiite Muslims has now begun to appear on the political arena in Kuwait.

On the diplomatic front, collaboration with Saudi Arabia is increasing. Kuwait joined the Saudi-led coalition of the willing for the military intervention in Yemen since March 2015, and recalled its ambassador to Tehran when Saudi Arabia broke off diplomatic ties with Iran in January 2016. Furthermore, in March 2016, Kuwait sent its troops to join the Saudi Arabia-sponsored multilateral military exercises, dubbed “North Thunder,” and Kuwaiti television broadcast Emir Sabah attending a ceremony concluding the joint exercise conversing with Saudi King Salman. Since April 2016, Kuwait has hosted peace talks to end the Yemeni civil war, working toward a political settlement of the war as an exit strategy for the Saudi-led military intervention.

3-4-2 Measures to Deal with Extremism

Terrorist activities by “ISIS/ISIL of Najd Province,” which is based in Saudi Arabia, are spilling over into Kuwait. On June 26, 2015, a suicide bomber attacked the Shiite Imam Sadiq Mosque in Sawaber in central Kuwait, killing 27 people. ISIS/ISIL of Najd Province claimed responsibility for the attack targeted at the Friday prayers at the mosque. The bomber was identified as a Saudi, but it is believed that he had supporters in Kuwait. Cited as one of the reasons why the Saudi could enter Kuwait with ease was the insufficient sharing of information as the National Assembly of Kuwait opposed security cooperation with other GCC states. On May 30, 2016, the Supreme Court of Kuwait upheld a death sentence ordered against one of the accomplices in the attack.

On January 12, 2016, the Kuwait Criminal Court, which is responsible for making judgment on spying charges, sentenced 2 people (1 of them an Iranian) to death on charges of spying for Iran and Lebanon-based Hezbollah, 1 person to life imprisonment, and 22 others to 5 to 15 years in prison. Since the GCC and the Arab League designated Hezbollah as a terrorist organization in March, Kuwait has deported a number of people suspected of having links to Hezbollah.

3-4-3 Economic Impact of Falling Oil Prices

Falling crude oil prices have impacted the Kuwaiti economy in various ways as well. In January 2016, Kuwaiti Finance Minister and acting Oil Minister Anas Saleh stated that the government had no plans to impose an income tax on Kuwaiti citizens. In March 2016, Finance Minister Saleh also said the Kuwaiti cabinet approved the introduction of a 10% corporation tax. While he did not clarify when the new tax would be introduced, Kuwait is now expected to become the first Gulf state to introduce corporation tax. The finance minister also mentioned the privatization of state assets, including airports, sea ports and part of Kuwait Petroleum Corporation (KPC), permission for private citizens to own 50% of public-private sector joint ventures, reforms of the labor market and citizen service systems, and streamlining of the public sector for greater efficiency.

In March 2016, the Kuwaiti government began discussing ways to raise funds from the financial markets at home and abroad by placing government bonds with a group of fiscal advisers. The government has already asked domestic commercial banks to submit reports on how much they could purchase in government bonds and how much liquidity they had. In response, the Kuwaiti banks replied that they could lend \$10

billion to \$16.7 billion over the next three years.

The impact of falling oil prices is also casting a shadow over the state-run oil company's operations as well. In March 2016, KPC and its subsidiaries discussed ways to reduce costs in response to declining prices of crude oil. In response, the Oil and Petrochemical Industries Workers Confederation (OPIWC), representing trade unions at state-owned oil, gas and petrochemical companies of Kuwait, launched strikes on April 17 in protest against the government's planned review of salaries and allowances for workers in the public sector. The OPIWC suspended the strikes on April 20, after Finance Minister Saleh stated that the government will not negotiate with the workers as long as they continue the walkout.

The above are good examples of how the deterioration of public finances due to falling oil prices has brought on much severer conditions than anticipated for the Kuwaiti government, widely believed to have previously been in a comfortable position with strong state finances.

3-5 United Arab Emirates (UAE)

3-5-1 Political and Social Situation in the UAE

In contrast to the unstable regional situation on the whole, the United Arab Emirates (UAE) has been benefitting from a relatively stable political and social situation. From 2015 through to early 2016, the UAE's political landscape has seen no significant change both at the federal and emirate levels. President Khalifa has not been seen in public at all since January 2014, due to health problems but there seems to be no concern about the stability of the UAE leadership, with a framework of cooperation firmly established between Crown Prince Mohammed bin Zayed of the Emirate of Abu Dhabi and Prime Minister Mohammed bin Rashid of the Emirate of Dubai. The two meet regularly, and Crown Prince Mohammed of Abu Dhabi, who does not have any political post in the federal government, is effectively involved in the running of the state.

In terms of major recent developments at the federal government level, a large-scale reorganization of government ministries and agencies and a reshuffle of the cabinet were carried out in February 2016. The Ministry of Foreign Affairs and the Ministry of Education were consolidated with other relevant ministries or agencies, while new posts, such as minister of state for tolerance, minister of state for happiness and minister of state for youth affairs, were created. The post of minister of state for youth affairs went to a 22-year-old Emirati woman, drawing keen attention both at home and abroad. However, continued close monitoring may be warranted about what specific roles and responsibilities those in the newly created posts will perform.

In October 2015, the third election of the Federal National Council was held. Compared with the previous election in 2011, the number of eligible voters who can exercise their voting rights rose by some 100,000 to 224,279. However, little enthusiasm was observed in the election campaigning, with the voter turnout staying low at 35.29%, though higher than the previous election. In the latest election, a total of 20 new members were elected, including one woman, with the two incumbents reelected across the nation. In the Emirate of Sharjah, the first-ever election of the consultative assembly was held in January 2016. In the first election at the individual emirate level, a total of 21 members were returned. However, both elections represent anything but "democratization," because neither of the councils is granted any specific political powers, such as the power of legislation. The UAE government hopes to foster a sense of participation in politics and a sense of belonging to the state among the public

through elections. On the other hand, the government may also hold some misgivings that the higher level of political awareness could help destabilize the status quo, such as a possible challenge to the monarchy.

In contrast to the stable political management, the year 2015 was marked by major social commotion in the UAE. The UAE has been participating in the military intervention in Yemen by the Arab coalition forces since March 2015. Initially, the UAE's participation was limited to air strikes, but its involvement continued to deepen over time, and around July 2015, the UEA started sending its ground troops to Yemen. Since the dispatching of the ground troops, a growing number of soldiers of the UAE forces have been killed in action. The number of soldiers killed in the line of duty has now reached nearly 80. In the face of casualties never before seen in the history of the UAE, the members of the family of the Emir, government officials and military officers made successive visits to express their condolences to the bereaved families. The government designated November 30 as "Martyrs' Day" in a bid to inspire the public with patriotism and boost the people's allegiance to the state and the establishment. The government has yet to become the target of direct criticism for the war casualties. If the number of soldiers killed in action increases further, however, government officials may come to face a torrent of public criticism. Given such a possibility, developments in the Yemeni situation going forward could have a major impact on the political stability of the UAE.

3-5-2 Measures to Deal with Extremism

The UAE is generally believed to be one of the countries with the least security risk in the Middle East. Based on the Global Terrorism Index, announced by the Institute for Economics and Peace in November 2015, the UAE is assigned the terrorism index of 1.045 points, or the "lowest impact of terrorism," ranking 101th among the 162 countries worldwide. It is thus evaluated as a country with a low risk of terrorism. While the UAE's terrorism index is higher than Kuwait (0.019 points/123rd), Oman (0 points/124th) and Qatar (0 points/124th), all of which are fellow members of the GCC, it is much lower than Saudi Arabia (4.006 points/43rd) and Bahrain (4.871 points/31st). While Kuwait and Saudi Arabia suffered suicide bombing attacks by ISIS/ISIL in 2015, the UAE has so far not seen similar terrorist incidents affecting large numbers of ordinary citizens.

While no actual terrorist attacks have yet occurred in the UAE, the number of arrests

has been on the increase in recent years. The UAE has tightened security measures in the wake of the Arab Spring. In particular, the UAE has arrested a significant number of members of “al-Islah,” the UAE-based Islamist group affiliated with the Muslim Brotherhood, with over 100 put on trial so far. While not confirmed independently, the prosecution alleged in court that the suspects have provided funds to the Muslim Brotherhood overseas or plotted to topple the regime. The UAE has repeatedly enacted counterterrorism and other relevant laws since 2014, and also designated over 80 groups and organizations, including the Muslim Brotherhood, the Houthis and Hezbollah, as terrorist organizations. The UAE is also cracking down on those who join or support organizations recognized as terrorist organizations or disseminate their ideologies.

Among the security-related trials held in the UAE in 2015, the trial of those associated with Shabab al-Manara drew much attention. A total of 41 members of the group, based at al-Manara Mosque in Dubai, were reportedly operating in the UAE. They were allegedly plotting to establish a “caliphate” as embraced by *Islamic State*. The focus of attention was on the fact that of the arrested suspects, as many as 39 were nationals of the UAE. In other security-related trials, a large number of cases involved Emiratis, who allegedly tried to join al-Qaeda and other terrorist organizations or provided monetary support to them. Thus, it is natural to assume that the UAE, just as Saudi Arabia and other GCC states, is faced with the potential threat of its own people participating in terrorist organizations to undertake terrorist activities as “returned soldiers” within the UAE.

The UAE also faces problems of foreigners living in the UAE attempting terrorist attacks or joining terrorist organizations. Foreigners account for 90% of the UAE’s total population, with many working in the UAE or taking in the sights. However, there are also foreigners who have recruited people to join ISIS/ISIL or disseminated terrorist ideologies online. Recently, Lebanese men were arrested for having established and managed a branch of Hezbollah, the Lebanon-based Shiite armed group, in the UAE.

As discussed above, even the UAE, generally believed to be a safe country, is not completely free of the risk of terrorism. It should also be pointed out that the UAE’s situation is closely linked to developments in its neighboring countries.

3-5-3 Economic Impact of Falling Oil Prices

The slump in crude oil prices since 2014 has been affecting the UAE, a major oil

producer, as well. In particular, the UAE's federal finances fell into deficit in 2015. The UAE economy has continued to grow, propped up by government spending. According to the forecast of the Economic Intelligence Unit, the UAE's GDP growth rate, which stood at 3.3% in 2015, will slow down somewhat to 2.1% in 2016.

In the recent economic situation, much attention is being focused on fiscal issues. The federal government budget for 2016 is expected to be balanced, with both revenues and expenditures decreasing 1.1% from fiscal 2015 to 48.5 billion dirham. Looking at the breakdown of expenditures, education accounts for 21.2%, social development 15.5%, public services 11.1% and healthcare 7.9%. Military spending was not disclosed, however. The federal budget is formulated mainly based on contributions from the UAE member emirates and administrative service fees. The Emirate of Abu Dhabi bears the bulk of the contributions, while it is also believed to be effectively covering all military and security-related costs. The Abu Dhabi government does not make public its own fiscal conditions but it has reportedly begun digging into the overseas assets under the management of a sovereign wealth fund, an indication that the emirate is also being adversely affected by the slumping oil prices.

Faced with the deteriorating finances in the wake of oil price falls, the UAE was the first to move to restructure government subsidies among the GCC member states. Abu Dhabi raised power and water rates for its citizens, abolished gasoline subsidies in August 2015, and introduced a mechanism to link gasoline prices to crude oil prices on the international markets. At the moment, there are no signs of social unrest growing, as domestic gasoline prices are not being lifted as high as initially estimated because of lower crude oil prices.

3-6 Qatar

3-6-1 Political and Social Situation in Qatar

The political situation of Qatar has been stable from 2015 through the spring of 2016. Emir Tamim bin Hamad is now in his third year of power since taking over government in June 2013. The Qatari government has been undergoing a generational transition since the years under the rule of former Emir Hamad. In 2014, Abdullah bin Hamad, Emir Tamim's half-brother by a different mother, became deputy emir, and in the spring of 2016, Mohammed bin Abdulrahman, 35, of the emir family, was appointed as foreign minister. Another noteworthy appointment came in March 2016, when Hind bint Hamad Al Thani, the daughter of former Emir Hamad, was named as the new chief executive officer of the Qatar Foundation, which leads the country's education and research sectors.

Major recent developments in Qatar's political arena were the cabinet reshuffle and the reorganization of government ministries and agencies carried out in January 2016. In the cabinet reshuffle, Foreign Minister Khalid Attiyah was appointed as minister of state for defense, leaving the foreign affairs portfolio to another person. In the government reorganization for elimination and consolidation of administrative functions, the City Planning Ministry, Environment Ministry, Administrative Development Ministry, and Labor Ministry were consolidated to form the Ministry of Administrative Development, Labor and Social Affairs. The Ministry of Culture and the Ministry of Sports were merged to form the Ministry of Culture and Sports, while the Transport Ministry and the Communications Ministry were integrated to form the Ministry of Transport and Communications.

In May 2015, the election of the Central Municipal Council, the local assembly, was held. A total of 118 candidates, including 5 female candidates, came forward, with the winners of 3 seats out of the total of 29 determined without contest. On May 13, the voting and ballot counting day, of 21,735 registered eligible voters, 14,670, or 69.8% of the total, cast their votes in the 26 election districts. Only 2 female candidates were successful. Regarding the Shura Council, or Majlis al-Shura, which is equivalent to the national assembly, no firm timetable has been set for its election.

Regarding the social situation in Qatar, conservative social policies have prevailed since Emir Tamim came to power. For example, Emir Tamim tightened the mandatory closing of cafes, restaurants and supermarkets at the time of Friday prayers in April

2015. Furthermore, the Shura Council is now debating a bill to restrict visits to large shopping malls by foreign male workers on Fridays on the pretext of the protection of shoppers coming with family members. Emir Tamim is said to be more conservative religiously than former Emir Hamad. A slowdown in the country's once rapid economic development and social change may be in the offing.

Another noteworthy point is the issue of foreign workers. For the hosting of the FIFA World Cup in 2022, Qatar is pushing ahead with the development of domestic infrastructure, including stadiums and railways, accepting a large number of construction workers from foreign countries for this purpose. Because of this, the total population of Qatar reached 2,421,055 as of the end of December 2015, an increase of about 46,000 over the level of May 2015. In the wake of criticisms of how Qatar is treating these foreign workers by international human rights groups and the foreign media, the Qatari government is striving to improve the employment conditions for them by revising labor laws and stepping up work site inspections.

3-6-2 Measures to Deal with Extremism

Qatar is one of the safest countries among the GCC states, and at the moment, no terrorist attacks by *Islamic State* or other terrorist organizations have taken place in the country. In the context of the Global Terrorism Index cited earlier, Qatar ranked 124th, or the country faced with the least threat of terrorism in the world.

However, the Qatari security authorities are paying greater attention to the domestic security situation in light of the increasingly unstable conditions in neighboring countries. At the time of the Arab Spring in 2011, a poet was arrested and drew a sentence of life imprisonment for releasing a poem interpreted as denouncing the Emir (the sentence was commuted later). In August 2015, the U.S. Treasury Department blacklisted two Qataris for financing terrorists. These men are suspected of supporting the al-Nusra Front, an al-Qaeda affiliate in Syria, and other extremists. In fact, Qatar has been the subject of international criticism for providing strategic financial support to organizations opposing the Assad government of Syria and *Islamic State* in coordination with Saudi Arabia and Kuwait. Aside from this, Qatar is mounting efforts to detect espionage operations within the country and has also introduced security-tightening measures ahead of the 2022 FIFA World Cup. Under these circumstances, the security situation in Qatar is likely to remain stable for the time being.

Amid the continued instability of the Middle East since 2011, developments in

Yemen and Syria and *Islamic State* are having particularly large impacts in the region. Since March 2015, Qatar has been participating in the operations against the Houthis in Yemen as a member of the Saudi-led coalition of the willing. In September 2015, Qatar sent some 1,000 ground troops to Yemen, broadening its involvement in the Yemeni civil war. In February 2016, the Qatari government also indicated a plan to send its ground troops into Syria, another sign of its willingness to participate in the “countermeasures against extremists” in the region.

3-6-3 Economic Impact of Falling Oil Prices

The crude oil and natural gas exploration and production sector accounts for 51% of Qatar’s GDP, and the country depends on oil and natural gas revenues for 39% of its state finances. As a surplus in oil and natural gas revenues also serves as the key funding source for Qatar’s national wealth fund, the slump in oil prices since 2015 has adversely affected the Qatari economy significantly.

Delivering a speech at an opening ceremony of the 44th Shura Council in November 2015, Emir Tamim made it clear that in spite of the falling oil prices, the Qatari government will continue to push ahead with its infrastructure development program and human resources development. However, he said the government will cut back on the government budget for fiscal 2016 in order to avoid a fiscal deficit stemming from further falls in crude oil prices. Furthermore, Emir Tamim said Qatar should seize this opportunity to enforce reform to get rid of waste, and urged politicians and people to share a sense of crisis over the country’s fiscal conditions, saying that “the government can no longer give everything (to the people).” These statements coming from the emir are rather unusual and serve as a strong indication of the government’s sense of crisis over the current economic conditions. The government budget plan for fiscal 2016, announced at the end of 2015, anticipates the first fiscal deficit in 15 years.

The fiscal constraints stemming from sluggish oil prices are also producing noticeable impacts on the government’s domestic operations. The Qatar Foundation, which has been the driving force of the country’s research and education, had its budget slashed by 40%, and satellite television broadcaster Al Jazeera laid off some 500 employees. The Qatari government is set to prioritize the implementation of projects that are currently being formulated, and while the development of infrastructure for the FIFA World Cup will probably be spared from any immediate impact, other infrastructure development and governmental projects will certainly be affected.

With its fiscal difficulties becoming more obvious, the Qatari government is beginning to reform its subsidies. In January 2016, domestic prices of gasoline and diesel fuel were lifted by 30%, and the government introduced a system to link these prices to crude oil prices on the international markets in April. The government is also considering the introduction of a value-added tax (VAT) in 2018 in a bid to diversify fiscal resources through tax collections.

3-7 Oman

3-7-1 Political and Social Situation in Oman

The political situation in Oman has been stable in 2015-2016 without any significant variation.

The spotlight was focused on the health of King Qaboos, who stayed in Germany from the summer of 2014 through March 2015 for the purpose of “medical testing.” While some press reports speculated that the king is suffering from colon cancer, he is now back in Oman after completing his treatment. However, his appearance in the media has diminished after his return home, and he now seldom attends cabinet meetings. King Qaboos underwent treatment in Germany again between January and April 2016, and the issue of his health has now emerged as a concrete political issue.

The state of health of King Qaboos is an issue that is directly linked to the political stability of Oman. Firstly, as Oman does not have a crown prince, no vision of the “post-Qaboos” government has yet to be laid out. Presumably, the gears are already in motion for the nomination of a successor within the royal family behind closed doors. As the Basic Law of the Sultanate of Oman sets forth, however, who will be the next king will not be known until the will of King Qaboos is confirmed. Secondly, whoever becomes the next king will have to address the many difficult state management problems that Oman faces. In the wake of the Arab Spring of 2011, there erupted public outcries against corruption among bureaucrats and cabinet ministers as well as against unemployment and other socio-economic problems. At the time, King Qaboos took the initiative in dealing with those issues, but it was in no part due to his charismatic governance that the concerns were assuaged. However, it is highly questionable whether the candidate successor to King Qaboos can contain public discontent in the same way. Amid the sluggishness of crude oil prices, much fiscal support cannot be expected, either. Therefore, by way of foreseeing the post-Qaboos Oman situation, continued stability will probably depend on the manner in which the government will make concessions to political and economic demands from the public.

In 2015, the eighth election of the Shura Council was held, the first since 2011. A total of 590 candidates, including 20 women, vied for 85 seats across the country. The voting took place in October, with the voter turnout coming to 56.6%. The successful candidates included only 1 woman, and 70% of the winners were relatively young. The reform of Oman’s parliamentary system in 2011 has provided the Shura Council with

the power of legislation to a certain extent. The Shura Council has recently displayed a level of sensitivity to domestic socio-economic conditions, which serves as an indicator for gauging Oman's stability.

In Oman, the foreign population has increased significantly due in part to progressing domestic development projects. The total population of Oman stood at about 4.38 million as of March 2016, and foreigners accounted for 45% of the total. Given the ratio of foreigners of 29% in 2010, the latest ratio is a clear indicator of the sharp rises in the past five years. On the other side of the expanding population of foreigners, the problem of the employment of Omani people is becoming ever more serious and unemployment rates remain high. The Omani government is poised to promote anew the policy of helping more Omani people enter the work force, but declining oil prices have put the brakes on this initiative. The government under King Qaboos was able to handle the situation by doling out unemployment benefits, but the fiscal latitude needed for doing the same thing cannot be expected in the future.

3-7-2 Measures to Deal with Extremism

Oman is one of the safest and most secure countries in the Middle East, little threatened by the risk of terrorism by extremists.

Fighters from countries in the Middle East are joining *Islamic State* in large numbers, and it is estimated that over 5,000 fighters have joined the terrorist group from the Gulf countries as well. However, any participation from Oman has not been confirmed, perhaps indicative of the stability and soundness of Omani society. No law-enforcement action against terrorist groups has been reported in Oman.

However, the security authorities have remained alert since the Arab Spring to what is being reported in the domestic media and the behavior of perceived activists. Omani bloggers and human rights activists are frequently detained. Five people, including a well-known blogger, were arrested in 2015. In 2016, a former diplomat was arrested and imprisoned for *lese majeste* and profanity.

3-7-3 Economic Impact of Falling Oil Prices

Oman has strongly felt the impact of falling international oil prices since 2014. Oman is trying to cope with lower prices by increasing production of crude oil. However, the country's efforts to increase production have their limits, as Oman's crude

oil deposits are not that large to begin with and existing oilfields are aging. The sluggish oil prices are estimated to have caused the opportunity loss of some US\$14 billion to Oman during 2015.

Since the petroleum economics sector accounts for 35% of Oman's GDP, there is no doubt that stagnant oil prices are adversely affecting the domestic economy. In the oil and natural gas sector in particular, over 1,000 Omani workers have been dismissed or laid off since 2014. In October 2015, trade unions walked out with their demand for the avoidance of layoffs, presenting the first replay of the chaos since the Arab Spring of 2011. The government is intervening in companies or providing administrative guidance to prevent the dismissal of Omani workers, but no radical solution to the employment problem has been found yet.

Oman is one of the first advocates among the Gulf countries for the need to reduce subsidies from a relatively early stage. In particular, government subsidies to gasoline prices and water and electricity rates are considered to be one of the primary causes of the deterioration of state finances. In January 2016, domestic selling prices of gasoline were raised despite the continuing sluggishness of international market prices, and then in March, electricity and water rates for the government, commercial and industrial sectors were increased. It has not become fully clear what adverse impacts the subsidization cutbacks are having on the Omani economy and the livelihood of citizens. The Shura Council is discussing a plan to introduce a value-added tax in 2017, and calls for the introduction of an income tax on foreign workers are growing increasingly louder. Also included in the measures under consideration for the diversification of fiscal resources are revision to the income tax law, increases in royalties in the oil and natural gas sector and issuance of government bonds.

Oman's economic policy in the future depends on whether the successor to King Qaboos can exercise strong leadership on the two fronts of economic and fiscal reforms. In addition, a greater aptitude for economic matters is required for running the state. Particularly at a time when Vision 2040 and other economic programs are being prepared with a view to the post-Qaboos years, Qatar is under pressure to steadily conduct its economic management in accordance with these programs.

4. Impacts on Oil and Natural Gas Production Policies

4-1 Oil and Natural Gas Production Policies of the GCC

4-1-1 Saudi Arabia

In Saudi Arabia, Oil Minister Ali al-Naimi, who had served in the post for 20 years or more, was dismissed in May 2016, and Health Minister Khalid al-Falih was appointed as his successor. The Ministry of Petroleum and Mineral Resources was reorganized into the Ministry of Energy, Industry and Mineral Resources, with jurisdiction over electric power and mining added. Energy Minister Falih, upon assuming office, stated that Saudi Arabia would continue to meet global demand for crude oil and maintain stable oil policies in coordination with global oil-consuming countries. Energy Minister Falih said that Saudi Arabia would maintain its role on the international energy market and establish its position as the most trustworthy supplier of energy in the world.

According to IEA's Monthly Oil Market Report, Saudi Arabia's crude oil production capacity reached 12.20 million b/d as of March 2016. The average production in January-December 2015 came to 10.13 million b/d (excluding production of natural gas liquids (NGL)).

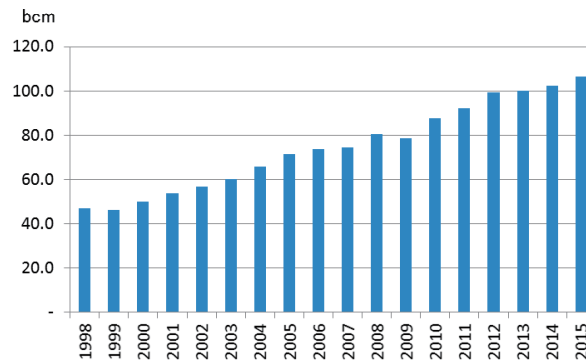
Figure 6: Crude Oil Production



Source: BP, "Statistical Review of World Energy 2016"

Production of natural gas, meanwhile, has been growing gradually in recent years, expanding from 78.5 billion cubic meters (bcm) in 2009 to 106.4 bcm in 2015. Domestic consumption of natural gas has also been on the increase.

Figure 7: Natural Gas Production



Source: *BP*, “Statistical Review of World Energy 2016”

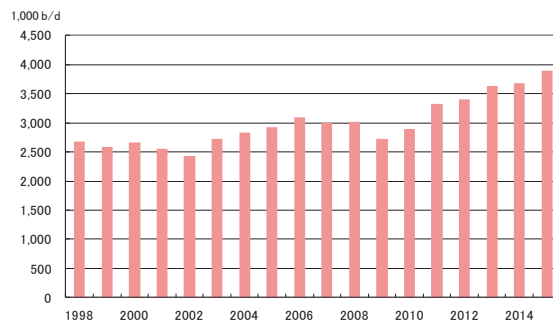
Saudi Aramco regards natural gas as the “essential material for diversified industries,” and as such, the core of the Saudi Vision 2030. In March 2016, Aramco CEO and President Amin Nasser stated that Saudi Arabia would produce no less than 12 million cf/d of natural gas and that the number would increase further once the Wasit natural gas processing plant comes online. Saudi Arabia plans to provide “70% or more of fuel mix to utilities” with natural gas.

4-1-2 UAE

According to the Oil Market Report of the International Energy Agency (IEA), the UAE’s crude oil production capacity stands at 2.93 million b/d as of May 2016. The average production during January-December 2015 came to 2.66 million b/d. Seeking an expansion of crude oil output, the UAE is aiming for a production capacity of 3.50 million b/d by 2017. Previously, the attainment of the production target was expected to be delayed due to the postponement of projects and the shortage of engineers. However, on January 12, 2015, UAE Energy Minister Suhail Mohammed al-Mazroui made it clear that “the UAE government will expand the production capacity of natural gas and will also have the crude oil production capacity of 3.50 million b/d by 2017.”¹⁰ However his statements were intended more to send the message that the UAE would not change the targets even against the backdrop of falling crude oil prices. Some say that the attainment of the targets will actually take at least until around 2020. Abu Dhabi National Oil Company (ADNOC) is reportedly planning to cut the payroll by up to 5,000 in the wake of falling crude oil prices. A negative impact on upstream investment is also feared.

¹⁰ *Gulf News*, 2015.01.12

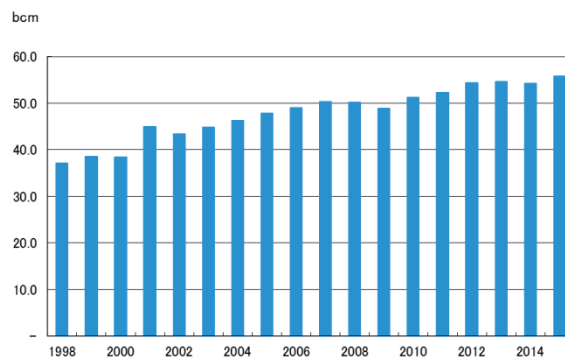
Figure 8: Crude Oil Production



Source: *BP*, “Statistical Review of World Energy 2016”

Production of natural gas, meanwhile, has been growing gradually in recent years, expanding from 48.8 bcm in 2009 to 55.8 bcm in 2015. The bulk of liquefied natural gas (LNG) is exported to Japan. Consumption of natural gas within the UAE is also increasing. In particular, natural gas for power generation is in short supply, and the UAE is importing natural gas from Qatar via the Dolphin Pipeline. At present, the UAE is a net importer of natural gas, with imports of natural gas exceeding its exports.

Figure 9: Natural Gas Production



Source: *BP*, “Statistical Review of World Energy 2016”

Crude oil production in the UAE is largely concentrated in Abu Dhabi. Most crude oil resources in Abu Dhabi are being developed by Abu Dhabi Company for Onshore Oil Operations (ADCO), Abu Dhabi Marine Operating Company (ADMA-OPCO) and Zakum Development Company (ZADCO), responsible for the development and production of onshore and offshore oilfields under the aegis of ADNOC. ADNOC holds an equity share of 60% in these three subsidiaries, with the remaining 40% owned by foreign companies.

As for natural gas, the Shah sour gas project in Abu Dhabi is approaching the completion phase. ADNOC President Abdullah Nasser al-Suwaidi said that “production will start at 100 million cubic feet per day (cf/d), but reach 600 million cf/d by the end of 2015.”¹¹

Royal/Dutch (RD) Shell withdrew from the Bab sour gas project in Abu Dhabi, citing technical problems and high costs. It has been a high-cost project from the start, but the declines in the international prices of crude oil and natural gas proved to be a major minus. The delay in the development project came as a blow to the UAE at a time when demand for natural gas is growing.

4-1-3 Qatar

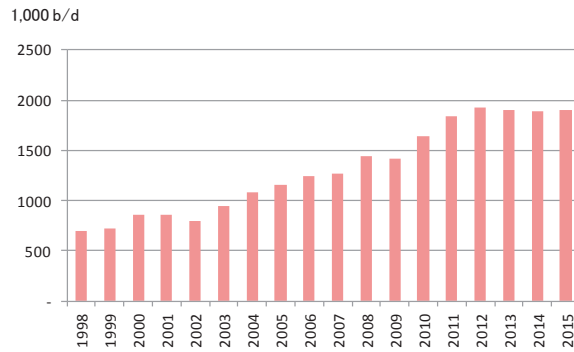
Looking at the composition rate of exports of oil (including oil products) and natural gas, the ratio of oil has been declining every year while the ratio of natural gas has been rising.

According to BP Statistics, production of crude oil (including condensate) has been on the increase, coming to 1.898 million b/d in 2015. Output of by-products associated with production of natural gas is contributing to the higher production of crude oil.

As for the outlook for crude oil production (including condensate) going forward, the IEA in its medium-term outlook estimates that Qatar’s production will likely move sideways at around 750,000 b/d between 2014 and 2019.

¹¹ “Shah sour gas project begins operation,” *Khaleej Times*, 2015.01.14

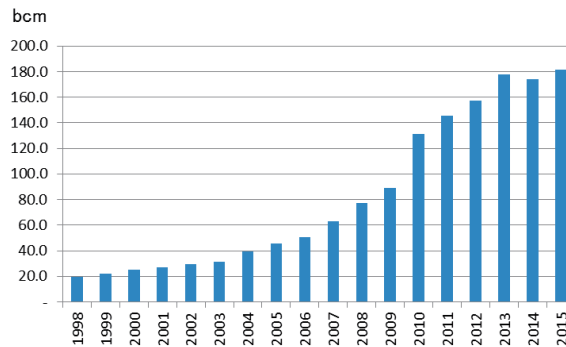
Figure 10: Crude Oil Production



Source: BP, “Statistical Review of World Energy 2016”

Production of natural gas has been on the increase, growing by an annual rate of 14.1% between 2000 and 2015. Natural gas production in 2015 rose 4.2% year on year to 181.4 bcm.¹² Qatar has the world’s third largest natural gas reserves, and the reserve-production ratio tops 150 years. Furthermore, while domestic production of natural gas is growing in tandem with increasing power demand in Qatar, exports of natural gas is also expanding. Of LNG export destinations, Asia accounts for about 70%, with the remainder destined for Europe. Qatar has been the world’s largest LNG exporter since 2006. Qatar is also a natural gas supplier in the region, exporting natural gas to the UAE, its neighbor, and Oman through the Dolphin pipeline.

Figure 11: Natural Gas Production



Source: BP “Statistical Review of World Energy 2016”

In Qatar, Qatar Petroleum (QP) controls the entire oil and natural gas operations, from upstream to downstream. With respect to the exploration and development of oilfields, the operations of QP center on the redevelopment of existing oilfields and the introduction of the enhanced oil recovery (EOR) method. QP has not discovered any

¹² BP, *Statistical Review of World Energy 2016*

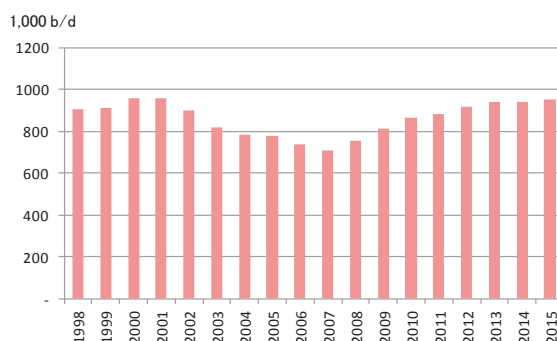
new large-scale oilfields since the discovery of the al-Rayyan oilfield in 1994. This trend is likely to continue for some time to come.

Regarding the development of natural gas fields, meanwhile, the North Field remains subject to the “moratorium” since 2005, and QP sticks to this policy. For this reason, no new development projects in the North Field are on the table. With prices of natural gas flagging, the moratorium is likely to be maintained.

4-1-4 Oman

Oman’s crude oil production, according to BP Statistics, peaked out at 959,000 b/d in 2001 and continued dwindling to fall to 710,000 b/d in 2007. However, production started recovering due to the proactive application of the EOR method to existing oilfields, and reached 952,000 b/d in 2015.

Figure 12: Crude Oil Production



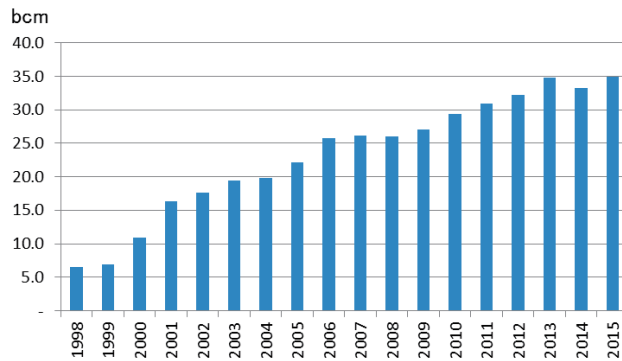
Source: BP “Statistical Review of World Energy 2016”

Production of natural gas in Oman has been on the steady increase, rising by an annual rate of 8.1% between 2000 and 2015. Since 2013, however, production remained stagnant, dropping from 34.8 bcm in 2013 to 33.3 bcm in 2014. However, production took a turn upwards again in 2015, rising 4.8% year on year to 34.9 bcm.¹³

Domestic consumption of natural gas has been growing, driven by domestic demand for power and natural gas demand for the EOR method in crude oil output. Natural gas imports from Qatar via the Dolphin pipeline have reached 200 million cf/d, or approximately 2 bcm.

¹³ BP, *Statistical Review of World Energy 2016*

Figure 13: Natural Gas Production



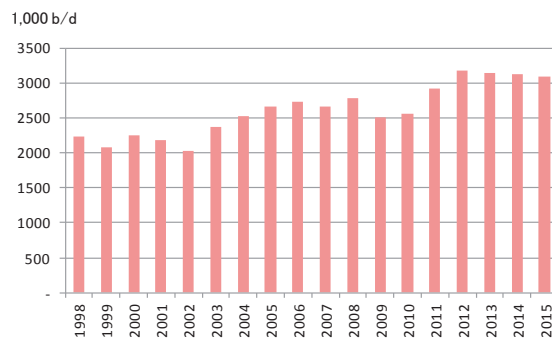
Source: *BP* “Statistical Review of World Energy 2016”

Oman is also considering imports of natural gas from Iran via the undersea pipeline. In August 2013, Oman concluded a memorandum of understanding with Iran on imports of natural gas through the undersea pipeline. According to Iranian officials, the supply of natural gas was to begin within two years under a 25-year contract. However, Oman appeared to be skeptical about this schedule from the beginning. This project fell apart in 2009 over differences on prices. The candidate site for the landing point of the pipeline on the Omani site is Sohar, a major city in the north.

4-1-5 Kuwait

BP Statistics show that Kuwait’s production of crude oil has been stagnant in recent years after peaking out at 3.171 million b/d in 2012 and declined to 3.096 million b/d in 2015.

Figure 14: Crude Oil Production

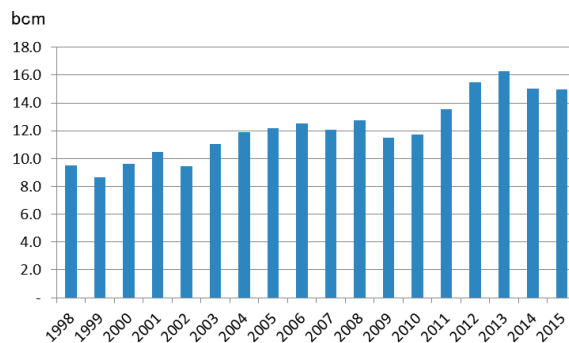


Source: *BP* “Statistical Review of World Energy 2016”

While production of natural gas has been on the rise, output growth has remained lackluster with an annual rate of 3.0% between 2000 and 2015. Since 2014 in particular,

natural gas production slackened from 16.3 bcm in 2013 to 15.0 bcm in both 2013 and 2015. In order to accommodate the increasing domestic consumption of natural gas, Kuwait is importing LNG from Qatar and other suppliers.

Figure 15: Natural Gas Production



Source: BP “Statistical Review of World Energy 2016”

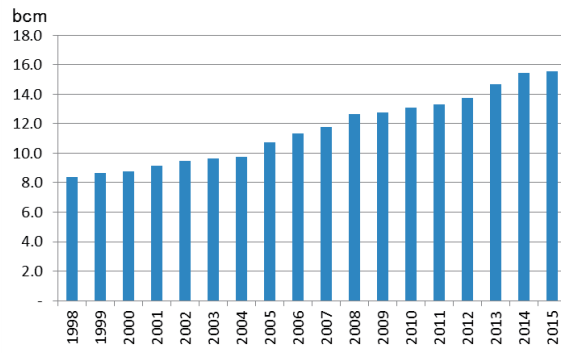
4-1-6 Bahrain

The first oilfield in Bahrain, al-Awali (renamed as Bahrain in 2005), was discovered in 1931. Another oilfield the country has is the Abu Safah oilfield located on the border with Saudi Arabia. Production at the Bahrain oilfield is set to be increased with the use of the EOR method. An aggregate amount of investment in projects to dig a total of 3,600 newly developed oil wells over the next 20 years is estimated at \$15 billion.

Production started at the Abu Safah oilfield in 1963. In 1985, Saudi Arabia and Bahrain reached a 50:50 production sharing agreement. When the oilfield’s production capacity was expanded to 300,000 b/d in 2004, Saudi Arabia suspended the charge-free provision of crude oil and allowed Bahrain to take over its 50% portion, or 150,000 b/d. This portion of crude oil is being marketed by Bahrain Petroleum Co. Partly because the Abu Safah oilfield is located in northern Bahrain, or off Ras Tanura of Saudi Arabia, it is exported from the Saudi crude oil terminal of Ras Tanura.

While production of natural gas has been growing, the increase has remained lackluster with an annual rate of 3.8% between 2000 and 2015. Bahrain’s production of natural gas trails far behind that of the other GCC countries, standing only at 15.5 bcm in 2015.

Figure 16: Natural Gas Production



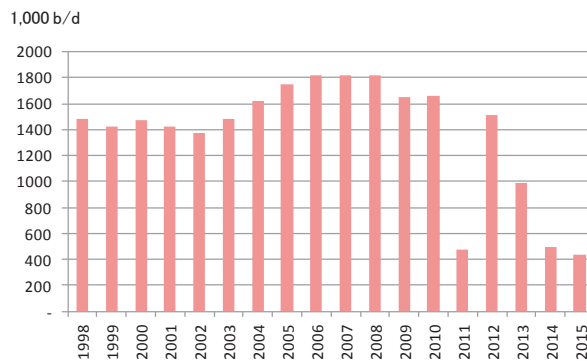
Source: *BP* “Statistical Review of World Energy 2016”

4-2 Estimate of Damage to Libyan Oil Facilities by Extremist Attacks

4-2-1 Crude Oil Production

According to the June 14, 2016, issue of the Oil Market Report of the IEA, as of May 2016, Libya’s production of crude oil has dwindled to 270,000 b/d. The country’s sustainable crude oil production capacity is estimated at 400,000 b/d, about a quarter of the highest level on record. Average production in January-December 2015 was 400,00 b/d. Based on BP Statistics, Libya’s crude oil production in 2015 stood at 432,000 b/d.

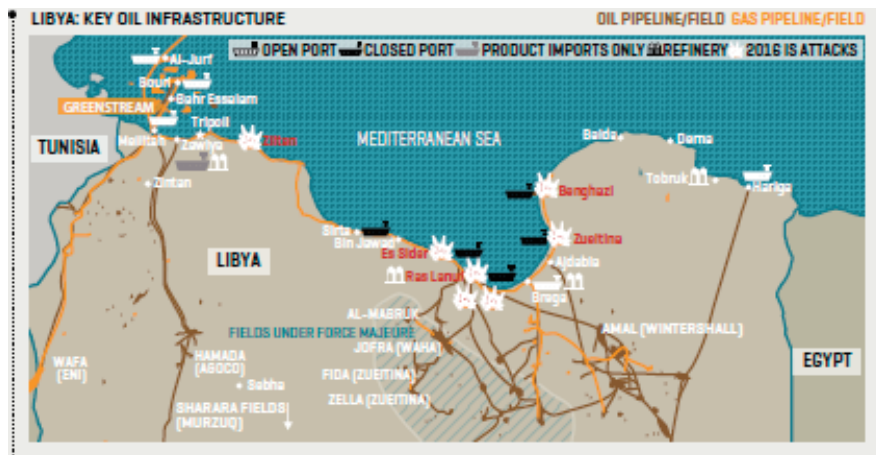
Figure 17: Crude Oil Production



Source: BP “Statistical Review of World Energy 2016”

While the damage done to the country’s oilfields and pipelines is estimated to be minimal, the shutdown of oil-exporting bases, as discussed later, rendered shipments impossible, decreasing recent output to just over 200,000 b/d. Libya’s crude oil production fell dramatically in May 2016, due to the shutdown of the Hariga export terminal near Tobruk.

Figure 18: Oil Infrastructure Facilities of Libya



Source: MEES, 2016.03.04

4-2-2 Attacks on Oil Facilities

On October 1, 2015, ISIS/ISIL fighters approached the gate of the Sidra oil export base (though its operation was suspended) and made an attack, but they were repulsed by the Petroleum Facilities Guard (PFG).

On January 4, 2016, ISIS/ISIL launched attacks against the Sidra oil export base and the Ras Lanuf oil export base, also using the suicide car bombing tactic. Fierce fighting with the PFG continued until ISIS/ISIL withdrew from the battlefield on January 6. Five oil tanks were destroyed by fire at the Sidra oil export base, as well as four oil tanks at the Ras Lanuf oil export base.

In addition, the Ras Lanuf oil export base was attacked with missiles and shells by IS from the small hours of January 21, and seven out of the 13 storage tanks were damaged. A spokesman for the National Oil Corporation of Libya said approximately 3 million barrels of crude oil was lost. After the attacks on the export base, the country's crude oil production fell to 362,000 b/d.

On February 18, IS attacked the Fida oilfield located to the southeast of Sirte, with two tanks with a storage capacity of 20,000 barrels set on fire. The Fida oilfield belongs to Zueitina Oil, which, just one week before, issued a statement boasting that its oilfields or pipelines had never been attacked before.

A spokesman for the National Oil Corporation of Lybia said on March 16 that production was lowered at the Sarir oilfield and the Mesla oilfield in the Sirte sedimentary basin, both operated by Arabian Gulf Oil Company, a subsidiary, due to the power supply shortage. The suspension of operation at the Sarir thermal power plant, some 80 kilometers from the Sarir oilfield, the target of a suicide car bomb attack by IS on March 14, appears to be the direct cause of oil production cutbacks.

The impacts of ISIS/ISIL attacks against oil facilities in Libya have been delivering a damaging blow to the country's oil industry without fail.

5. Conclusions

When considering the state of the Middle East from the perspective of energy security in the Asia-Pacific region, the factor most worth monitoring is the increasing instability of individual oil- and natural gas-producing countries as well as the Middle East region as a whole. From this viewpoint, it can probably be said that the leeway for *Islamic State* to expand its territories from Syria and Iraq at present beyond the borders of these two countries is considerably limited in light of the responses of the international community, countries participating in the coalition of the willing and other individual countries. On the other hand, the possibility of terrorist organizations on the extended lines of ISIS/ISIL and its extremist ideology constituting a direct or indirect threat to the energy supply structure in areas, countries or regions without any geographical link with *Islamic State* cannot be entirely ruled out. Rather, proactive attention must be paid to the propagation and chain of events of this kind.

Above all, the relentless repression of heretics and minorities by ISIS/ISIL and the logic that justifies it are spreading with the passage of time, and its hostile views about Shiite Muslims in particular are widespread in the Middle East. The attacks against Shiite Muslims appear to be spurred also by the political confrontation between the Arab world and Iran, with an amplification of mutual distrust and animosity observed. As these challenges are bound to disrupt the current order of the region and the international community, this is a point that relevant countries must not neglect to consider in taking measures against ISIS/ISIL. In order to curb the outbreak of further civil war, the indiscriminate attribution of the strategic confrontation between Saudi Arabia and Iran as a sectarian issue must be avoided.

As noted previously, the probability of *Islamic State* having more direct control of the oilfields than in 2015 is not high. With the medium-degree concerns in Libya as an exception, the possibility of the spreading “branches” of ISIS/ISIL taking over major oilfields or natural gas fields is rather low. What instead deserves caution is the fact that the existence and activities of extremist terrorist organizations, spearheaded by ISIS/ISIL, are posing a threat to neighboring countries and spreading the seeds of instability.

The question is, therefore, where in the Middle East will a new crisis triggered by ISIS/ISIL occur? One country that can be said to require close monitoring is Bahrain, where Shiite residents form a majority of the population and social tensions are

widespread. Needless to say, clashes between Shiite residents and the Saudi authorities in Saudi Arabia's Eastern Province and the civil war in Yemen bear monitoring as well, but Bahrain surpasses other countries not only in terms of an outbreak in the country itself, but also in terms of the higher risk of sparking a chain reaction and spillovers to neighboring countries.

These geopolitical risks offer a bargaining tool in the international oil market. However, given the easing supply-demand relationship as of 2016, the leeway for geopolitical factors to function and the extent of their effects are being reduced and do not guarantee an early recovery of crude oil prices.

Even as oil prices currently hover around low levels in 2016, it is hard to see the OPEC oil producers cutting back on their production. This is because, despite low oil prices dealing a blow to the economy and government finances of all the oil-producing countries, the political confrontation among the OPEC member states is preventing them from seeking collaboration, and as a result, they have no choice but to maintain increased production that has already lifted their production to the highest levels on record in order to maximize immediate revenues. The need to take domestic security measures, including those against ISIS/ISIL, and the continuing military intervention in the civil wars of other countries are making it necessary to maintain revenues above a certain level. Therefore, the stagnation of prices on the grounds of the conventional oversupply of crude oil is likely to continue unchecked for the time being.

Over the very long term, ISIS/ISIL poses a risk of a different dimension. As the countries concerned are mounting operations to eradicate *Islamic State*, the People's Protection Units (YPG), the Kurdish resistance forces mounting an offensive in northern Syria, and the Syrian Democratic Forces (SDF), with the YPG at its core, are expanding the territories under their control and taking the oilfields in Syria away from *Islamic State*. These developments offer some similarity with the chain of events in which the Kurdish forces were establishing their autonomy in northern Iraq with the support of Western countries from the 1990s through the Iraq war, and can be viewed as the beginning of a process by which the Kurdish people may declare semi-independence or full independence from Syria in the future. It is worth pointing out again that Syria's oil production capacity and the quantity of resources held by Syria are limited and the above prospect per se is unlikely to have a strong impact on the market directly. From the perspective of geopolitical risk, the real problem would be if an event were to occur

in the Middle East that requires the re-demarcation of borders and the shock and strain caused by the breakup of a single Arab nation may spread to neighboring countries. That would certainly heighten the uncertainties over the supply of energy in Asia.