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Letter From The Editor

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Yours Sincerely,

George Hatziioannou
Editor

Middle East Turmoil Is Challenging Saudi Arabia

Strange if not weird times have arrived for the Kingdom of Saudi Arabia! One may presume that Riyadh is dictating world oil prices, pushing them down right now, formatting the Middle East's political agenda (including the spread of jihadists), and above all, becoming ever more powerful and almighty.

The fact is that the oil-rich monarchy is facing serious challenges, strengthened by regional instability and the risk of dissolution of state borders and established statehood models. The kingdom is becoming an involuntary hostage of its geography and current policies: it does not control its own borders, straits and channels, vital to oil deliveries. Suez, Hormuz and Bab al-Mandeb are not managed by the Saudis. Land frontiers are no longer secure and stable, still shaken by wars and conflicts echoing the collapse of the Ottoman Empire, resurgence of religious fanaticism producing jihadists, and post-traumatic syndrome of the regime-change fervor labeled Arab Spring. The regional borders are now similar to local treaties and alliances, all written on moving desert sand.

The main obsession of the House of Saud is stability of the monarchy and the preservation of dynasty, not of the Saudi state. Consensus among influential social groups and clans, the unifying concept of being the custodians of the Two Holy Mosques, two sacred cities, Mecca and Medina, and strict religious regulations form the basis of the regime. The pressure of the modern world, with the presence of foreign residents making up 90% of workforce, creates a system failure and tension between the sensible segment of society aware of the need of reforms and the tenets of Islamic puritanism. The situation is exacerbated by clashing interests within the Royal family made up of some 5,000 princes! At the same time, Riyadh is dependent on foreign countries for its security, and the most important protector, the US, still a strongman but losing weight and muscles in its risky power play in the Middle East.

The dizzying home-brewed cocktail should be tasted with a view to an explosive environment all around Saudi Arabia's borders. A couple of years ago the kingdom seemed to be in full control of regional politics, but now new actors are striking back and imposing their order of priorities linked to the Sunni-Shiite schism, tribal rivalry and Jihad agenda. A couple of years ago the kingdom was primarily challenged by Iran and its Shiite proxies. The traditional standoff was part and parcel of the political panorama in the Middle East and had its own dynamics. The Sunnite jihadists represented by some al-Qaeda followers and field commanders were questioning the supremacy of the Royal family but posed no real threat and were effectively contained by the Saudi police forces and law-enforcers.

Now things have changed dramatically. Saudi Arabia has two new zones of instability close to the borders. First, there is a vast and still spreading territory under control of the Islamic State (IS), a new kind of Muslim religious extremism. Following a rigid strict interpretation of the Quran, the IS' supporters seek to re-create a proto-State with the Islamic law (sharia) as a spiritual and legal foundation. Now the IS controls and administrates, using extreme violence too, a huge territory (they call it Caliphate), in Iraq and Syria inhabited mainly by Sunnite Arabs; the Islamists produce and sell oil generating stable income flows (see "IS's smuggled oil - where, how, why", EIRA, Volume 2, Issue 10, October 2014) and fight a somehow classic war, not limited to guerrilla warfare and sporadic terror attacks.

IS from the very start was organized, armed and financed by outside sponsors specifically for the purpose to combat the regime in Syria. Saudis were among those who generously contributed to the IS build-up providing finances, arms and political support. But now that the strongest Islamic component of anti-Assad heterogeneous front under the name IS is setting its own agenda, the temple tables are overturned.

The lands, now under the IS rule, were of particular interest for Riyadh for apparent reasons of complementing its oil reserves with natural gas, conspicuously absent in Saudi soil.

Gas fields and gas processing and transportation infrastructure are located in that part of Syria, and also in the Iraqi Anbar province, namely Akkas.

At present, Saudi Arabia is worrying for the impregnability of their border line with Iraq: 40,000 soldiers are reported to be on alert to secure it. Some accidental shelling (by Shiite forces?) of the Saudi territory occurred as a result of fighting in the neighbouring country. But the main threat for the kingdom is the coming back of the IS jihadists, Saudi nationals, who might use their battle expertise at home and attempt to practice what the Islamic radicals preach.

The Saudis have a negative experience: in the 1980's they helped the US in Afghanistan to finance and train mujahidins fighting the Soviet army, but eventually discovered tutors and trainees of these jihadists inside their own country and almost everywhere in the surrounding states. It should be noted that from the jihadist's point of view the House of Saud (and other Gulf dynasties) are illegitimate because the Royals are collaborating with the West. That consideration explains why religious and political officials in Saudi Arabia are attacking the jihadists, also from the Islamic doctrinal perspective and views them not only as a security threat.

The situation is aggravated for Riyadh by a worrisome development of the war in the region which is turning the Iranian rivals into the objectively strongest local opponent of the IS and, on top of all, into a partner for the US due to the strong anti-Shiite stance of the jihadists. That new configuration of powers in the region persuades Saudi Arabia to support the US air strikes against IS, sending out on sorties some Saudi military planes; it also makes Riyadh contain its political and ideological confrontation with Qatar for a while and to play out some limited *détente* with Iran. It is not a very comfortable position. It complicates the Saudi political games, including a sophisticated poker with and within the royal family. That's why Riyadh recently donated $100,000,000 to a UN counterterrorism center and Saudi Muslim clerics declared IS and al-Qaeda affiliates to be arch enemies of Islam. The kingdom is involved in an intricate maneuver: on the one hand, it wants to block the jihadist's expansion yet avoid 'unblocking' Iran in the region and at least slow down its rapprochement with the US.

The Sinai Peninsula is another dangerous spot for Riyadh. Geographically, it's a part of the Arab Peninsula and not of North Africa which is rather far from Mecca and Medina. After the ousting, with a little bit of Saudi assistance, of the Egyptian President with his legacy emanating from Muslim Brotherhood, Mohamed Mursi, and the situation keeps deteriorating. Saudi Arabia included the main local extremists' movement, Ansar Bait al-Maqdis, into the black list of terror organizations. The kingdom is nervous seeing jihadists from Syria and recently Yemen going there while the recent Israeli-Palestinian confrontation fueled the tension in the region even more. The cultural and economic links between Palestinian Hamas and the local Bedouin tribes, unhappy with Egyptians coming from the Nile valley looking for jobs, contributes to the forming of a very dangerous blend of explosive factors. Tension in the Sinai area is weakening the Egyptian President, Abdel Fattah al-Sisi, who is financially and politically supported by the Saudis in their anti-Brotherhood crusade.

Both developments, the rise of IS' and the Sinai knot, could be perceived as a political evolution of the Arab Spring follow-up unrest which is driving the process toward a redistribution of territories in the Middle East on an ethnic and confessional basis, threatening to wipe off the European-designed national borders fixed in 1916. It undermines Saudi Arabia's attempt to set rolling a regional conservative counterrevolution to offset the controversial outcome of the Arab Spring. The fight against IS strengthens Iran and his Shiite allies, while Saudi Arabia's influence in the Sunnite areas of Iraq and Syria is reduced. Any counteraction through the traditional tribal and clans-based mechanism is risky: the jihadists have infiltrated them. Simultaneously, the traditional Islamist terrorists are being atomized, turning into small, autonomous and hence uncontrolled factions and even sects.

As a result, Saudi Arabia finds itself in a strange if not awkward position, with no secure allies, with time-honored enemies acting in tune with them (Iran), with vague goals and undefined strategy. One element in this peculiar mix is contradicting another. What way out from that nightmare of a geopolitical fix would be found by the No. 1 global oil producer?

Tunisia: The Only One To Survive The Arab Spring

Tunisia, where first free parliamentary elections took place in late October, has no visible impact on the energy markets in the Mediterranean zone, yet the importance of the country is (and was) of a different nature. Under the firm grip of its first President, Habib Bourguiba, and his successor, Zine el-Abidine Ben Ali, it was a secular, secure and stable place, but it had a price: it existed only in the form of a dictatorship. The regime was keeping part of the population in a state of poverty, namely those who were living far from the tourist-crammed coast areas, with many college-graduated young people not able to find jobs, and religious movements targeted as terrorist entities which gradually left them with the only choice but to swing to the radical verge of Islam.

Tunisia was the first to stage the Arab Spring. So far, it seems this is the only country in the MENA region to survive that social and political experiment. The recent elections show what went wrong in other countries and why Tunisia is not following their dangerous path.

Let's have a look at the scene-setter. At the time Ben Ali was ousted the country had a large segment of secular, well-cultivated, and open-minded population. When the first post-revolutionary elections occurred (2011), the Islamic party Ennahda (Revival) won the majority, but with less than 40% of votes, it was not an overwhelming victory. The Islamists were obliged to form a governmental alliance with two other, non religion-oriented parties. Later, the "revivalists" met strong resistance and were not able to base the new Constitution on the sharia law, and failed to solve security and economic problems. The number of unemployed is still more than under Ben Ali's rule (15% against 13%). To aggravate the turbulent transitional period, the Islamic extremists went out of control. Two resonant killings of liberal political opponents (Chokri Belaïd and Mohamed Brahmi) happened. Tunisia is now sending to the 'jihad wars' in the neighborhood more fighters than other countries: the number of Tunisia-born jihadist is estimated to be 3,000. Tunisian Ennahda Islamists (some analysts call them "moderate") made many mistakes, most of them originating in poor knowledge of the Tunisian realities, since many of their leaders were locked up for decades in prison or spent years in exile. Ennahda faced strong protest movements and finally, in January 2014 preferred to give up power and pass it over to an interim Government. In anticipation of the October election, the Islamists tried to rebrand themselves, reshuffle their leadership and change slogans but, nevertheless, they lost and were removed from their previous high-ranking position.

The Islamists' relative decline was accompanied by a comeback of secular political forces, in some measure linked to the late regime. In 2012, a former Bourguiba's minister, now 87 years old Béji Caïd Essebsi, or BCE, founded a new party, Nidaa Tunes (Tunisia's Appeal). He reunited some key figures from the ousted regime, as well as leftists and trade union activists, and even disillusioned Islamists. This heterogeneous movement managed to federate a majority of non-Islamist Tunisians and came on top through the elections' democratic process. But the new party could not govern all alone and had to establish alliances with other political actors.

What will be the final configuration of power in the country will be revealed after the presidential elections due on 28 November. BCE is perceived as a favourite. Nevertheless, inside the Nidaa Tunes there are early signs of "emancipation" with the party setting itself free from BCE's control; Ennahda is still the second strongest party in the country; some other movements with a certain degree of influence appeared, like the liberal Free Patriotic Union (Union Patriotique

Libre, UPL) of Slim Riahi (some perceive him as a Tunisian version of Silvio Berlusconi).

Is Tunisia really starting on an evolution path toward a democratic regime or will this country also pass from the Arab Spring which never blossomed to an Islamist winter? Anyway, the Tunisian political experience, so far, proves that any democratic evolution has to have deep social roots, limited Islamist factor, and a political class capable to generate relevant leaders. Tunisia during its time span as an independent state, even under a dictatorship, successfully put into place all of the prerequisites for a smooth democratic evolution. Other Arab countries failed dismally to do so.

Power Price Hikes Overburden Politics In Bulgaria

In the aftermath of the October 5 early parliamentary elections, which resulted in the GERB party getting most of the votes but staying short of outright majority, a bitter and painful consultations' marathon ensued which revealed the actual state of minds in the Bulgarian political class and the general public.

Often the extent of both deeply-rooted naivety and sophistication in doing politics "in local style" is hidden from the outside world. During the post-election behind-the-scene bargaining it comes out into the open. As in similar Balkan nations undergoing a dramatic transitional period to a more or less stable democracy, Bulgaria remains in the grips of popular myths, prejudices and romantic visions of a shining city on top of a hill to be gained without pain and losses.

To begin with, here is the arithmetic of the final vote count. GERB has secured 84 of the 240 in the 43rd National Assembly which is good but not good enough to rule alone. The coalition seemed to be the only solution to avoid a stalemate. Yet, forming a coalition government turned out to be a painstaking although not a boring experience for onlookers and outside analysts.

As a sample of what the Bulgarian citizens were fed as a routine political dish, here is the case of the Patriotic Front (PF) — listed fifth in the hierarchy of eight parties and coalitions that managed to jump over the 4% threshold to enter parliament. PF made it to the front page headlines many times with either provocative or simply extravagant demands. In the course of the somewhat messy consultations, Mr Borisov had to disclose reluctance to enter into coalition with the "patriots" due to their insistence on two preconditions. First, PF demanded to set up a military base on the southern borders (at frontier with Turkey) and deploy surface-to-surface missiles; second, to conduct obligatory tests among the 6-year old children to determine their proper knowledge of the Bulgarian language.

The other remarkable demand came from Krasimir Karakachanov, leader of the VMRO party which forms part of the Patriotic Front, was to increase police presence and patrol activities in the districts inhabited by Roma people.

Mr Karakachanov said that nothing less round-the-clock video surveillance of the troubled neighbourhoods would satisfy his party.

Local politics might sometimes resemble a soap opera but unlike the existing parties and politicians, the issues that face them and need prompt and comprehensive settlement are as large as life and often "twice as natural" (as Lewis Carroll phrased it). The Patriotic Front, Ataka (nationalists), and "Bulgaria without censorship" are nothing but "television screen parties", professor Bozhidar Dimitrov, Director of the National history museum, suggested recently.

Even the EU politicians voiced concern over the prospects of a coalition with the three said parties defined as "undemocratic". The chairman of the conservative European People's Party (EPP), Joseph Daul, held a round of talks in Sofia with GERB as well as representatives of the Bulgarian socialist party, the "Alternative to Bulgarian resurrection" and the pro-local Turks Movement for rights and freedom. Mr. Daul made no bones about his unequivocal non-acceptance of the inclusion of the indecent

radicals from the three parties (Patriotic Front, Ataka (nationalists), and "Bulgaria without censorship") into the future government.

After the initial shock, since the so-called Reformist block had earlier signaled readiness to incorporate the Patriotic Front into the composition of the cabinet, Mr. Borisov swore to Brussels to keep the "patriots" at bay and if the attempts to form a coalition with the moderate parties fail, he would go it alone, putting together a minority government. As an experienced politician with vivid memories of his tenure as a Prime Minister, Mr. Borisov can realize the challenges of administering such a complex country with incessant turbulences in the pending parliament.

No matter how ridiculous the moves by the marginal political groupings might look and sound, it often has a bearing on the actual aspirations and grievances of the people. One of the conditions set forward by the VMRO party (it happened before PF was kicked out from talks on forming a coalition) was to freeze power prices for households. It is a powerful irritant for the citizens. Since 1 October, Bulgaria's energy regulator DKEVR raised prices for electricity by 9.8% on average which comes in the wake of the previous hike on 1 July (up 2%).

Actually, Mr. Karakachanov has got a point when he questions: "Why are we exporting cheap electricity generated by Kozloduy (nuclear power plant) and Maritza East 2 (coal fired power plant) while here we are buying expensive power from (coal fired) Maritza East 1 and Maritza East 3?"

Bulgaria has to rely on aging thermal and nuclear power generation for its base-load requirements. The two Bulgarian power stations, Maritza East 1 and Maritza East 3, are owned by US companies AES and ContourGlobal. These plants are selling electricity to the state-owned utility under a 15-year power purchase agreement. The tariffs payable in Euros escalate annually. Mr. Karakachanov can make himself heard by the people when he thumps his invective: long-term power purchase agreements with US investors cannot be an obstacle to defending Bulgaria's national interests, claims the leader of VMRO party.

The power price hikes have long been the major irritant for the population of this, most likely, poorest member state of the European Union which culminated in mass street unrest last year. It brought down the government formed by the GERB party leader Boiko Borisov (PM from 2009 till 2013) who can now proudly claim "I am back" and call the shots. What he will inevitably have to aim at are the issues of ensuring energy security. They are all pitched high on the agenda of all political actors, not surprisingly among the opposition leaders, and they stand tall in the minds of ordinary citizens.

What are the expedient solutions to provide Bulgarian people with affluent, affordable, that is cheap (if there is such an option), and secure sources of energy to the end-users of the thoroughly disillusioned population?

One can build a strong case that here is where geopolitics and energy concerns are intertwined as nowhere else. A recent poll conducted by the Bulgarian Institute of contemporary politics revealed the hierarchy of external hazards in the perceptions of the outside world. Two out of every three respondents subscribe to the assumption that Islamists with their wide networking tactics constitute a formidable challenge to the nation. Almost half (43%) point their finger at the uncontrollable in-flow of migrants from the poor Third World countries, and 23% think the true risks come from within the society with local criminal syndicates having the leverage to influence political, economic and social affairs in Bulgaria and undermine its national security.

While the current surge and spread of radical Islam and its militant offshoots in the MENA region, neighbouring the Balkans, is viewed as the number one danger, Russia is still considered as the least viable threat. Some 4% believe that Russia is a potential menace while 6% attribute this quality to the United States.

This undercurrent sentiment can be a partial explanation why the Bulgarian proponents of the project to construct a nuclear power plant in Belene using Russian technology (the project was effectively frozen by the former government of Prime Minister Boiko Borisov who is now back in

the "driver's seat'), still enjoy a certain lead over the opponents (37% to 27%). Remarkable enough, almost one in five respondents has no definite opinion on the controversial matter.

Noteworthy, the public opinion is split almost right in the middle with 51% supporting the construction of the South Stream pipeline and 14% opposing it while the rest remain undecided, according to a poll conducted this autumn. The slight tilt towards the acceptance of further dependence on Russian natural gas is not very telling but it comes against a rather skeptical attitude to local substitute in the form of shale gas. Optimists who place their bets on the possibility to clone the North American shale revolution at home are in a minority, with 17-19% respondents opting for the start of exploration and future production of shale gas against a third of those polled (33-36%) who reject this idea outright.

The volatility on the energy markets, in particular the long-lasting impasse over the risks to the transit of Russian gas to Bulgaria via Ukraine, added to the anxiety of the local distributors and end-users. What exacerbate the uncertainties, are the chronic arrears of the Bulgarian power generation plants, notably in the cities of Vraz, Pleven and Bourgas. The major plant of the capital city, Sofia has accumulated a debt of more than 500 million levs, and Bulgargaz, the main provider and wholesale purchaser, warned of possible cuts in the coming months.

The power cuts would come as an uncomfortable déjà vu for Prime Minster Boiko Borisov since he was toppled exactly by public protests triggered off by unacceptable electricity bills (they doubled in January 2013). Once again, one does not have to be a pundit to predict that in Bulgaria the fluctuations of politics are largely a function of the volatility on the local and global energy markets.

Caspian Sea Status. Agreed To Agree, Sometime Later On

An unusual political event happened this fall in the Russian city of Astrakhan: a summit of the 5 Caspian countries, namely Azerbaijan, Iran, Kazakhstan, Russia and Turkmenistan focused on the complicated issues linked to the definition of the status of that big water surface. It was the 4th summit of that kind in history, after Ashgabat (2002), Teheran (2007) and Baku (2010).

The main question is whether to declare it a lake (the Caspian has no connection with other seas and is an isolated watery plain, like a lake, but its water is salted) or a sea? Depending on the answer you give, its legal status changes. For example, if it's considered to be a sea the United Nations Convention on the Law of the Sea (1982) should be applied. It regulates all the issues, including the definition of internal waters, exclusive economic zone, continental shelf, etc.

In Astrakhan, some important decisions were taken (Presidents were even talking about a "breakthrough"): first of all, the Caspian Five agreed that military presence in the sea/lake should be limited only to riparian countries. It was also agreed in principle that the Caspian Sea should be divided into a zone under the sovereignty of bordering countries and a fishing zone. However, no compromise was reached on the division of the shelf plate, which remains the most controversial issue.

The host, Russian President Vladimir Putin, acknowledged that not all of the problems were solved but the list was effectively shortened. Putin expressed hope that in the near future the 5 countries would sign the Convention on the status of the Caspian Sea. What kind of compromise would it require? So far, it is hard to guess due to controversial declarations of the summit's participants made in the aftermath of the summit.

The President of Turkmenistan, Gurbanguli Berdymukhamedov, confirmed his position: pipeline projects on the Caspian are part of the sovereign rights of each Caspian country. The President of Iran, Hassan Rouhani, on the

contrary, believes that all the decisions should be taken by consensus by the 5 nations and not be dictated solely by national interests of any of the countries concerned.

Before the collapse of the Soviet Union, the Caspian Sea status was regulated by an array of Soviet-Iranian agreements, the oldest one dated 1921. They defined fishing, transportation, resources and military fleet issues. These documents were internationally recognized. But at that moment there was no problem linked to the marine underwater pipelines and off-shore oil and gas production.

After the break-up of the Soviet Union, the post-Soviet countries signed agreements stipulating the compliance of new countries to the obligations of the Soviet Union. The same principle was supposed to be applicable to the Caspian Sea. Iran declared that the juridical principles of agreements signed with the USSR remain intact. But Azerbaijan pretended that it was not bound by Soviet era arrangements.

Since the 1990s, the global approach to the problem was fluid. At the beginning, Iran and Russia insisted on a common use of that sea by all the 5 countries, then Russia started to conclude bilateral agreements, the first was signed with Kazakhstan (1998) delimiting the seabed of the Northern part of the sea. Simultaneously, the US declared the Caspian the zone of its national strategic interests and entered into negotiations with Azerbaijan about the possibility of building a military base. In 2003 a framework convention about the protection of the marine environment of the Caspian Sea ("Teheran's Convention") was signed, stipulating that all main local problems will be settled by consensus of all the riparian countries.

The discussions are focused now on 2 main issues, all linked to the seabed status. First, it is needed to define the owner of the off-shore oil and especially natural gas fields. Azerbaijan and Turkmenistan are disputing some of them, not being able to delimit the respective parts. Second, it is necessary to establish who has the right to decide whether to build or not a pipeline on the Caspian seabed across all the possible frontiers.

For example, Azerbaijan has no problems to build a pipeline from its gas field Shah-Deniz 2: it is within Azerbaijani territorial waters. But building a Transcaspian pipeline from Turkmenistan to Azerbaijan, supported by the EU, has to be regulated in another way, by a convention on the Caspian Sea status. So far, Iran and Russia were blocking the juridical possibility of such a pipeline. At the Astrakhan summit, there was no breakthrough on that issue.

Besides the legal aspect, there are some other components to consider, all linked to local gas reserves. Iranian and Russian gas fields are located far from the Caspian zone, and they are not in direct competition. Kazakhstan has oil but no gas, so the countries with high stakes in bridging the Caspian Sea with a seabed pipeline are Azerbaijan and Turkmenistan.

Azerbaijan has rather limited reserves, around 1.3 trillion cubic meters (tcm), maybe less: there is still controversy about the actual volumes. Presently, Azerbaijan is producing more that 16 bcm (2013), exporting less than 10 billion cubic meters (bcm) of gas and is not considered to be a big player on the market. The expected increase of production in Shah-Deniz 2 field up to 25 bcm would allow to export more gas and use TANAP/TAP pipelines to deliver gas through Turkey to Greece, Albania and Southern Italy. The planned export volumes amount to 16 bcm (6 bcm are to be sold to Turkey). But that surge in exports will hardly elevate Azerbaijan into an important market player: in 2013, Europe consumed 538.2 bcm of natural gas.

Turkmen gas reserves are more significant, 17.5 tcm, with the production reaching 72 bcm (2013), and exports of more than 42 bcm, bound to some former Soviet Union countries, Iran and China. By 2020, the export pipeline to Iran is planned to increase the off-take up to extra 20 bcm and the gas flow to China up to 80 bcm. Basically, Turkmenistan does not have enough gas for export through a Transcaspian pipeline, planned from 1996 and aimed to deliver 16 bcm to Turkey and 14 bcm to Europe. At this stage it should be noted that Turkmenistan would not be able to export gas westward taking into consideration that China is heavily investing in

production and transportation capacities in Turkmenistan with the inevitable implication that extra volumes would be delivered to the Chinese market and nowhere else.

Last but not least, Azerbaijan not having too many reserves perceives Turkmenistan with its huge reserves as a competitor on the Turkish and European markets. Baku is not really interested now in constructing a Transcaspian pipeline. Maybe later, after having depleted its own resources Azerbaijan would be interested in transit fees from the flow westward of the Turkmen gas, but most certainly this is not the case now.

Bearing in mind the unsettled status of the Caspian Sea, the limited gas reserves in Azerbaijan and the reserves in Turkmenistan allocated mainly for deliveries to China, the conclusion looks as follows: both Caspian countries seem to be using the discussion on the Transcaspian pipeline project as an additional bargaining leverage in their negotiations and not as a realistic plan to implement the grand idea of increasing export to Turkey and Europe within the EU concept of South Corridor.

Croatia And Hungary. Here Goes The Neighbourhood

Croatian Ministry of Finance has opened a second front (to use the notion dating back to the WWII) against its own, albeit in the grips of controversies, industry champion, the oil and gas group of companies INA. The government demands to be paid 319 million kuna ($52.8 million) in overdue tax debt for 2010 and 2011.

Despite relatively small arrears, INA has all the reasons to believe it has been stabbed in the back by its own lord-protector at a time when this largest Hungarian utility is conducting arbitration court proceedings against it major stakeholder, the Hungarian company MOL which owns 49.1 percent of shares.

Structured attempts to resolve this full-fledged and long-lasting crisis go back to September 2013. Actually, talks at finding a compromise were to no avail. Sharp differences in approach to managing the group of companies persisted with the Hungarians claiming some 'branches' of the group have been economically unviable for too long and need to be reinvigorated or cut off.

The official position of the Croatian INA amounts to accusation of MOL for failing to make investments in the refineries. In return, MOL places charges against the government of Croatia, which owns almost 45 percent of INA, for not observing the 2008 agreement which stipulated some kind of state intervention to save INA's loss-making gas trading business. MOL makes a reference to the agreement's provision stipulating the commitment of the Croatian government to buy all natural gas produced locally by INA at market prices. It was not happening and, as a result, MOL incurred losses of $385 ml and is determined to receive compensation.

In September, the Hungarian stakeholder claimed it was essential for keeping the company afloat to close down the Sisak refinery (one of the two on INA's balance) because its obsolete equipment adversely affected its market performance, burdening the company with just another loss-making asset. The Croatians refused the proposal, rubbing additional salt into the wounds of their opponents.

The two sides exchanged blows in courts. The Croatians claim MOL acquired its 45% stake and accompanying management rights through graft. The Hungarians allegedly bribed the then-Croatian Prime Minister Ivo Sanader who ended up in jail sentenced on charges of corruption.

Similar charges were brought against CEO of MOL, Mr. Hernadi who was reportedly implicated in the illegal transaction scheme. In May, a Hungarian court cleared Mr. Hernadi of this accusation. But Croatians were unimpressed. A trial aimed at MOL's boss is due to start on 24 November in Zagreb. Both Sanader and Hernadi have denied any wrongdoing.

Due to the weighty state ownership of INA, the conflict between the two regional energy majors inevitably escalated into a "cool war" of words

on the official level. The commercial dispute acquired political overtones. Stakes were raised. Hungary-Croatia quarrel was projected on the key issue of regional energy security. This could be the hidden reason of a third party stepping in.

Recently, the verbal tug-of-war between Zagreb and Budapest has acquired a truly international clout after the US Administration proposed to become a formal mediator. Experts in mediation to be put together in a team by Washington would be of different nationalities, as the U.S. Ambassador to Croatia, Kenneth Merten, specified in the official proposal to the Croatian government.

In fact, the US was already involved in several rounds of talks held between the conflicting parties earlier this year. Amos Hochstein, a U.S. diplomat with expertise in energy, was sort of a go-between person at negotiations between MOL and the Croatian government. Yet, the mediation did not facilitate a deal.

More importantly, the motives of the United States remain unclear. The American government's mediation is viewed with a bit of suspicion by Hungary. This nation under the steermanship of the somewhat eccentric Prime Minister Victor Orban has already reserved itself the role of *enfant terrible* of the European Union due it recalcitrant and unbending stance on doing everything its own way.

At face value, the US is concerned with "energy security for all of Europe, but particularly for central and eastern Europe and for south-east Europe", as spelled out by Ambassador Merten. Yet, there is a fair deal of probability that the US intervention has been triggered off by speculations that MOL could eventually opt for selling its share if no acceptable deal is reached.

Privately, MOL executives admitted they do consider this option if the two sides fail to rise above the conflict of interest and overcome the current impasse. The rumor has it, there could be "hostile takeover' with Russian Rosneft or probably Gazprom allegedly interested in adding this asset to its Balkans acquisitions.

There must be fire behind the fumes. Gazprom bought the Serbian oil company NIS some time ago and pursues an aggressive policy of enlarging its footprint in the Balkans. Head of Gazprom Alexei Miller held talks in Zagreb in July on energy matters. So far, neither Gazprom nor Croatia admitted having held any initial negotiations on MOL's stake in INA. The Hungarians keep it under the lid as well.

The tumultuous plight of INA has a direct relevance to the stability of in-coming energy flows and security of local energy production in the wider territory of former Yugoslavia. INA cannot be discarded as a minor player. After all, the company employs 13,000 people and in 2013 posted revenues of 27 billion kuna ($4.5 billion). Whoever controls INA controls not only the Croatian market but has the potential to partially shape the markets of adjacent Balkan states.

The performance of the industry champion, INA is deemed crucial for the energy sector and the national economy on the whole. In 2013, INA's oil production decreased almost twofold compared to 2011 (mostly due to retreat from Syria where it netted some 1 ml tons of oil equivalent per year). Croatian oil fields would last for another 22 years while local gas deposits will expire in 16 years.

At present, the state of affairs in the national economy is far from being satisfactory, exacerbating the social ills. In June 2014, the average pay was fixed at €730. Croatia keeps sliding down in the Global Competiveness Report index.

These macro-economic woes were reflected in the August public opinion poll. It dealt with the effect of Croatia joining the EU one year down the road. Nothing has fundamentally changed, neither for the good nor for the worse, claimed 15% of the respondents with another 13% subscribing to a more euro-skeptic assessment. Only 3% believe membership in the EU was a benefit for the country.

Against the accumulating frustration of the people, the unresolved conflict between MOL and the government of Croatia would remain a

powerful irritant and a de-motivator for potential foreign investors into the energy sector.

Oil Markets. Prescribed Erratic Behaviour

The global oil prices' slow but steady downward spiral turned into a powerful unnerving factor for the energy markets and their geopolitical dimension.

By mid-October, the WTI submerged below $80 per barrel, the lowest benchmark since June 2012, while Brent tumbled to less than $83, the minimum since 2010. In a matter of three months, Brent lost almost $26, a 24% downfall, and the average price of all brands of crude slumped by 21.7%, enough to fuel apprehension and even panic, not counting out speculations on the evolving trend.

For the very first time in four years, the average price for OPEC-produced oil barrel dropped to $78,11. The OPEC General Secretary Abdalla Salem El-Badri openly admitted that experts cannot come to a consensus whether this was a temporary aberration or a fundamental tendency.

The sort of game-changer on the oil markets appeared to be the Saudi Arabia's decision to lower the benchmark on South-East Asia contracts to $90.02 per barrel starting 1 October. Although the break-even point for balancing the Saudi budget is reportedly close to $100 per barrel, the oil-rich monarchy opted for lower prices.

Major traders forecast a further cut in Saudi oil futures supported by the statement coming from another market heavy-weight, Kuwait: the price will keep its downturn slide, lose some additional 14%, and stabilize around $76. According to industry insiders, Saudi Arabia is readying to lower the price to $80 per barrel and keep it fluctuating around this reference point for a year or even two years.

The intrinsic curiosity of "what's going on?" is all the more relevant because the short-term consequences of these developments produced an odd composition of winners and losers. The camp of winners features Saudi Arabia and the Gulf petro-monarchies, as well as China reaping the benefits of cheap crude. In the camp of losers, you find, astoundingly, the United States, Venezuela, Russia, and Iran.

The Gulf Cooperation Council (GCC) emirates joined ranks with Saudi Arabia probably counting on their huge financial buffers. Experts believe that if the current downward trend persists, the GCC monarchies would have to downscale their expectation of financial surplus from $275 bn to $100 bn. It does not amount to a financial bloodshed, yet it could lead to a squeeze of budgets.

Why would the desert kingdom with gulf monarchies on its side embark on this rather risky path? In the early 1980s, Saudi Arabia deliberately compressed oil production to maintain an acceptable price corridor. The strategy backfired: the Saudi's share of the global market shrank, and it took many years to recapture what was lost. Today, with the 70% surge of domestic oil production in the United States since 2008, the price manipulations initiated by Riyadh look no less hazardous, were it not for the imminent conspiracy theory pretending to uncover the plot allegedly masterminded by the Saudi strategists.

It is a well-known fact that the US has achieved a remarkable level of oil self-sufficiency having lowered the import intake by one third to a mere 33% dependence on outside providers. Yet, it does not shield the internal US market from the pressure of oil imports. Cheap Saudi crude would drastically undermine the position and prospects of local oil producers, especially those involved in deep-water offshore drilling and in shale oil business.

The low-margin US shale oil companies which flocked to the smell of the relatively easy profits will then face a toughened competition from cheap Arab crude, and will be left with no other alternative but to scrap investments into green fields. A halt to investments into shale oil exploration in the US spells the inevitable shortage of production capacity in mid and long-term, which will automatically drive the oil prices

up, maybe reaching unprecedented heights (could the price surpass the absolute record of $147 per barrel in July 2008?).

Noteworthy, as a collateral damage, cheap Saudi and Gulf oil would also hurt if not kill a large number of US shale gas companies because they extract most of the revenues from shale oil and not from gas which is essentially a by-product for them due to the artificially depressed prices on Henry Hub.

The conspiracy scheme looks convincing but questions remain. Can Saudi Arabia do it? Yes, it can, theoretically. With production fixed at 9.7 million bopd, constituting one-third of the OPEC's total, the desert sheikhs can effectively manipulate the global oil market to its advantage but only if OPEC does counter-strike. If OPEC hammers out a compromise between its warring factions, puts its act together and comes up with a consolidated stance on a concerted simultaneous decrease of oil production, the tide would be reversed.

It is worth taking notice of the recent pronouncements by the Gulf monarchies: they keep denigrating OPEC as a useless and impotent assembly. Ahead of the 27 November OPEC summit, these invectives are most probably aimed at enhancing frustration among member states by this demonstrative show of solidarity among the main purveyors of black gold to the global market.

Will bullying tactics be enough to rent asunder the immediate losers? The outcome of the November battle royal is not written yet. Iran, forced to lower contract prices as well, issued a somewhat timely reminder that OPEC's failure to act in 1998 has brought down oil prices to $6-8 per barrel. Today, history could repeat itself. Venezuela is fidgety. Nigeria and Angola are nervous and hint they might side with the Iranian mullahs. Algiers is viewing the situation as worrisome.

Despite the apparent displeasure of the mentioned nations due to incurred losses, the opponents of the Saudi's grand gamble can hardly fuse a united front. OPEC, fundamentally, is both a marriage of convenience and inconvenience with most of its members sleeping in one bed but dreaming very much different dreams.

Saudi Arabia and Co are hitting at quite an array of market adversaries with OPEC member states (formal allies, aren't they?) heading towards a bumpy landing. If price drops to $80 per barrel, it will wipe out $200bn off OPEC's 2014 revenues. It will widen the hole in the earlier expected profits of the non-OPEC Russia, exerting additional pressure on Moscow which is subject to US-EU sanctions.

Unintentionally, by lowering oil prices to four years low level the Gulf monarchies are doing an unexpected favor to China and, concurrently, to all exporters of natural gas and LNG with oil-linked contract prices. However, if the hidden agenda envisages a price hike in a matter of two years, it would make sense for China and others to capitalize on the lucrative moment. However, the truth is, they cannot do it because the conspiracy theory, despite its acceptable logic and historical precedents, does not substitute market fundamentals.

The hard-core reality of the energy markets is as follows: oil production exceeds demand, and this glut is likely to last the next year at least. According to the IEA adjusted analysis, in 2015 the overall demand for oil will be lower by 165.000 bopd, amounting to 93.8 million bopd. Overproduction and modest demand growth, these twin factors will largely determine the price fluctuations. Goldman Sachs professed a further plunge with oil prices stabilizing around $70 in 2015.

Recently, OPEC analysts have also downgraded demand for its oil, cutting 600.000 bopd for the year 2017. Nevertheless, the OPEC's forecast is overly optimistic: by 2040 the global economy, counted in terms of purchasing power parity, will increase by 260%. To sustain the demand growth, oil industry will have to invest $7.300 bn into production and an additional $10.000 bn into transportation infrastructure, storages and refineries. As for the current downward spiral, OPEC analysts refuse to term it mid-term trend forecasting the average price up till 2020 staying

at $110. OPEC believes the price per barrel will level at $124 in 2025 and reach $177 by 2040.

Another crucial factor should be included into the current market equation. The average break-even point for most oil producers will force them to lobby for the freeze of the downfall. OPEC will eventually step in and, according to the Morgan Stanley assessment, will lower output by 500.000 bopd for 2015 to pacify the producers and improve balance sheets. The most likely spread by the end of 2014 would be in the interval from $82 to $87, analysts forecast.

…All in all, the multi-factor scrutiny of the current oil markets' volatility proves that prices behave not erratically but logically. The logic is basically prescribed by the rational egoism of a group of energy majors which apply their dominant market position as primary purveyors to secure capital gains and cash flows. Nevertheless, whether Saudi Arabia's gamble will pay off or not, remains to be seen.

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