

Saudi succession issues surface once more as Sultan rests after US medical trip

Riyadh governor Salman has emerged as a key advisor in the crown prince's efforts to reassert his role, as King Abdullah presses key princes into considering the future.

Reports of his imminent death again seem premature, but with Crown Prince Sultan Bin Abdelaziz resting in Morocco after further medical tests in the United States, Saudi sources report that King Abdullah has privately suggested that members of the *Allegiance Council (Al-Hayaat Al-Bayaa)* start to consider possible candidates for a new heir apparent. King Abdullah is said to have advised family members to reflect on the qualities of at least two sons of the Kingdom's founder Abdelaziz Ibn Saud, Municipal Affairs Minister Prince Mitaeb and General Intelligence Directorate head Prince Miqrin, plus a third unnamed contender, as possible replacements, should Sultan prove unable to continue (GSN 842/4).

But Prince Sultan – who is also deputy premier, defence and aviation minister, and inspector general of the armed forces – remains determined to hang on in office. While some of his sons are keen to see him return to the USA for further medical treatment, GSN has learnt that Sultan wants to go home, to reassert his role within the Al-Saud. He has entrusted day-to-day

charge of his Ministry of Defence and Aviation (MoDA) to his son Prince Khalid Bin Sultan, further underlining the joint commander of the 1990-91 Gulf war's return to the front line of Saudi establishment politics.

Sources said the ailing Prince Sultan had also taken an enthusiastic role in making arrangements for the marriage of his grandson, Prince Fahd Bin Faisal Bin Saud Bin Mohammed, to Madawi, a daughter of London ambassador Prince Mohammed Bint Nawwaf, at *The Dorchester* hotel in London on 24 January. Faisal is not a direct descendant of Ibn Saud through the male line, but he is the son of Itab, one of Sultan's favourite daughters. The Crown Prince has arranged for a fleet of private jets to bring in 500 guests to the party, although he himself is not expected to attend.

Sultan arrived at his Agadir holiday home from New York on 9 January, to be greeted by Interior Minister Prince Nayef Bin Abdelaziz (his full Sudeiri brother), Eastern Province governor

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Sinking KDown

The collapse of the Dow Chemical/PIC KDown joint venture plan may be unsurprising given a harsh financial climate and Kuwaiti opposition to huge foreign ventures. Only the lawyers will now make money. But amid opposition derision to Prime Minister Sheikh Nasser Mohammed Al-Sabah's limited government reshuffle, the KDown débâcle underlines enduring problems of doing business in Kuwait. It will not help others who are weighing up their strategic options.

—SEE PAGES 4 AND 16

Single currency

This promises to be a crucial year testing the commitment of Gulf Co-operation Council members to monetary union. GCC heads of state formally endorsed next steps for the scheme at December's Oman summit. Now they must clear the way for implementation, by ensuring key terms are ratified at national level. Few believe the new single currency can be introduced in January 2010, as originally planned, but GSN's market soundings showed a growing expectation of real progress.

—SEE PAGE 10

Qataris look to keep Iranians off their rigs

The global media and analysts look up when, occasionally, an Iranian official mentions the view widely held in Tehran that Qatar is taking more than its fair share of gas out of the giant North Field/South Pars field. Any power play over such a strategic, world-scale gas reserve would have big consequences far beyond the Gulf. So far, all sides have kept these concerns under control, with the Qataris prudently trying to make common cause with the Iranians (and Russians) over global gas supply and pricing strategy.

Far less noticed are the day-to-day tensions that mark an area that still has a 'wild west' feel, with both sides staking out their claims with drilling rigs instead of fence posts.

Qatar has long confronted the thorny problem of Iranian penetration of its exclusive economic zones. The emirate's *National Security Shield* system of radar and coastal surveillance has focused on monitoring Iran's powerful and unpredictable naval forces. Some insiders suggest that Qatar is concerned about this to a near paranoid extent. But the issue has occasionally escalated to arms, with the Iranians boarding and breaking into unmanned Qatar Petroleum rigs to steal machinery and data, or even machine-gunning such outposts. QP is thus installing multiple layers of protection on its rigs, to react faster to Iranian or terrorist threats.

FOR MORE SEE PAGE 8



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Risk management reports (RMRs)

Following *GSN's* special issue *Assessing political, financial risk across the region*, published in December (842), our *RMRs* have been slightly redrawn (for details visit our www.gsn-online.com website). The standard fortnightly double country *RMR* format will return in issue 846, starting with **Bahrain** and **Iran**.

Saudi succession issues

CONTINUED FROM PAGE 1

Prince Mohammed Bin Fahd Bin Abdelaziz and his son Prince Turki, ambassador to Spain Prince Saud Bin Nayef Bin Abdelaziz, and the late King Saud's sons Princes Khalid and Mansour. Also present were several offspring of Prince Nayef including Princes Abdelaziz Bin Saud Bin Nayef, Nawwaf Bin Nayef, Mohammed Bin Saud Bin Nayef and Fahd Bin Nayef. Travelling with Sultan was his another full brother, Riyadh governor Prince Salman Bin Abdelaziz, who had been with him in New York. In all, the Crown Prince had spent six weeks in the USA.

Salman has taken charge of managing the news about Sultan's condition. In a marked break from old traditions of secrecy, the official *Saudi Press Agency (SPA)* has released a number of admittedly sparse bulletins about Sultan's medical trips.

This is a critical moment for the Al-Saud's Sudeiri branch. King Abdullah's move to open up discussion of the succession and promote the case for his own allies such as Mitaeb and Miqrin, puts the Sudeiris under pressure to defend their position.

Some sources said Salman was emerging as a pivotal figure in this context. While Nayef is next in line – and wants to stake his claim – the interior minister is widely viewed as a hard-line conservative, and he may lack a sufficiently broad base of support within the Allegiance Council (chaired by Abdullah's appointee Prince Mishaal Bin Abdelaziz) and the wider family. (*GSN 820/1*). The Riyadh governor, on the other hand, is a shrewd operator who has escaped categorisation and has skilfully cultivated a wide range of interest groups. In the media he is close to *Al-Arabiya TV* director and *Ash Sharq Al-Awsat* columnist **Abdelrahman Al-Rashid** and to **Othman Al-Omair**, who runs the liberal *Elaph* website (with which Salman is thought to have connections).

But at the same time, Salman has been careful not to alienate senior Wahhabi *ulema*, and has assiduously cultivated relationships with senior tribal figures and leading Riyadh families, turning up in person to give his condolences at the death of senior members. Unlike Sultan or Abdullah, Salman does not command a section of the military. But he could count on the backing of Nayef, head of the experienced and well-trained interior security forces.

The latest discussion of Sultan's health and the succession outlook has so far been largely confined to discreet manoeuvres among ruling family members and their close associates. Reaction to the King's discreet promotion of the issue has been cautious. Few Allegiance Council members are prepared to reveal their own views – they don't want to be caught out having 'backed the wrong horse' as events unfold.

But talk of the succession rivalries and manoeuvres will spread, inevitably, even if the officially approved media remain tight-lipped.

Abdullah's latest move to encourage debate over the succession will be seen by the Sudeiris as an attempt to marginalise their role, at the expense of the King's allies such as Nawwaf, Miqrin, Mitaeb and the sometimes outspokenly liberal former 'red prince' **Talal Bin Abdelaziz**. However, there are also non-partisan reasons for the Al-Saud to face up to the issue. In calling upon the loyalty of ordinary Saudis, the family has always presented itself as a guarantor of stability and the embodiment of national identity. But this appeal will be undermined if the inevitable rivalries over the succession surface into the public realm in a disorderly way – whereas measured consideration of succession matters by Allegiance Council members may send a more reassuring message of order and calm leadership.

Conflicting reports on the state of Sultan's health are expected to keep tongues wagging, with some sources reporting that his doctors have abandoned hope of a recovery, and others insisting that his condition has stabilised. The Royal Court has stated that he will return shortly to the United States for follow-up treatment.

Indeed, some non-official sources are claiming Sultan is at death's door. The *Stratfor* website on 8 January reported that "a source close to the Saudi royal family confirmed... the imminent death of Saudi Crown Prince Sultan. The source claims he is in an induced coma, and that members of the royal family travelled to Morocco to escort him to Riyadh, where his death will be announced." But the SPA on 6 January had reported that Sultan received New York mayor **Michael Bloomberg**, at his NY residence. The audience was attended by Prince Salman, **Prince Faisal Bin Turki Bin Abdullah**, Prince **Khalid Bin Abdullah Bin Abdulrahman** and a number of other notables, SPA reported. SPA printed a photograph of the billionaire prince and financial information mogul turned mayor sitting together.

BAHRAIN

Mushaima presses Al-Wefaq to stiffen its spine

Al-Wefaq National Islamic Society and *Haq*, Bahrain's two largest parliamentary and extra-parliamentary opposition movements, have engaged in renewed talks about a potential joint strategy, as the 2010 elections approach. *Haq* leader **Hassan Mushaima** continues to argue that now is not the time to back down over a potential election boycott.

GSN has learned that *Al-Wefaq* chief Sheikh **Ali Salman** and *Haq*'s **Hassan Mushaima** met in November to begin a review of the decisions they took in 2006 – when they split over whether to participate in the national assembly elections. *Al-Wefaq* holds 17 of the 40 *Majlis Al-Nawab* (Chamber of Deputies) seats, but **Ali Salman** has been exasperated by the fact that all his party's efforts to promote policy ideas or challenge official decisions have been blocked by MPs supporting the administration (*GSN*

840/1, 834/3). Mushaima feels that this experience vindicates his opposition to participating in the 2006 polls. He told GSN that Haq would be ready to work with Al-Wefaq, co-ordinating their actions to maximise their public impact. However, he is taking a tough line in talks with Ali Salman over the possible terms for co-operation.

Mushaima insists that Haq will only come out in favour of electoral participation if King **Hamad Bin Isa Al-Khalifa** changes the constitution to strengthen the elected lower house's role and ensure it has real power. He said that Haq was prepared to actively campaign against a continuation of the status quo, and if Al-Wefaq opted to maintain its participation.

The Haq leader does not believe the opposition should retreat – it should, indeed, maintain the pressure for change. Despite his firm line he was invited to talks with King Hamad in London last spring and he has subsequently held discussions in Manama with national security chief Sheikh **Khalifa Bin Abdullah Al-Khalifa**, a former ambassador to the UK.

Mushaima's confidence in his stance has been boosted by friendly overtures from *Waad (National Democratic Action Society)*, which participated in the last election but failed to win any seats. Mushaima argued that Waad now realised that its leading figures, such as **Ibrahim Sharif** and **Munira Fakhro**, would not be allowed to win seats in 2010.

KUWAIT

Cabinet choices fail to impress

Following weeks of negotiations and delays – which prompted talks of a walkout by parliamentarians and fresh grilling threats against the prime minister – Kuwait has a new government, albeit one with only two new faces. Many MPs have responded angrily to what is in effect a minor reshuffle rather than a new government, with 12 parliamentarians staging a walkout at the National Assembly ceremony to swear in the new cabinet.

There is no place in the new government line-up for the *Islamic Constitutional Movement (ICM)*-affiliated **Mohamed Al-Olaïm**. The former oil minister reportedly decided to stand down in line with earlier remarks by the ICM that its Sunni Islamist members would not participate in the new government. Responsibility for the oil portfolio has been handed on an acting basis to Foreign Minister Sheikh **Mohammed Sabah Al-Salem Al-Sabah**, while the electricity and water portfolio has gone to new face, **Nabil Bin Salamah**, who will also take responsibility for communications, a post previously held by **Abdelrahman Al-Ghunaim**.

The other new appointment is former National Assembly general secretary **Roudhan Al-Roudhan**, an independent MP who takes charge of the health sector, replacing **Ali Mohammed Al-Barrak**. Liberal MP **Ali Al-Rashed** has been elected general secretary as Rodhan's replacement.

All other positions remain unchanged. Education and Higher Education Minister **Nuriya Al-Subeih**, who faced down a grilling a year ago and has continued to weather flak from conservative and Islamist parliamentarians, thus keeps her post, as does Kuwait's other female cabinet figure, State Minister for Housing and Administrative Development **Mudhi Abdelaziz Al-Humoud**, who was appointed last May.

Prime Minister Sheikh **Nasser Mohammed Al-Sabah** has pledged his determination to “double efforts... for positive co-operation with parliament in shouldering national responsibilities.” But the prospects do not look good. The reaction of MPs has prompted speculation that 2009 may see an emiri dissolution of parliament and another round of elections. Islamist MP **Dhaifallah Buramia** accused Sheikh Nasser Mohammed of provoking MPs and warned that political crisis may intensify. Such sentiments were echoed by another MP, **Faisal Al-Muslim**, who described the new government as being “born dead”.

Talk of suspending democracy has resurfaced. Outspoken *Popular Bloc* MP **Musallam Al-Barrak** – whose group has led criticism of the handling of the proposed fourth refinery project and the cancelled Dow deal (see GSN view, below) claimed “the new government has come to prepare the ground for an unconstitutional decision”. The last such dissolution was in 1986, but the Gulf has changed dramatically in the intervening years and Sheikh Sabah would see this as a last resort.

An updated Kuwait government list may be found on the Kuwait country page, accessed through the GSN's *World* portal on www.gsn-online.com.

QATAR: Cultural recognition

Qatar over the past few years has focused on expanding its non-oil economy, with a heavy focus on education. Following the opening of the new *Museum of Islamic Arts* in November, *The New York Times* this month named Qatar its cultural destination of the year. “Housing one of the world's most encyclopaedic collections of Islamic art, it is the cornerstone of a monumental effort by Qatar to transform itself into the arts hub of the Middle East,” the liberal US paper said.

SYRIA: Could Washington follow the French model?

A new briefing paper from the *International Crisis Group* asks: How is one to engage Damascus? France's recent experience offers useful lessons for an incoming US administration that is “seemingly persuaded that an improvement in bilateral ties and an Israeli-Syrian agreement could fundamentally modify the regional landscape.” The ICG observes that: “Determined to engage in dialogue – but also ready to break off if the other side was unco-operative – and creative in approach, while fixing it within a clearly defined framework of objectives, President **Nicolas Sarkozy** also knew how to seize on unexpected opportunities when they presented themselves.” A copy of the paper is lodged in the *Subscriber's Library* at www.gsn-online.com.

Umm Al-Quwain's Sheikh Rashid dies

Umm Al-Quwain Ruler Sheikh **Rashid Bin Ahmed Al-Mualla** died in London on 2 January. He had been in poor health for some time and has been succeeded by his son Sheikh **Saud Bin Rashid Al-Mualla**, who had been crown prince since 1982 and becomes the eleventh Al-Mualla ruler of UAQ since the mid-18th century. Other sons of the late Emir include UAQ Deputy Ruler Sheikh **Abdullah**, UAQ Administrative and Finance Department chairman Sheikh **Mohammed** and **National Bank of Umm Al-Quwain (NBUAQ)** head Sheikh **Nasser**.

New ruler Sheikh Saud (born 1 October 1952) attended high school in **Lebanon** and holds an economics degree from **Cairo University** (graduating in 1974). He became heir apparent in 1982. Married to the daughter of **Ras Al-Khaimah** Ruler Sheikh **Saqr Bin Mohammed Al-Qasimi** and in recent years he became the *de facto* ruler of UAQ. Sheikh Saud received his elementary and primary education in Umm Al-Quwain before. His biography on the official WAM news agency records that Sheikh Saud "has also played an active role in the development of the hydrocarbons industry in the emirate, having been involved in negotiations related to oil concessions and subsequent exploration, these being crowned with success when he inaugurated Umm Al-Quwain's first offshore gas field in 2006." He has also chaired a number of public companies, including **Abu Dhabi Securities Market**-listed **NBUAQ**, **Umm Al-Qaiwain Gas Company** and **Umm Al-Qaiwain Cement Company**.

On 13 January Sheikh Saud issued a decree appointing his son (one of them) Sheikh **Rashid Bin Saud Bin Rashid Al-Mualla** as crown prince.

In one of his first actions as ruler, Sheikh Saud ordered the construction of a grand mosque in Gaza and the renovation of all damaged mosques in the territory, to be built at his expense. The new mosque is to be named after his late father.

Rulers face European property troubles

Reports in **French** newspapers suggest that **Qatar's** Emir Sheikh **Hamad Bin Khalifa Al-Thani** may not have his way over a multi-million dollar renovation of the **Hotel Lambert** in Paris. Paris mayor **Bertrand Delanoë** has said the Emir's plans for the building, built in 1639 and part of a **Unesco** world heritage site, include underground parking, new elevators and additions to the living areas. "This is a real threat to a gem of Paris heritage, the only private house from the end of **Louis the XIII's** reign that remains untouched," Delanoë said in a letter to French cultural minister **Christine Albanel**, "I want this plan to be reconsidered, taking the time for a thorough examination." Sheikh Hamad bought the property from the **Rothschild** family for some \$100m in 2007. Critics of the Emir's plans point out the lavishly appointed mansion already has 12 bathrooms and three elevators.

In early January, *The Times* newspaper, reported that **Dubai** Ruler Sheikh **Mohammed Bin Rashid Al-Maktoum (MBR)** had run into difficulty over his 1920s lodge in **Scotland** (Inverinate Estate). The paper said, "when Sheikh Mohammed... decided that his 14-bedroom 1920s lodge in **Scotland** was no longer adequate for his purposes, he did not stint on a replacement. He proposed to build a lavish new home from lead, timber and stone, with three separate structures linked together by glass-covered walkways. It would have 16 bedrooms, a central living area with master bedroom, penthouse chambers, dining room, kitchen, mezzanine level, living rooms and two bedroom wings, some with living-room areas." The London paper reported that because the design was not "sympathetic" to its rural surroundings, a confrontation developed with local planning officials who have now rejected the proposed development. MBR has had problems before over proposals for his Scottish properties, and clashed with one local community over plans to raze his Killian estates historic shooting lodge.

QATAR

EMIR SHEIKH HAMAD: Lack of co-ordination over Gaza

Emir Sheikh **Hamad Bin Khalifa Al-Thani** has spoken out about the ongoing troubles in Gaza, labelling the **Israeli** attacks on the territory a "war crime". Arguing for a more concerted Arab diplomatic campaign he said that: "our Arab people in Gaza are subject these days to an unjust aggression which does not differentiate between children, women and old people, and between civilians and fighters... A war launched with such tools at such targets cannot be anything other than a war crime." Sheikh Hamad said that calling on Israel and the **Palestinians** equally to end the violence was equivalent to "putting the henchman and the victim on an equal footing". Arab calls for **UN Security Council** action to bring about a ceasefire in Gaza had failed, because Arab leaders had not managed to meet to co-ordinate their positions. "The mobilisation on the Arab street and several peace movements in the world have proven that this is the least the people expect from us. We believe we can achieve something [at a summit]... and that we can take measures to influence the international arena and Israel." The Emir renewed an earlier call on fellow Arab leaders to hold an extraordinary summit in support of Gaza. "The horrors befalling the Gaza Strip oblige the [Arab] nation and its leaders to move," he said. It is unusual for the Emir to comment on such matters – he usually leaves it to Prime Minister and Foreign Minister Sheikh **Hamad Bin Jassim Bin Jabr Al-Thani**.

SHEIKH ABDELAZIZ: Barclays settles claim

Barclays Bank has settled a legal claim by the **Qatari** Emir's brother Sheikh **Abdelaziz Bin Khalifa Al-Thani** over an alleged €50m fraud. The sheikh – an older half-brother of Emir Sheikh **Hamad** – had claimed that gross negligence by Barclays had allowed an employee to siphon off huge sums from a personal account in Marbella between December 2001 and February 2003 (*GSN 832/12, 769/14*). The Sheikh's wife, Princess **Kasia Gallanio Al-Thani** (an **American**) spoke to the UK's *Sunday Telegraph*, "we're delighted it's all over, it's a huge weight off our shoulders," but refused to reveal details of the settlement. Kasia told the paper it was she who spotted the irregularities: "I just saw some papers on my husband's desk and noticed something was wrong. We added the figures and found all the money we thought had been going into the bank had been going straight back out again." The sheikh has lived in Europe for many years. He became finance and petroleum minister in 1972 (and was an **OPEC** chairman in the mid-70s), being nominated by his father, former Emir Sheikh **Khalifa**. Abdelaziz was pushed from the cabinet in 1992 in one of current Emir (then crown prince) Sheikh Hamad's reshuffles. His wife said that now the investigation is over, she is putting her efforts into a new online website for luxury gifts. She has said that "as a wife and mother of three children, I have very little time to do the fun things that make everyone happy, like finding the perfect presents for friends and family. Even when I did steal the time to shop, it was difficult to choose the perfect gift."

SAUDI ARABIA

NAWWAF BIN ABDELAZIZ: Term extended

The service of Prince Nawwaf Bin Abdelaziz, special advisor to King Abdullah at the rank of minister, has been extended for four years. Prince Nawwaf was previously head of the *General Intelligence Directorate* but suffered a stroke in 2002. His son Prince Mohammed Bin Nawwaf is the Saudi ambassador to the United Kingdom.

TURKI AL-FAISAL: Gaza comments

The former ambassador to London and Washington and ex-head of the *General Intelligence Directorate* has criticised the US government for its “reckless position” towards Israel’s attacks on the Gaza Strip. “The Bush administration has left you [with] a disgusting legacy and a reckless position towards the massacres and bloodshed of innocents in Gaza,” Prince Turki said in a message directed at President-elect Barack Obama. “Enough is enough, today we are all Palestinians and we seek martyrdom for God and for Palestine, following those who died in Gaza,” he added.

PRINCES: Marriages

In a ceremony overseen by Interior Minister Prince Nayef Bin Abdelaziz, Prince Mishaal Bin Abdullah, one of the King Abdullah Bin Abdelaziz’s sons, married a daughter of Prince Nawwaf Bin Mohammed Bin Abdullah, on 4 January. Nawwaf, of the Abdelrahman branch of the family, has two daughters, Lulua and Al-Anud. The event in Riyadh attracted an especially large number of royals. On 24 December, Prince Saud Bin Sultan Bin Mohammed Al-Kabir married a daughter of Prince Faisal Bin Saad Bin Abdelaziz in a ceremony at the Palace of Culture in Riyadh. Faisal has two daughters, Rime and Arij.

PRINCESS AL-JAUHARA: Death

Princess Al-Jauhara Bint Faisal Bin Hathlul Bin Nasir of the Al-Saud family’s Al-Thunayyan branch, died on 11 January at the age of 75. She was the mother of *Saudi Basic Industries Corporation* chairman Prince Saud Bin Abdullah Bin Thunayyan.

AL-SUDAIRI: Death

Dr Mohammed Bin Abdullah Al-Sudairi died on 9 January. He was the brother-in-law of *Saudi Arabian National Guard* deputy commander Prince Badr Bin Abdelaziz, who received mourners at his palace.

UAE

AL-MAKTOUMS: Family wedding attracts big guns but is then postponed

Federal President and Abu Dhabi Ruler Sheikh Khalifa Bin Zayed Al-Nahyan led the guest list at a 27 December banquet lunch at the Dubai World Trade Centre hosted by federal Vice President and Prime Minister and Dubai Ruler Sheikh Mohammed Bin Rashid Al-Maktoum (MBR) to mark the marriage of his daughter Sheikhha Hassa to Sheikh Saeed Bin Dalmouk Bin Juma Al-Maktoum. Other emirates rulers who participated were Sharjah’s Dr Sheikh

Saudi princess speaks out on domestic violence

King Abdullah’s increasingly high-profile daughter Princess Adila has spoken about family violence in the Kingdom (*GSN 841/6*). She is deputy chairperson of the *National Family Safety Programme*, and speaking at an event to mark the signing of a MoU between two Saudi organisations, said that the negative picture of human rights in the Kingdom cannot be denied. She called for deterrent laws to protect women from family violence and said that a draft law proposed by the *King Khalid Foundation* will soon be referred to the Shura Council and to King Abdullah for approval.

The pioneering deputy chair of the *National Society for Human Rights, Al-Jawhara Bint Mohammed Al-Anqari* has also called for laws to protect women from violence. She said problems include the lack of an authorised body to look into domestic violence cases, and divisions in the judiciary over the classification of cases and the definition of family violence. Al-Anqari has long called for the promotion of women’s rights in the Kingdom. She is from the distinguished Al-Anqari family, holds a degree in anthropology from the *American University of Beirut*, and writes for the *Okaz* newspaper.

Sultan Bin Mohammed Al-Qasimi, Fujairah’s Sheikh Hamad Bin Mohammed Al-Sharqi and Ajman’s Sheikh Humaid Bin Rashid Al-Nuaimi. Other powerful guests included Abu Dhabi Crown Prince and UAE Armed Forces deputy supreme commander General Sheikh Mohammed Bin Zayed Al-Nahyan, Ras Al-Khaimah Crown Prince Sheikh Sultan Bin Mohammed Al-Qasimi and Umm Al-Quwain’s Sheikh Saud Bin Rashid Al-Mualla.

The wedding party was then postponed in observance of the state of mourning for Umm Al-Qaiwain Ruler Sheikh Rashid Bin Ahmed Al-Mualla, who died on 2 January (*see above*).

The bride, Sheikhha Hassa Bint Mohammed (born November 1980), is MBR’s first child (of a dozen) to his first wife Sheikhha Hind Bint Maktoum Bin Juma Al-Maktoum. The groom’s late father Sheikh Dalmouk Bin Juma Al-Maktoum (1937-2004) was the son of Sheikh Juma Bin Maktoum Al-Maktoum, brother of former Dubai ruler Sheikh Saeed Bin Maktoum Al-Maktoum; he was in the real estate business. Further cementing the alliance, a Hind Bint Maktoum son, Sheikh Ahmed Bin Mohammed Al-Maktoum (born February 1987), is engaged to a daughter of Dalmouk Bin Juma Al-Maktoum, Madiyah Bint Dalmouk. Among other MBR/Hind Bint Maktoum children, Sheikhha Latifa Bint Mohammed recently married increasingly prominent Fujairah Crown Prince Sheikh Mohammed Bin Hamad Al-Sharqi.

MBR AND OTHERS: Victory in the new sport of kings

Abu Dhabi’s spending on *Manchester City FC* may attract more headlines, but endurance riding is attracting ever more Gulf royals. Riding Tahhan, Dubai’s Sheikh Mohammed Bin Rashid Al-Maktoum on 10 January won the second round of the 120km *Giants Endurance Challenge (Body Weight) Ride* series in Bahrain – dedicating his win to the suffering Gazans. He came in ahead of Bahrain’s Sheikh Nasser Bin Hamad Al-Khalifa, who was followed by Dubai Crown Prince Sheikh Hamdan Bin Mohammed Bin Rashid Al-Maktoum and UAE Presidential Affairs Minister Sheikh Mansour Bin Zayed Al-Nahyan.

Iraqi and Kuwaiti navies join forces in northern Gulf coalition

Kuwait and Iraq have signed their first formal military agreement since the 1990-91 occupation, as both countries build up their coastal security.

When Saddam Hussein's Iraq invaded Kuwait on 2 August 1990, the stoutest and longest resistance came from the *Kuwaiti Coast Guard (KCG)*. For the 12 years that separated the 1991 liberation of Kuwait until Saddam's fall, it was the KCG that was involved in the greatest number of armed clashes and police actions against Iraqi forces. For these reasons, the late December collaborative patrolling agreement between the *Iraqi Navy* and the KCG is a major step forward, as the first formal military agreement between the two countries since the occupation nearly 18 years ago.

The new agreement was signed by Kuwait's director of Coast Guard operations Lieutenant General Sayyid Al-Buaijian and Iraqi Navy head Staff Brigadier-General Ahmed Jasim Muarij. Its key thrust is the establishment of procedures and roles in the protection of the strategically vital sea-lanes and littoral waterways in the northern Gulf. Almost 90% of Iraq's government revenues are earned via the southern oil export terminals (oil platforms or 'Oplats' in naval terminology), while Kuwait views the northern waters as its first line of defence against narcotic smuggling.

The Iraqi Navy

Now around 2,000 strong, the Iraqi Navy is mainly composed of two battalions of marines, a total of approximately 900 personnel, who are based near Umm Qasr port. The marines include the following components:

- **PORT JOINT SECURITY CENTRE (PJSOC)** – run by the Iraqi Navy and a British support team;
- **COASTAL BORDER GUARDS** – headquartered from Al-Maqil port, the 750-man CBG battalion has companies in Al-Maqil, Al-Faw, Abu al-Khasib/Abu Al-Faloos and Umm Qasr. Each of these companies will eventually be expanded into battalion-strength units;
- **1ST MARINE (WOLVERINES) COMMANDO BATTALION** – based at Umm Qasr, this unit is leading on oil terminal security. The battalion consists of 12 platoons, six of which execute point defence of the Oplats, while the other six are trained to conduct vessel, board, search and seizure (VBSS) operations in coastal waters and on the Shatt Al-Arab and Khawr Al-Zubayr waterways. The marines' maintain tactical operations centres at Al-Basrah Oil Terminal and Khawr Al-Amaya Oil Terminal;
- **1ST (PATROL BOAT) SQUADRON AND 2ND (ASSAULT BOAT) SQUADRONS** – these are forming at Umm Qasr, with the latter training on 24 fast attack boats (FABs); and

- **2ND MARINE SECURITY BATTALION** – leading on Umm Qasr port security, by undertaking perimeter and access control duties previously performed by the *Facilities Protection Service*. These forces are competently performing their basic security task but have no way to preventing much of the officially sanctioned oil smuggling that goes on using falsified documentation.

Taking on new vessels

The level of maritime patrolling undertaken by the Iraqi Navy is already quite impressive. According to Coalition figures, since March 2008, the Iraqi Navy has completed 923 out of 995 planned patrols (a 92.7% execution rate), with the majority of cancellations due to weather and high seas. The current operations tempo results in just over 160 independent patrols and 60-130 VBSS operations each month. Even so, a shortage of seaworthy and sufficiently powerful patrol boats has been a restraining factor on the force's effectiveness, leaving the Kuwaiti and Coalition naval forces in the northern Gulf to make up the slack.

Iraq is now building towards a higher-quality coastal force and has absorbed a large number of craft in the last year. As of last October, Iraq had ten light inflatable launches, five Chinese *Predator* patrol boats (PBs) and ten patrol boat river (PBR) vessels in Umm Qasr; the latter were transported down from Baghdad, where they previously undertook riverine duties. In December, ten *SAFE Boat International Defender* fast patrol boats (FPBs) were delivered, raising the Iraqi small boat inventory to 24 FABs and 16 larger FPBs. The FPBs are 27ft-long US-built vessels with powerful twin *Yamaha* 250 horse power four-stroke engines that enable the boat to reach speeds up to 45 knots. These craft allow the navy to finally match the speed of Iranian smuggler boats.

In April, the Iraqi Navy will receive a further ten *Defender* FPBs, and in September, Iraq will receive the first three of 12 new 34-metre Malaysian PBs. Baghdad is expected to place orders for 20 larger 30- to 35-metre patrol boats in 2009-10, as well as up to 50 smaller fast interception craft.

Also in 2009, Iraq will take on its first large vessel in the post-Saddam period, the first of four 450-tonne *Saettia* class patrol ships (PS) from Italy. Specialised seamanship and engineering training for this class of vessel began last September. The first vessel will be sailed back to Iraq from Italy by an Iraqi crew this July.

Qataris consider ways of keeping Iranians off their rigs

The problem of Iranian penetration of Qatar's exclusive economic zones (EEZs) has long been a thorny one for the **Qatari Emiri Navy (QEN)**, the emirate's coast guard and **Qatari Emiri Air Force (QEAF)**. GSN's periodic surveys of the *Project National Security Shield (NSS)* system of radar and coastal surveillance has focused on the deep paranoia and touchiness that Doha feels when confronted with Iran's powerful and unpredictable naval forces. With the giant North Field/South Pars gas reserve not yet unitised, the shared field still has a 'wild west' feel about it, with the Iranians and Qataris staking out their claims with rigs instead of fence posts.

The issue has occasionally escalated to arms and the Qataris have not been backward about coming forward. The Iranians have certainly undertaken their fair share of dirty tricks – notably boarding and breaking into unmanned **Qatar Petroleum (QP)** rigs to steal machinery and data, or even machine-gunning such outposts. Together with the one or two industrial espionage cases brought against purported Iranian commercial spies in QP and **Qatargas**, it is tempting to think back to the Cold War intrigues.

Qatar, rather than Iran, has taken steps towards hot war on a number of occasions. In June 2004, a QEN patrol boat killed one Iranian and injured two others when they shot at the men as they sailed near an unmanned rig. Shortly beforehand, Iran had warned Qatar not to tap more than its share from the shared gas field. Although most media attributed the action to tension related to fishing rights in the mid-Gulf, security insiders have long said the action was a deliberate Qatari reaction to an oil rig break-in. The waters around such rigs are often used by fishermen as mooring points but Doha has no way of telling such trespassing from more serious incidents.

QP is currently installing multiple layers of protection on the rigs in order to reduce the 'false positive' alerts generated by fishermen and to react faster to genuine Iranian or terrorist threats. The system includes the following elements:

- **DETECTION** – a Vessel Exclusion Barrier (VEB – boom) in the water and short-range radar detects vessels 500 metres out. CCTV, lights and a public address system can be used to identify and warn the vessel off;
- **JAMMING** – at 300 metres, radio jamming of communications and navigation is activated to prevent the use of radio-controlled bombs;
- **INNER BARRIER** – at 50 metres out another VEB is met. If this barrier is breached, the incident is taken to be a serious penetration; and
- **REACTION** – helicopter forces or patrol boats can be dispatched from Ras Laffan, from Doha, from various Qatari islands and from a Coast Guard mother ship in the fields. In extreme cases, Doha can scramble a helicopter-borne **Naval Special Forces** unit maintained in the capital for such tasks or could even use its alert force of combat aircraft. GSN's canvassing among QEAF officers in recent years indicates that aerial interception of Iranian aircraft or terrorist light aircraft is a commonly exercised scenario.

Due to the small size of the QEN and Coast Guard, the response forces typically have not reached the area before genuine attackers have left. As the small patrol boat and fast patrol boat forces are viewed as too slow to reach such incidents, increasing emphasis is being placed on QEN special forces based on a mother ship in the North Field.

The growing Iraqi Navy				
Type	Current	End-2009	End-2010	Goal 2011
Italian Saettia class PS	0	2	4	4
Malaysian 34m PB	0	9	15	15
Chinese Predator class PB	5	5	5	5
30-35m PBs	0	0	20	20
Patrol Boat River (PBR)	10	10	Phased out	Phased out
Offshore support vessels	0	2	5	5
FAB and FPB	40	50	50	50
Inflatable RHIB boats	10	10	10	10

Coalition support

As almost no Iraqi sailors have experience of handling the powerful larger classes of vessels currently being ordered by the navy, the 50-strong **Coalition Naval Transition Team (NaTT)** and the nearby **Combined Task Force (CTF)**. Some 158 are required to provide most of the training and logistical support for the fledgling navy.

Training assistance includes VBSS training for the 1st Marine Battalion on the **Royal Fleet Auxiliary (RFA) Cardigan Bay**, a British vessel that acts as a base for Iraq's FAB fleet, a training aide for VBSS operations and a general seamanship training facility.

FAB training around the oil platforms is carried out by British and US advisors, who go out on patrols with Iraqi sailors in the existing force of Chinese-built Predator vessels. FPB training is carried out by the **US Coast Guard's International Training Division**, which runs a two-week course on boat coxswain instruction, navigation, general seamanship, and engine repair and maintenance, with mandatory refresher training. The programme uses a train-the-trainer approach intended to reach as many Iraqis as possible.

NaTT is also providing specialised 11-week training programmes for each of the *Saettia* class boats' 31-men crews, to prepare Iraqi sailors for the challenge of the 6,000 nautical mile passage back from Italy in these large vessels.

Alongside the work undertaken by the Iraq-based NaTT, the northern Gulf-based CTF-158 is also playing a vital role in securing the sea lanes at the Iraqi-Kuwaiti line of control. This flotilla consists of at least two frigates or destroyers, four patrol boats, the RFA *Cardigan Bay* and a number of helicopters. These forces work directly with Iraqi Marines to enforce the maritime exclusion zones around the oil terminals.

The Kuwaiti side

The **Kuwaiti Coast Guard**, formally under the Ministry of Interior but operationally part of the navy, was originally trained

by US Coast Guard Law Enforcement Detachments. The Coalition presence around Kuwait's coast is still strong, with *US Coast Guard Port Security Unit 311* deployed to the naval base at Ras Al-Qalaya. The unit, part of the US Navy's *Maritime Expeditionary Security Squadron One*, has a broad mandate: to provide harbour defence and port security to Kuwait and Iraq's seaward approaches and waterways, including oil terminals and force protection to vessels transiting choke points and in ports.

Compared to the US forces in Kuwait, the KCG is fairly small: four large 32-metre *Intissar* PBs, between one and three operational *Al-Shaheed* 33-metre FPBs, plus around 70 smaller PBs in the 10- to 20-metre class or smaller. The KCG employs only around 500 personnel. Kuwait has no marine forces, although its special forces have a maritime role and may expand their capabilities by acquiring 12 Mk V class fast interception vessels similar to those in service with the US Navy Seals.

In terms of sensors, Kuwait is becoming quite advanced, with its main surveillance centre located at the new KCG base at Fintas. The facility is rumoured to be the largest and most advanced of its type in the Gulf; an additional three radar sites and a further sub-centre are planned at a later stage.

Countering the 'terrorist threat'

In addition to the interdiction of drug and oil smuggling, trash-dumping and other crimes, a stronger Iraqi Navy would provide welcome assistance in the struggle against terrorist activity and Iranian presence.

Kuwait has gone to high alert on a number of occasions due to rumours of 'suicide dhows' launched from Iraq, or seaward assaults on refineries and ports.

Meanwhile, Kuwaiti-Iranian relations were sullied by fresh allegations of Iranian spying in November when Kuwaiti security seized several radio transmission devices mounted on Iranian commercial boats. The devices had the ability penetrate military radio communications and record them.

A capable Iraqi Navy will therefore – for the moment at least – be a welcome partner to the overstretched Kuwaiti Coast Guard, which has been forced to cope with the slow collapse of state control in Iraqi waterways since the early 1990s. If the day comes that Baghdad begins to buy offensive missile-armed craft again, Kuwait may begin to reassess its naval relationship with Iraq.

IRAQ

Diyala blocks give MOO licensing round added political dimension

Among the issues thrown up by the Ministry of Oil (MOO)'s second licensing round, announced on 31 December, is the challenge it poses to the *Kurdistan Regional Government (KRG)* through Baghdad's decision to offer exploration permits in the Qamar, Nau Doman and Gilabet oilfields and Khashm Al-Ahmar gas field in upper Diyala province. The fields' inclusion in the round comes before the Kurds can resolve the ownership of disputed territories in these fields. Indeed, according to analysis by *GSN's* sister publication *Iraq Focus*, "Baghdad is playing the Kurds at their own game of laying down markers on key terrain in the border oilfields."

The KRG's borders are formally the boundaries of Dohuk, Erbil and Sulaymaniyah provinces, but the reality is more complicated. Certain segments of Erbil still need to be administratively reattached to the KRG having been separated by *Iraqi Army* deployments in 1991. But in most cases it is the Kurds who are living beyond their formal boundaries: their *Peshmerga* militias poured forth in April 2003 to garrison areas beyond the official limits of the KRG provinces and they have been undertaking *de facto* boundary changes ever since. Thus almost all of Kirkuk province north of the Kirkuk oilfield's Baba and Avaneh domes is now *de facto* KRG territory.

As *GSN* has noted at length – most recently in issue 844,

dedicated to *Iraq's oil challenge: a GSN special report* – the KRG has staked out its boundaries by issuing permits for oil and gas exploration and development. In late 2007, the KRG tendered a range of fields in disputed areas that lay outside the current boundaries of Sulaymaniyah province in today's Diyala governorate. The KRG awarded an exploration contract for the Shakal concession, which mainly lies within Diyala, to a consortium of *Prime Natural Resources (United States)*, *Petoil (Turkey)* and *Oil Search (Papua New Guinea)*, with the KRG retaining a 25% stake (*GSN 844/21*). But Shakal overlaps with the Qamar concession now being offered by the federal MOO.

Other MOO second round acreage, such as the Gilabat oilfield and Khashm Al-Ahmar gas field, are close enough to the disputed territories that they could become flashpoints in the KRG/Baghdad struggle. There is already a precedent in the Kirkuk field's Khurmala Dome area – which mostly rests within the KRG but extends into Kirkuk province – where the Kurds physically blocked federal access in 2007-08, preventing MOO's drilling engineers and foreign consultants from entering.

The Nau Doman concession is located in one of the most hotly contested parts of Diyala. In nearby Khanaqin, the federally-controlled 4th Iraqi Army brigade clashed with the KRG-controlled 34th Iraqi Army brigade in July-September. At least one soldier was killed on each side during clashes within the Nau Doman field itself, near the town of Jalula. Since then, the 4th Iraqi Army brigade has garrisoned the areas around Khanaqin, penning in the KRG forces and staking out the frontline of federal government control.

After the GCC's Muscat summit, currency plan credibility hangs on acts, not words

Five country ratification is the first hurdle. Policy and structural detail will have to follow soon if markets are to take the GCC's monetary union plan seriously.

This promises to be a crucial test year for the commitment of *Gulf Co-operation Council* members to their long discussed monetary union project. At December's Muscat summit, GCC heads of state formally endorsed next steps for the scheme. Now they must clear the way for implementation, by ensuring that it is ratified at the national level. While few believe it is now practicable to introduce the planned new single currency at the beginning of 2010, there is a growing market expectation that GCC states need to rapidly finalise and publish the practical details, if they want the plan to be taken seriously.

The late December annual's summit agreed on a final draft of the monetary union accord, and approved plans to set up a monetary council that should be the precursor to a new Gulf central bank. But this cannot be set up until the Muscat agreement has been ratified by each of the five participating states – **Bahrain, Kuwait, Qatar, Saudi Arabia** and the **United Arab Emirates**. Ironically, the summit host **Oman** is not joining in at this stage.

Leaders first decided on monetary union back in 2001, promising to complete the necessary legislative steps by 2005, in time for notes and coins to be issued in 2010. Governments later agreed a set of economic and financial convergence criteria, largely modelled on the *European Union's* Maastricht framework. But little progress was made in finalising the actual plan for a currency, because of leaders' reluctance to face up to the unavoidable sacrifices in national sovereignty that would be required for the project to become workable. They were slow to admit that a common central bank would be required and they have still not agreed on where it should be located, despite earlier assertions that it would be based in **Abu Dhabi**.

Several big hurdles were eventually overcome. In 2006, central banks governors agreed on the need for a common monetary council. At talks last September in Jeddah with *International Monetary Fund* managing director **Dominique Strauss-Kahn**, GCC states accepted the need for decisive progress in integrating financial markets and building a common institutional structure. These decisions, reconfirmed at talks in October and endorsed by at the Muscat summit, signalled a new seriousness in their commitment to monetary union: they have now accepted the scale of the measures needed, while starting to think in practical terms about a timetable that is achievable.

Kuwaiti Finance Minister **Mustafa Al-Shimali** said at the summit that agreement had been reached on achieving monetary union by December, whereas the launch of an actual new currency was a "next stage" that could follow a separate timetable.

Fixed rates achievable

The achievement of the first basic stage of monetary union – fixed exchange rates between the participating national currencies – should be achievable by end-2009. All GCC countries are dollar-pegged except Kuwait, which abandoned that anchor in 2007, in favour of a basket valuation in which the dollar counts for 70%; the rest is shared among the euro and other currencies. Kuwait saw the basket as a better defence than a weak dollar against the inflation that was then surging ahead in the Gulf, but circumstances have since changed. Inflationary pressures have softened across the region, while growth has slowed sharply, thanks to the global downturn and subsequent plunge in oil prices; a lax US-style monetary policy is no longer inappropriate. This creates conditions in which, once again, GCC states can unite around a common stance.

Kuwait would have to abandon its basket. But with inflation easing anyway, it could now afford to do this, to secure the greater goal of first stage monetary union. And in any case, IMF research suggests that, in the dollar-weighted form adopted by Kuwait, the basket has been of only limited use in containing price pressures.

Given the strength of Saudi Arabia's political commitment to the dollar peg, it seems most likely that initially the monetary union will start out by retaining the fixed link to the dollar. But in the longer term, governments will come under strong market pressure to move to full monetary independence, based either on a basket of currencies or on their own independent monetary policy, run by the new central bank.

The case for dropping the dollar peg

"The arguments in favour of a unified currency that is not based on a dollar peg are still pretty strong," *HSBC's* chief economist for Gulf markets **Simon Williams** told *GSN*. "We still see an argument for a flexible currency regime that could reflect oil price movements and also allow Gulf countries greater control over their interest rates." Since early 2008, as inflation and growth have slowed, GCC needs have come back into synch with those of the United States as it maintains low interest rates. But that situation would not endure, Williams believed: "Now, following the [*US Federal Reserve*] Fed is not causing difficulties. But when we return to normal times, I expect that the monetary policy needs of the Gulf and the Fed will diverge again." Moreover, it's not just about monetary issues – fiscal policy also matters, Williams noted.

Oil is priced in dollars and the fixed Gulf/dollar peg therefore means that the full impact of energy price volatility is directly translated into local currency and GCC government revenues. During the oil boom, revenues soared, boosting revenues and creating an inflationary tendency for public expenditure to surge. Now, after the oil price slump, Gulf governments' capacity to spend in local currency terms has been slashed commensurately. Williams argued that an independent exchange rate would moderate such volatility: at times of high oil prices, the Gulf currency would rise against the dollar, reflecting market confidence in the region but limiting the degree of excess government local spending power. And at times of oil price slump, the decline of the Gulf currency against the dollar would help to soften the blow, in state revenue and spending power terms.

Stronger dollar creates 'false sense of security'

Gulf governments should not think that the dollar's resurgence, and the easing of inflationary pressure, has spared them the need to face up to difficult decisions about the long term, believes *Standard Chartered* group chief economist Gerard Lyons. "The recovery of the dollar has lulled some people into a false sense of security," he warned. With the inflationary pressures of recent times, the GCC countries have paid the price for their slowness in moving towards a common monetary policy independent of the dollar. "The whole region had too loose a monetary policy for far too long," Lyons told GSN. "The last 18 months should be telling them that they should have decided on a single currency or a switch to a basket of currencies much sooner – perhaps two years ago – as the boom was gathering momentum. The lesson is that you need to have a currency or monetary policy that's suited to domestic or regional needs."

As it happens, the likely impending new decline of the dollar will suit the Gulf economies at a time of economic slowdown, Lyons said. And the immediate priority should be economic recovery rather than a fundamental rethink of monetary policy. But he feels that the fundamental case for a change in policy remains strong – and has been amply demonstrated by the inflationary impact of dollar-pegging during 2007 and 2008.

From words to action

The agreement to create a monetary council and the Muscat summit's reaffirmation of the single currency plan, have now created a sense of expectation. The project's credibility will be badly damaged if governments of the five participating countries fail to ratify their draft agreement by their end-December 2009 target date. Furthermore, Lyons said that countries also needed to take steps towards the deepening and the integration of capital markets. One key contributory factor in this regard will be the harmonisation of financial regulations and structures – a point made by Strauss-Kahn in last September's Jeddah talks.

But GCC countries' commitment will also look questionable if they fail to agree or publish the essential principles and details

behind the proposed single currency – such as whether the planned central bank's mandate will be limited to monetary stability or whether it will also include other goals such as sustaining non-oil GDP growth. Institutional development could probably move in two phases. Headline issues such as the location of the central bank – the subject of nationalistic rivalry for this prestige role – or the identity of the first governor will be less important than the principles governing its structure and operation. Both *dinar* and *Khaliji (Gulf)* have been suggested as possible names for the currency.

The Muscat summit adopted a monetary union accord that sets the legal and organisational framework, and it also reached an agreement on how the monetary council should be governed – which itself could be a pointer to the central bank's eventual governance structure. However, the detailed content of these key agreements is not widely known to the markets. For example, it is not yet known whether votes on the central bank board will reflect simply the number of countries – so that Bahrain or Qatar each carry the same clout as Saudi Arabia – or if they will also be weighted to reflect population or GDP.

Monetary council

The monetary council is designed to carry out many of the technical preparations required before the bank can be fully established and the actual currency launched. It is modelled on the *European Monetary Institute*, the forerunner of the *European Central Bank*. But by the time the institute was set up, most of the key decisions about the future shape and operation of the new eurozone institutions had been settled; the institute's relative lack of profile and political clout therefore did not matter. If the GCC states plan to emulate this example, they do not have much time to clarify their planned new council's role.

A key test of their recognition of these practicalities will come in the middle of this year, when GCC secretary-general Abdelrahman Al-Attiyah said governments will finally select the central bank's location. *Dubai International Financial Centre* chief economist Nasser Saidi said some departments will be hosted by different countries.

Observers have noted that the currency project will work to enhance the standing of the GCC as a regional group. "You're talking about a trillion dollar economy, with immense foreign assets under its control, managing a very large proportion of the global energy supply. I think it would be a formidable economic block," said Williams. Lyons was similarly upbeat: "The important thing is to view the single currency as a positive development and not as a defensive gesture. The world economy needs to be more balanced – and this means that capital surplus regions need to rise to the challenge and play on the world stage."

For Williams, that is a reason for the Gulf countries to be self-confident in their planned new monetary policy, and not feel the need to remain tied to the US currency and policy stance.

“They could start off with a dollar peg, and then move on.” But, he said, “In my view, this would be an ideal opportunity to adopt a more flexible currency regime, even if this is one of the factors that pushes back the launch of a single central bank a little way.”

QATAR

Surviving the credit crunch

Recent bank reports have given the Qatari economy the thumbs up. Saudi Arabia's *Samba Financial Group* predicted strong growth in 2009. In December, Samba said that “while not immune to the crisis... Qatar is well placed to weather the storm and is projected to continue growing at around 10% in real terms in 2009. On the basis of most available growth projections, this would make it the fastest growing economy in the world next year [2009].” This strong performance was fuelled by growing LNG exports and an expansionary fiscal

policy to support large-scale infrastructure investment. Per capita income is forecast to exceed \$75,000 in 2008 and 2009. Samba noted that while the economy suffered in H2 08 due to tightening domestic liquidity, falling stock market and real estate prices, and reduced access to foreign funds, the continued growth in LNG exports would keep the fiscal and current account balances in surplus. However, Samba added that: “While increased recourse to public funds will help offset the adverse impact of the global credit crunch, it is inevitable that some of Qatar's many projects will be delayed or cancelled due to higher financing costs and reduced availability of funding. A slowdown in project implementation will help ease capacity constraints and so contribute to containing soaring inflation,” projected at 16% for 2008.”

Standard Chartered Bank predicted that inflation will fall to 6% this year, from 15.8% in Q3 08, while real growth in 2009 will be the fastest in the Gulf at 4.5%. *EFG Hermes* in mid-January said that growth in Qatar would be 9% in 2009.

Risk analysts remain cool-headed over violence in Gaza, such episodes are ‘built into risk thinking’

GSN canvassed opinion in the credit and political risk markets to see how financing for the wider Middle East region might be affected by the New Year conflict. *GSN* may not agree with all their views, but specialist analysts can move markets, and several saw the Israeli assault on Gaza as a warning to Tehran; some believed that Israel would consider military intervention in Iran over the next six months, even without US support – but only as a last resort.

Middle East observers have been gauging the extent to which the humanitarian and economic crisis unravelling in Palestine's Gaza strip could impact neighbouring countries and the wider region. Hundreds of lives have been lost and vital infrastructure smashed as a result of Israel's 27 December air strikes on Gaza, followed by a ground invasion in early January. With the fighting showing no evidence of ceasing, and Israel's Defence Minister Ehud Barak – potentially a big political winner at home from recent events – speaking of an all-out war against Hamas, “regional tensions have been heightened by Israel's heavy response to rocket attacks on its territory out of Gaza,” said credit insurer *Euler Hermes*, in a recent risk bulletin. The Paris-based insurer noted that the “display of force was not unexpected” given the Israeli elections scheduled for February and a hiatus in Washington prior to the Obama presidency.

Inge Lambrechts, country policy advisor for Belgium's *Office Nationale Du croire Delcredere (ONDD)*, noted that “the conflict has not truly spread to neighbouring countries”, despite the protests against Israel's offensive. Israel fired artillery at Lebanon on 8 January, attributed by the *Israeli Defence Force* as a response to rockets fired at northern Israel. “The situation at the border

between Israel and Lebanon is tense but *Hizbollah* quickly denied responsibility for the rockets that were launched from Lebanon and hit northern parts of Israel,” Lambrechts said.

Jardine Lloyd Thompson's head of credit and political risk analysis, Elizabeth Stephens told *GSN* that “the risk profile for Israel has increased in response to uncertainty surrounding the duration of the conflict and any form of retaliation by ‘terrorist’ cells against it.” She added that “Lebanon, given its geographical proximity, could be considered a higher risk now for political violence but its government appears determined to keep the country out of the conflict.”

“The current Gaza-based conflict does not materially alter our risk perspective on the region,” noted another insurance sector analyst, who preferred to speak anonymously. “This is partly because Palestine – let alone Gaza – is not a sovereign entity but mainly because such episodes are built into our risk perceptions. Another layer to that is that the Israeli economy can perform well under intensified military action,” he said.

In terms of wider risks such as *Hizbollah* opening up another front from Lebanon, or the direct involvement of Syria or Iran, “we can discount these for now”, the insurance sector analyst

said. “However, there must be containment of the conflict either through a quick military resolution, which would appear unlikely to some, or a ceasefire. If this does not take place then our risk perceptions may alter, but not before.”

“I haven’t personally seen any consequences worthy of comment yet,” added **David Neckar**, executive director political and credit risk at *Willis*’ London unit. The daily pace of events makes judgement calls difficult, according to **James Cunningham**, head of *Marsh*’s political risk broking team in London, and “we are not passing any comment on this issue for now, as things are evolving quickly.”

Limited impact on GCC markets

A prevailing view is that Gulf Arab markets are unlikely to see much if any impact from the escalating violence in Gaza, as investors deem the conflict to be localised rather than regional. By way of illustration, the *Saudi Stock Exchange (Tadawul)*, the Arab world’s largest, closed higher for a ninth successive day on 7 January. “From what we’ve seen the impact hasn’t been that dramatic across the region and is fairly localised to the territory involved in the conflict,” JLT’s Stephens pointed out.

Equally significantly, brokers and insurers told GSN that political risk pricing for the GCC area had altered only negligibly if at all since the conflict erupted. “To date events in Gaza have had no noticeable impact per se on demand, appetite or pricing – all financial markets seem to be underestimating the geopolitical risk largely because of the focus on the credit crunch and economic slowdown,” *ACE Global Market*’s London-based head of country and credit risk management **Steve Capon** said. “We are not cutting limits or changing strategy in relation to the wider Middle East,” Capon added. “Our approach to risk in the region for the past four years has taken into account the Israel-Iran issue and its various scenarios. So we continue to write risks with this in mind.” Similarly, there has been no change of ONDD’s cover policy for any Middle East countries since the start of the Israeli offensive, Lambrechts affirmed.

Stephens observed that the GCC countries “are considered to be directly affected so perceptions of risk haven’t changed.” She added: “There have been shows of solidarity with the Palestinians in some countries with an increase in strikes in **Egypt** for example. In the short term this could be considered to affect strikes, riots and civil commotion risk but will be very short-lived i.e. until the end of Israeli attacks on Gaza.”

Iranian angles

The attacks against Hamas “can also be regarded as a warning for Iran, which is still defiant on its nuclear programme and is considered to be one of Hamas’ sponsors”, Lambrechts said. This echoed a view that one observer raised, that “the Iran/US issue is increasingly the Iran/Israel issue.” He continued: “Iran will not stop developing its nuclear capability and many believe it should achieve this by end of this year although it may not test. Indeed, the consensus is that Tehran is unlikely to militarise in

the short-term, their objective being what is known as ‘strategic ambiguity’ whereby **China**, **Russia** and others support Tehran up until they militarise.” In the face of this threat, “the new US administration, plus the **UK**, **France** and **Germany** are showing no appetite for intervention, now accepting that Iran will go nuclear and looking to secure a **North Korean** style solution,” the analyst said. Israel, by contrast, “believes Iran continues to represent an existential threat to its existence, and views the ‘strategic ambiguity’ scenario as presaging a deal between Tehran and either the US, or if that fails with regional powers in the Gulf,” he noted. “Either way Israel sees this as weakening its influence in the region and its strategic flexibility, and fears the impact that this status would have on their geo-political influence and also on Iranian proxies in Lebanon and Palestine.”

This analyst added that “Hamas and Hizbollah would probably be emboldened, especially as Iran would feel she could provide more arms to her proxies in the knowledge she has a potential nuclear protection blanket. For some the next 12 months is perceived as the last opportunity to clear out those proxies before Iran goes nuclear. Therefore the move against Hamas could be seen in this context and we could expect moves against Hizbollah – an air campaign is the most likely. Even air strikes against Hizbollah would significantly increase fears of a broader regional conflict.”

According to ACE’s Capon, Israel “will probably consider military intervention [in Iran] over the next six months even without explicit US support – but only as a last resort.” The picture is complicated by 2009 elections in both countries. Capon observed that if Iranian President **Mahmoud Ahmadinejad** “feels he is likely to lose the June elections he may provoke Israel and/or the US.”

Regarding Israel’s forthcoming elections, the key political movers – *Kadima*, *Labour* and *Likud* – have traditionally been keen to go into electoral battle having shown evidence of strength. “A military interlude may strengthen those three parties at the expense of smaller religious groups that usually have a disproportionate say in coalition governments,” said another analyst.

The most likely outcome, said Capon, would see hardline former prime minister and finance minister and Likud party chairman **Benjamin Netanyahu** becoming prime minister and forming a government with Labour, possibly with **Ehud Barak** retaining the defence portfolio (which he has used to rebuild his political career). “Security therefore dominates the agenda,” and over a longer horizon, “a nuclear Iran could result in regional nuclear arms proliferation.” The fallout from this could involve the further straining of Sunni and Shia relations, “which could be destabilising for a number of states but especially **Bahrain**.”

In Gaza, Euler Hermes is forecasting no swift resolution of the key issues in 2009. “Hamas is unlikely to be defeated entirely and support for it may even grow so that a long-term solution to the Palestinian problem is still required,” it says.

Domestic politics: Potential presidential election candidates

- There is growing speculation over the identity of candidates in this year's presidential election. While *Rahbar* (Supreme Leader) Ayatollah Ali Khomeini seems comfortable with the president's team, there are a number of plausible conservative challengers were Mahmoud Ahmadinejad to have outlived his usefulness. They include Tehran mayor Mohammad Baqer Qalibaf and Majlis speaker and ex-nuclear negotiator Ali Ardashi Larjani.
- Pressure on reformist ex-president Mohammad Khatami has reportedly intensified in recent weeks, and those clamouring for his return include not only many reformists but also some prominent conservative politicians. Khatami has said he would not compromise on his call for a more democratic government, were he to head the executive again; he told guests at a recent Majlis that economic development could not be achieved without democracy.
- Potential reformist candidates also include the 71-year-old former parliamentary speaker and cleric Mehdi Karroubi, who has already announced his candidacy.
- Also contender is Hassan Rowhani, Iran's top nuclear negotiator from 2003-05. According to the *Financial Times*, he is believed to have received the green light from Khamenei and has recently increased his attacks on Ahmadinejad's economic policies.

International relations: US policy

- US President-elect Barack Obama will take a new approach to Iran, emphasising respect for its leaders and spelling out expectations for their behaviour. Speaking on 11 January in an interview with *ABC*, Obama said that "Iran is going to be one of our biggest challenges." Tehran's support of *Hizbollah* and nuclear enrichment was a concern, but in a move away from the Bush administration's policies, Obama said he would seek much broader engagement with Iran. Tehran has responded by saying it will wait to see if Obama's remarks lead to "essential change" and then take appropriate matching actions. During the election campaign Obama regularly talked tough on Iran (*GSN 837/6*).
- Former Pentagon chief William Perry this month said that Obama would soon face a nuclear crisis with Iran, which was "moving inexorably toward becoming a nuclear power, with ominous implications for the Middle East."

Economy: Tackling subsidies

- With oil prices plummeting, there are signs the government might finally be moving to tackle its gritty subsidies problem. In late December, President Mahmoud Ahmadinejad presented a plan to the Majlis Al-Shura that would end energy subsidies, which have long been a drain on the economy; they are said to account for an estimated 25% of government spending (\$100bn/yr in direct and indirect subsidies); gasoline is sold for \$0.36/gall and electricity at just \$0.006/kwh.
- Ahmadinejad has urged the parliament to vote for the bill because of the need to curb costly energy consumption, but economists have warned that the move could spur inflation – already at nearly 30% – and raise unemployment. The past few years' high oil prices have up till now masked the urgent need for structural reform, while the populist president has shown himself to be a subsidies junkie, reluctant

to put the breaks on spending in an election year. But pressure on the government has risen as oil prices have fallen. "Falling oil prices encourage us to promptly implement the bill – it is time we made a decision," Ahmadinejad told the Majlis, which has agreed to study the package and vote within a month.

- Mindful of the need to appeal to voters, Ahmadinejad reportedly plans to offset the unpopular plan's impact by promising to place much of the money now paid in subsidies directly to the poor in the form of a monthly allowance. *Bank Markazi Jomhouri Islami Iran* (Central Bank of the Islamic Republic of Iran) governor Tahmasb Mazaheri was removed last autumn after publicly opposing moves such as this (*GSN 838/3*).
- In a further sign of the new thrift, *Rahbar* Ali Khamenei in early January ordered that 20% of oil and gas revenues should in future be set aside for a new investment fund. This is part of a set of guidelines to be included in Iran's next five-year development plan (2010-15).

GSN view: Kuwait's Dow deal débâcle

CONTINUED FROM PAGE 16

and is a total waste of public money," it said. The Bloc also criticised the size of the penalty clause. In response, Al-Olaim stressed that negotiators of *Kuwait Petroleum Corporation* and its PIC subsidiary had "made strenuous efforts to reach a fair deal with Dow Chemical." Referring to the penalty clause, Olaim said that without it "the judicial claims could be open, thus leaving the door open for the judge to decide any sum of money."

The Islamic Constitutional Movement (ICM) has led calls for an investigation of the joint venture amid accusations that ICM members may have benefited from the project; Al-Olaim is associated with the ICM. ICM MP *Jamaan Al-Harbash* supported the calls for an investigation, saying that "Kuwait has now become the laughing stock of the whole world due to this deal." Influential ICM MP *Nasser Al-Sane* said he had been receiving text messages accusing him of benefiting from the deal, and so he was also eager for an investigation. However, as of 14 January, legislators had failed to reach an agreement on the formation of a committee, with public disagreements over what the focus of the investigation would be.

At a time when many Kuwaitis are feeling the pinch of the global financial crisis – with heavy losses at the *Kuwait Stock Exchange*, *Kuwait Investment Authority* and a liquidity shortage among financial companies, as well as the low price of oil – it is not unusual that talk of a joint venture with a foreign company would come under severe scrutiny and opposition. In Kuwait's deeply conservative, nationalist society, it was near impossible to sign major deals with foreign companies in 'strategic sectors', even when liquidity was abundant. However, the KDow debacle – which is likely to play out in the courts and in the press as the US giant struggles to come to grips with its own financial issues – will undoubtedly leave a scar on Kuwait's reputation as a place to do business.

Risk management reports (RMRs)

Following *GSN's* special December issue (842), *Assessing political, financial risk across the region*, our RMRs have been slightly redrawn – details on the website. After a rest this issue, the standard fortnightly double country RMR format will return in issue 846, starting with *Bahrain and Iran*.

25-26 January: Operational Risk Management for Banking & Finance, Manama

Contact Vmac Group. Web: www.vmacgroup.com/

26-28 January: Global E&P Summit, Barcelona

The third annual staging of this WTG event. Web: www.epsummit.com/

28-30 January: Gas Transport & Storage Summit, Barcelona

Organised by WTG Energy. Web: www.gtsevent.com/

9-10 February: Middle East Energy 2009, London

Tel: +44 (0)20 7957 5753. Web: www.chathamhouse.org.uk/energy09

17-18 February: Islamic Project Finance, Dubai

Contact Fleming Gulf. Web: www.fleminggulf.com

24-25 February: 8th Annual Islamic Finance Summit, London

Web: www.euromoneyseminars.com

24-25 February: Middle East Trade and Export Finance, Dubai

Tel: +44 (0) 20 8673 9666. Web: www.exportagroup.com

18-19 March: 4th OPEC International Seminar, Vienna

Tel: +44 (0)20 7017 7711. Contact: Web: www.opecseminar.org

23-24 March: LNG 2009, London

SMi's annual event. Web: www.smi-online.co.uk

23-25 March: Middle East Energy Security Forum

Tel: +971 4 609 1578. Email: afrah.saibo@fleminggulf.com

25-26 March: Project Finance Middle East, London

Contact SMi. Email: sbrock@smi-online.co.uk Web: www.smi-online.co.uk

30 March-2 April: Islamic Finance World North America

To be held in New York. Tel: +1 212 379 6320. Web: www.terrapinn.com/2009/iivamericas/

20-21 April: Legal Issues in Oil and Gas, London

Email: lkennedy@smi-online.co.uk Web: www.smi-online.co.uk

22-23 April: Reducing Political Risks in Oil & Gas Contracts

To be held in Paris. Web: www.c5-online.com/legal/oilgascontracts.htm

3-5 May: Strategic Private Equity Investment Middle East

To be held in Dubai. Tel: +971 460 915 86. Web: www.fleminggulf.com

4-6 May: Smart Grid and Smart Metering Middle East, Dubai

Tel: +27 21 700 3500. Web: www.spintelligent-events.com/

26-27 May: TradeTech Middle East, Dubai

Tel: +971 4 363 3557. Web: www.wbr.co.uk/TradeTechmiddleeast/

26-27 May: Middle East Project Finance Forum, Abu Dhabi

Tel : +971 4 609 1575. Web: www.fleminggulf.com

DATA: Stock markets, trade payments and exchange rates

Stock Market (Index)	Index value (15 January 2009)	Index % change One week	Since 01.01.09	2008 performance	Preferred terms	Currency	£	Exchange rate \$	€	¥ (x100)
Bahrain ¹	1,756.15	-1.35	▼	-2.66	-34.52	OA (Dinar)	0.5485	0.3770	0.4963	0.4245
Iran ²	8,463.7	-1.31	▼	-2.66	11.10	CIA (Rial)	14,556.00	10,005.50	13,171.20	11,266.20
Iraq	n/a	n/a	-	n/a	n/a	CIA (New Dinar)	1,677.68	1,153.20	1,518.07	1,298.50
Jordan ³	2,774.58	-1.0	▼	0.58	-24.94	OA (Dinar)	1.0316	0.7091	0.9335	0.7984
Kuwait ⁴	7,079.2	-3.97	▼	-9.04	-38.03	OA (Dinar)	0.4151	0.2853	0.3756	0.3212
Oman ⁵	5,021.55	-7.48	▼	-7.71	-39.78	OA (Rial)	0.5602	0.3851	0.5069	0.4336
Qatar ⁶	5,632.30	-12.43	▼	-18.21	-28.12	OA (Rial)	5.2980	3.6418	4.7940	4.1007
Saudi Arabia ⁷	4,935.33	-7.27	▼	2.76	-56.49	OA (Rial)	5.4563	3.7505	4.9372	4.2231
UAE – Abu Dhabi ⁸	2,385.35	-5.62	▼	-0.19	-47.49	OA (Dirham)	5.3440	3.6734	4.8356	4.1362
UAE – Dubai ⁹	1,643.65	-4.93	▼	0.45	-72.42	OA (Dirham)	5.3440	3.6734	4.8356	4.1362
Yemen	n/a	n/a	-	n/a	n/a	ILC (Rial)	291.113	200.105	263.418	225.318

¹ Bahrain Stock Exchange – All Shares Index. ² Tehran Stock Exchange – Tepix Index. ³ Amman Stock Exchange Index. ⁴ Kuwait Stock Exchange Index. ⁵ Muscat Securities Market – MSM 30 Index. ⁶ Doha Securities Market – DSM 20 Index. ⁷ Tadawul All Shares Index. ⁸ Abu Dhabi Securities Exchange. ⁹ Dubai Financial Market. n/a = data not available ULC = Unconfirmed letter of credit. ILC = Irrevocable letter of credit. CIA = Cash in advance. OA = Open account

Sources: Reuters, Global Consultants, New York. Cross-border Information, Hastings. Financial Times, London

Kuwaiti government caves in to populist calls by cancelling KDow deal

The breakdown of the deal between **The Dow Chemical Company** and **Petrochemical Industries Company** – in which the Kuwaiti state-owned PIC would take a 50% stake in the **United States'** largest chemicals group for around \$9bn in return for the Americans developing the emirate's downstream value-added via the **KDow** joint venture – is unsurprising. Not only does the harsh global financial climate make the deal unattractive (Dow's share price has more than halved over the last 12 months), but the **Popular Bloc** in the National Assembly and other Kuwaiti opponents have long fought against the government's plans to open up the upstream and downstream hydrocarbons sectors to foreign companies: the KDow deal would have marked a significant precedent, which the state does not appear ready for yet.

These events will not help executives in other major international companies (and especially of US firms) who are, at present, weighing up their strategic options for Kuwait (*GSN 842/1*). The best that can be said, as both sides line up expensive legal teams, is that the affair is a reminder of Kuwait's genuinely democratic flavour, that makes it distinctive in the **Gulf Co-operation Council** region. In this political environment, disputes between government and members of parliament are an everyday factor, however frustrating to business partners. This will continue, with Prime Minister Sheikh **Nasser Mohammed Al-Sabah** still under intense pressure despite finally naming a 'new government', while pledging his determination to "double efforts... for positive co-operation with parliament in shouldering national responsibilities" (*see Politics, above*).

Over recent months, *GSN* had heard that Dow suspected problems, including possible contract revisions, but it is understood that the company had been reassured that all was basically well only weeks before Kuwait's end-December announcement of the cancellation. The rush to cancel the KDow venture was determined by a clause stipulating that a penalty fee of \$2.5bn would have been

due if either party were in breach of the contract after 1 January. The **Supreme Petroleum Council**, chaired by Sheikh Nasser Mohammed, therefore took the decision to cancel the agreement on 28 December.

In a statement, Dow Chemical said it was "extremely disappointed". However, it would appear that Kuwait has a strong legal case to avoid Dow's attempts to sue it for the penalty fee, given that it had not yet signed any written agreement. Dow said it was awaiting written notification after it had only been "verbally informed" of PIC's then plans to go ahead with the venture.

Opposition to KDow was led by Popular Bloc leader **Ahmed Al-Saadoon**, who voiced concerns at the size of Kuwait's investment and the deal's transparency. The government has refuted claims that individual members benefited from the deal, and at first resisted pressures to cancel it. On 22 December, then oil minister **Mohammed Al-Olaim** insisted the joint venture would go ahead, saying that "the deal has passed through proper channels after thorough studies." But with the resignation of the cabinet and MPs threatening to grill the prime minister, as well as past experience of delays to schemes such as Project Kuwait and the planned fourth refinery at Al-Zour, the government clearly decided to cut its losses. Al-Olaim has been replaced, for the moment on an acting basis, by Foreign Minister Sheikh **Mohammed Sabah Al-Salem Al-Sabah**.

Outlining its objections to KDow, the Popular Bloc said in a statement that it was unhappy that the deal was signed after the government had resigned, and with parliament effectively suspended by the government's absence from sessions. "Signing the contract at the time and the inexplicable rush in finalising the deal raised many questions... the worst aspect of the controversy is the overrated sums of money allocated for the project that seems beneficial to the other party

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