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## G S N

### Companies & People

#### **Qatar And Saudi Arabia Have Yet To Make Up**

Snubbed by the absence of Saudi Arabia's **Crown Prince Abdallah** from last month's Gulf Co-operation Council summit in Doha, Qatar has rejected Riyadh's suggestion the UAE mediates in their dispute. Qatar wants face-to-face talks. Nor is Emir Sheikh Hamad Bin Khalifa Al-Thani willing to give ground on the editorial freedom of Al-Jazeera Satellite Channel, the US military presence at Al-Udeid or his democratic reforms, all of which irritate the Saudis.

The absence of CPA and **Bahrain's King Hamad Bin Isa Al-Khalifa** from Doha was much noticed. But the UAE, **Kuwait** and **Oman** were represented at standard summit level and the meeting launched the GCC customs union and confirmed 2010 as start date for the single currency. It was a quiet success for GCC Secretary-General **Abdelrahman Bin Hamad Al-Attiyah**, a Qatari.

CP Abdallah remains a driving force behind projects such as the GCC currency and power grid, regardless of his annoyance at Qatar's GCC chairmanship in a crucial year. To ensure Doha does not claim all the credit, Riyadh may step up its promotion of regional integration.

### Across the Region

The smaller Gulf monarchies must respond to change in 2003, as their populations become restive over a range of domestic and international issues. **PAGE 3**

**Bahrain is tense following New Year's Eve riots in Manama** when hundreds of youths attacked Saudi and other targets; peaceful demonstrations have been held against the US presence. Following the new Parliament's first sitting King Hamad has hinted at a readiness to move the political process along further. **PAGE 4**

**Kuwaitis are ambivalent about war but the Emirate's main conflicts are domestic, pitting Islamists against the Al-Sababs and liberals like Finance Minister Youssef Al-Ibrahim.** Education is one important battle zone. **PAGE 3**

**Qatar's Sheikh Hamad counts on domestic support for the massive US military presence, but the spat with Saudi Arabia and suspicions of continued links with Israel are among factors making life more uncomfortable.** **PAGE 3**

**Local elections are planned in Qatar, where Al-Misnad influence grows.** **PAGE 8**

**The assassination of Jarallah Omar shook Yemenis during a period when opposition realignments could pose a new challenge to President Saleh.** Parliamentary elections are scheduled in April. **PAGE 5**

**The battles to constrain conservatives powers continue in Iran,** with some liberal advances in social policy offset by hardline efforts to clamp down on freedoms fostered by President Khatami. GSN analyses recent developments as reformists and conservatives threaten finally to come head to head. **PAGE 6**

**Conservative Mohsen Rezaie has toned down fears that US aggression against Iran could play into hardline hands.** **PAGE 8**

**A new generation of techno sheikhs is emerging in the UAE. Ruling families are producing a younger generation of political and business leaders.** **PAGE 20**

**Iraq's sanctions list is revised.** **PAGE 10**

**The IMF broadly approves of Kuwait's economic programme.** **PAGE 18**

**The Abu Dhabi Fund and IDB continue to lend and grant billions of dollars.** **PAGE 18**

### GSN's Analysis

It seems inevitable the Iraq crisis will be resolved in 2003. As the regional status quo changes key states, face reduced revenues; Iran is confronted with isolation and Saudi Arabia with the prospect of a democratic Iraq on its doorstep. With the Palestinian conflict a raging sore swathes of the international community have opted out of the war against terror — and while the Bush Administration may find its Iraqi gambit enjoys tactical success it could well fail to achieve its strategic objectives, leaving the Middle East even more unstable in 2003 than it was in 2002. **GSN VIEW, PAGE 2**

**In an economic outlook for 2003, GSN takes a view on oil prices and Gulf budgets, payments and other prospects for business.** **BUSINESS TRENDS, PAGE 14**

**Kuwait's strategy to protect its oil exports is a blueprint for the region during a period of heightened market tensions.** **BUSINESS TRENDS, PAGE 13**

**Iraq's infrastructure will quickly be targeted in a new war, but in a more sophisticated and public relations-friendly way than in 1991. GSN analyses the prospects.** **MEI IRAQ, PAGE 11**

**Concerns over Iran's political crisis only partly offset good financial news. GSN maintains a cautious C-/3 Risk Grade.** **RISK MANAGEMENT REPORT, PAGE 17**

**Bahrain remains volatile, but for now GSN keeps its C+ political Risk Grade.** **RISK MANAGEMENT REPORT, PAGE 16**

**The USA has escalated its programme of psychological operations, to transform Iraq's psychological environment, reduce Arab and international antipathy to US policy — and create a platform for a new political dispensation in the Middle East.** **CENTREPIECE, PAGE 9**

**One year ago, GSN saw an extremely challenging time approaching, with reformist leaders in Iran and Saudi Arabia sore tested to overcome internal resistance to structural change. Pakistan's conflict with India provoked concerns that the USA's victory in Afghanistan could produce fallout of the worst kind, while the political fallout from the war against terror had settled on Saudi Arabia.** **PERSPECTIVE, PAGE 2**

## GSN View

The issue of inevitability hung over 2002 like the sword of Damocles, but the last year saw very few inevitable events in the Gulf. Saudi Arabia did not radicalise to the extent feared one year ago, and its relations with the USA — based on the rocks of durable strategic and economic fundamentals — weathered some very severe storms (*GSN 699/3; 677/3*). An early, unilateral US operation against Iraq may have come close in November but did not happen. However, it seems inevitable that the Iraq crisis will be resolved in 2003 and the status quo will thus change. Less certain is what form resolution will take, although disarmament, regime change and US occupation of Iraq are likely outcomes.

It looks highly likely that in 2003 one uniquely powerful external actor, the USA, will recast Iraq's government and redistribute the balance of power in the Gulf. Key regional states and UN Security Council partners face acute disadvantages: Saudi Arabia, Iran and Russia face reduced oil revenues after an un-embargoed Iraq's rehabilitation. Iran faces isolation and encirclement as the sole remaining Gulf member of President George W Bush's Axis of Evil. Saudi Arabia faces the unpalatable prospect of a democratic Iraq on its doorstep — which, if made to work, could represent a more seductive and persistent challenge to the royal family's primacy than either the Arab socialist regimes or Osama Bin Laden's brand of radical Islam. Egypt, Turkey, Syria and Jordan cannot count on the return of their current patterns of trade once regime change is effected in Baghdad.

The reality is that a new war against Iraq has been sought by only one nation — the USA — and although it is broadly accepted that Iraq was not directly involved in the 11 September 2001 attacks, 9/11 aftershocks continue to drive US policy. 2002 saw the Department of Defense buzzword transformation migrate from defence modernisation to broader regional policy. The war against terror changed from an attempt to defeat

America's current foes (with Bin Laden and most of his cronies still on the run) to an attempt to transform the regional environment that cultivated them. Increasingly, the Administration's objectives have incorporated the dissemination and entrenchment of democracy across the greater Middle East.

Iraq has become the centrepiece of this Wilsonian recasting, and the pursuit of this idea will drive US policy and regional events in 2003. Although US leaders are banned from using the word, this is a crusade. With even the UK's resolve wavering — although not Prime Minister Tony Blair's instinct to stick with Bush and a policy rooted in shared religious-tinged values — the majority of the international community has opted out of the broader war against terror. As in 1991, the phenomenon of a consensual New World Order was short-lived. Goodwill towards a hegemonic America was quickly spent by the Pentagon and by Israel.

In 2003, the war against terror — including a probable war against Iraq — will become a war with three sides, in which states choose to be neither for nor against the USA — unless overtly bullied into action by Washington. Faced with the option of tackling Middle East issues from the Israel-Palestine end or the Gulf end, Bush opted for Iraq. Few doubt the US military will win the battle with Saddam Hussein, perhaps quickly; evidence is scant that the Arab street is the potent force some Western analysts fear. But there will likely be a major increase in the Islamic world's simmering discontent, and success in a war against Iraq could represent a setback in the war against terror, driving at least some of the Arab street into the Islamist underground. Borrowing from Saddam's style, the Bush Administration may find its gamble enjoys tactical success, but fails to achieve strategic objectives, leaving the Middle East even more unstable in 2003 than it was in 2002.

## Perspective: One Year Ago

This will be another extremely challenging year for the Gulf region. Leaders promoted abroad as reformists, notably Iran's President Mohammad Khatami and Saudi Arabia's Crown Prince Abdallah Bin Abdelaziz, will be sore tested to prove they can overcome internal resistance to the structural changes the Gulf's biggest populations demand. We fear these leaders' innate conservatism will hold them back while at street level the social situation — and political perceptions — deteriorate. Meanwhile potentially bigger political problems still beckon. While Pakistan's conflict with India provoked concerns that the USA's victory in Afghanistan may yet produce fallout of the worst kind, the political fallout from the war against terror has settled heavily on Saudi Arabia, where the humiliation of radical Islam has directly impacted on many families.

As fears about the imminent collapse of Pakistan have receded, concern about the Saudi regime's political health has increased. Unusually virulent criticism of the Saudi royal family in the USA and international media has

fostered the impression that something has suddenly changed — an assertion that those charged with a watching brief over Saudi affairs might contest. Yet gloomy economic forecasts, unusual public order incidents and unusually straight talking from some Saudi royals have cemented growing concern about the stability of the Al-Saud dynasty. Any turbulence in Saudi Arabia would have serious spillover effects in the region. Small states locked into the Saudi orbit such as Bahrain and Qatar would feel the tremors.

Kuwait will continue to depend on US military support — and the USA will remain the key guarantor of Gulf security in 2002. It could also prove the biggest cause of turbulence in the region if, as seems increasingly likely, Washington turns to Iraq in its war against terrorism — possibly after a mixture of military, intelligence and financial moves against countries such as Yemen, Somalia and Sudan.

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# Monarchies Squeezed By International Pressures

**W**ar or no war with **Iraq**, the Gulf coast Arabian monarchies find themselves confronted with the impossibility of escaping regional change over the coming year. That will be decided for them by Washington, Baghdad and the **United Nations Security Council** in events that will shape the smaller states domestic arrangements, local inter-governmental relationships and **Gulf Co-operation Council** efforts to find enhanced strength and security.

**Bahrain, Kuwait, Oman, Qatar** and the **UAE** have almost no control over the international context in which their own political and social evolution will be played out. They make no secret of their public preference for a peaceful resolution of the Iraq crisis, but this not an issue on which they will have a decisive voice. None of the five is in a position to make the diplomatic weather, but they must respond to storms (*GSN 694/3*).

The smaller Gulf states have exhibited an impressive ability to adapt to new circumstances and cope with developments that, at one time or another, have appeared likely to undermine their local equilibrium. Popular affection for leaders such as UAE President and **Abu Dhabi** Ruler **Sheikh Zayed Bin Sultan Al-Nahayan** and Oman's **Sultan Qaboos Bin Said** give a wide margin of manoeuvre and domestic acquiescence. In all the Gulf monarchies, well-equipped security services and huge patronage networks underwrite family rule.

If war goes ahead, the Zayeds and Qabooses will probably be able to afford the **USA** and its military partners a measure of low-key co-operation without domestic upheaval — although student demonstrations in staunch Western ally Oman suggest that even here problems could ensue.

It would not be surprising if the UAE authorities took a discreet hand in steering demonstrations against an American intervention in Iraq, the better to channel protest and keep it within limits — as happened with demonstrations against the **Israeli** crackdown in the West Bank and Gaza, an issue about which Sheikh Zayed feels passionately.

### QATAR IN THE FIRING LINE

Qatar's **Sheikh Hamad Bin Khalifa Al-Thani** appears to have a degree of public acceptance of the massive US military presence at Al-Udeid airbase. Qataris' readiness to tolerate this may even have been enhanced by the cold shoulder turned to Sheikh Hamad by giant neighbour **Saudi Arabia** — angered by **Al-Jazeera Satellite Channel** and other issues (*GSN 699/6; 695/3*). This meant **Crown Prince Abdallah Bin Abdelaziz** stayed away from the mid-December GCC summit.

Riyadh's rejection of overtures from Qatari Foreign Minister **Sheikh Hamad Bin Jassim Bin Jabr Al-Thani** could risk being regarded as bully tactics; some Qataris canvassed by *GSN* have expressed quiet satisfaction and Ruler Sheikh Hamad's move to distance Doha from the Wahhabi Kingdom. But repeated Saudi snubs — emulated in lower key by Bahrain and Kuwait — have effectively punctured Qatar's ambitions to play a diplomatic bridge-building role, exploiting its strong ties with Baghdad, Europe and the USA.

Sheikh Hamad Bin Jassim still has a few cards to play: this year, Qatar is not only GCC chair, but it remains chairman of the **Organisation of Islamic Conference (OIC)**. Western diplomats in Doha observe that even Saudi Arabia cannot ignore this.

However, Qatar's diplomatic spats may give a bigger role to the Kuwaitis or perhaps the UAE.

Qatar's prospects of regaining favour in Riyadh have not been helped by claims in Israeli newspaper *Yediot Ahronot* that despite the official closure of the Israeli trade office in Doha, Israeli representatives remain active in the Qatari capital. Israeli business delegations reportedly pay frequent visits, while Qataris seek visas for Israel, to visit Jerusalem or seek medical treatment.

### KUWAITI AMBIVALENCE

In Kuwait, attitudes towards the prospect of war are mixed. Almost everyone is understandably apprehensive; some Islamists are overtly critical of the USA, and there is a substantial Islamist underground which has been apparent in recent attacks on US personnel and, through leading luminaries such as **Khaled Sheikh Mohammed** and Osama Bin Laden's spokesman **Sulaiman Bu Ghaith**, in **Al-Qaeda**'s ranks (*GSN 698/3*).

But fear, loathing and a strong sense of national identity mark attitudes towards **Saddam Hussein** — and whatever their private worries, a majority of Kuwaitis feel their government has every right to permit the mass basing of US troops on national territory.

The Kuwaiti government is under pressure, mainly from populist and Islamist MPs opposed to market-oriented economic reforms. There is speculation about another Islamist attempt to submit liberal Finance Minister **Youssef Al-Ibrahim** to a fresh parliamentary grilling and a motion of no-confidence. Last year, Ibrahim narrowly survived efforts to force him out of office, with his opponents pursuing transparency issues. This time round, the ostensible cause of concern is different, but the unspoken subtext is populist worry at the minister's determination to overhaul

Kuwait's state-dominated economy and lavish welfare system. In the long term, such changes are likely to help the country to attract more foreign investment and new technology activities, improve public services and secure Kuwaitis long-term employment prospects. But the new approach is unsettling for a society which has grown accustomed to reliance on an all-providing if sluggish state machine.

This time around the new liberal-progressive nationalist alliance of MPs could employ more proactive procedural tactics to derail any fresh conservative assault on Ibrahim. Veteran leftist/nationalist **Abdallah Al-Naibari** — one of the Assembly's most respected members — is rumoured to be planning his own proposal to grill ministers over proposed cheap allocations of construction land, in a bid to forestall moves against Ibrahim.

The government is struggling to carry off a difficult double act. It is trying to circumvent conservative resistance to economic reform — an important long-term preparation for a post-Saddam era in which Kuwait might hope to revive its position as a business hub for the northern Gulf. But it also has to cope with Islamism's persistent political muscle, especially in education.

Ministers have set up panels to review text books, to check whether they include language that might inspire violence and fanaticism. Higher Education Minister **Musaed Rashed Al-Haroun** is from a liberal background and wants to ensure the textbooks lay adequate emphasis on Islamic principles of tolerance, brotherhood and mercy. But he is well aware that to successfully carry through

the textual review he will need to build a consensus well beyond his own political camp. He has to reach out to the Islamists and has therefore invited parliamentarians to talks.

Kuwait has been consolidating its regional relations. Deputy Premier and Foreign Minister **Sheikh Sabah Al-Ahmed Al-Sabah** was to visit **Iran** on 11 January for talks which could at last finalise the two countries' maritime border agreement. This would include the offshore Dorra field, the focus of a potential joint gas project involving territory shared with Saudi Arabia.

Kuwait and Saudi Arabia are expected soon to agree on terms for the administration of their joint offshore zone, uniting the joint administration of the Al-Khafji area following the takeover by **Kuwait Gulf Oil Company** of the concession previously operated by **Japan's Arabian Oil Company**.

#### WHERE CAUTION IS KING

Faced with continuing Kuwaiti reminders of the complications posed by life with a lively parliament, the UAE seems unlikely to abandon its cautious approach to political change — save for the frequently rumoured possible appointment of women to the **Federal National Council**.

In Oman and Qatar, parliamentary development will continue, but in an apparently comfortable situation for their rulers. In Oman, ministers are pressured, but Sultan Qaboos' personal standing remains apparently unaffected. In Qatar, Sheikh Hamad has pinned much on the election of a National Assembly whose election is unlikely to herald radical change (*see page 8*).

#### Bahrain On tenterhooks

The prospect of war in **Iraq** threatens new difficulties for **King Hamad Bin Isa Al-Khalifa's** government. The Kingdom's new Parliament has already made clear its opposition to military action against Baghdad. New Year's Eve riots around Manama's Exhibition Road area saw hundreds of youths rioting, attacking hotels and cars — many **Saudi**-registered — in a neighbourhood favoured by Saudi and **Kuwaiti** weekend visitors. Several women were attacked, and some vehicles were set alight. Police deployed tear gas and eventually arrested 45 people, although almost half were rapidly freed or released on bail. Three days later, after Friday prayers, around 400 protesters staged a peaceful demonstration against the presence of the **US** Fifth Fleet and the prospect of war against Iraq.

These events appear to spring from slightly differing causes. The rioters were mainly young men and teenagers, their anger apparently fuelled by a blend of long-standing social and economic frustrations — in a country where local unemployment is relatively high and many families, particularly Shias, have relatively low living standards. Weekend break visitors from wealthier Gulf states appear to have been the target, as much as any wider concern about Iraq and **Palestine**. But it is also the case that anti-American feeling is widespread.

The mainstream political opposition — notably the **Al-Wafaq National Islamic Alliance**-led coalition of Shia and liberal groups which boycotted the parliamentary elections — knows violence is

more likely to scare the government into slowing reform than it is to force a change of policy. The opposition joined other parties in issuing an uncompromising condemnation of the riot.

Since the controversial elections, and with Parliament now in place, King Hamad has been hinting at a readiness to move the political process on further. On 5 January, he received Deputy Chairman of the **UK** Parliamentary Human Rights Group **Lord Avebury**, a long-time activist on Bahraini human rights, who was on a visit sponsored by local groups. Avebury said the King agreed further reforms were possible and indicated a readiness to hear good ideas from any quarter. Avebury suggested the elected National Assembly and local parties could be given more powers. It remains unclear how far the King is prepared to pursue such notions, but he may have been encouraged by his broadly positive talks with Avebury.

War would inevitably create a more difficult climate for further political development, in which it is harder for the King — who is publicly committed to the strong alliance with the USA — to persuade the opposition of his genuine commitment to further reform, and in which it would be harder for the opposition to be seen working with him. The elected Parliament seems unlikely to rock the boat, dominated as it is by government supporters and Sunni religious conservatives. Chairman **Khalifa Al-Dahrani**, Parliament's oldest member, is a pro-government independent for Riffa — where royal residences are concentrated. He gained 90.15% of the vote in October's poll.

# Yemen Abuzz With Rumour After Assassination

The murder of three American staff from the Baptist Hospital in Jableh attracted renewed international attention — and another visit from US *Federal Bureau of Investigation (FBI)* anti-terrorism experts — but Yemenis are far more troubled by the 27 December assassination of veteran leftist **Jarallah Omar**.

*Yemeni Socialist Party* Deputy Secretary General Omar was shot just after addressing the conference of *Al-Islah*, the Islamist party. A noted advocate of peaceful opposition to President **Ali Abdallah Saleh**, Omar had impressed *Islah* leaders with a speech that harshly attacked the government over corruption and social inequality — and called for gun control.

The killing stirred suspicions and recrimination as the authorities hurried to pin the blame on religious extremism: the individual who pulled the trigger, **Ali Jarallah Al-Hushaishi**, has an Islamist background. But the full truth behind the affair has yet to emerge.

Following the murder of the three Americans — **Kathleen Gariety**, **Martha Myers** and **William Koehn** — the US Embassy organised a voluntary evacuation of its citizens from the Jableh area in Ibb Province (coincidentally Omar's home region).

Hospital killer **Abed Abdel Razzaq Kasmel**, from nearby Zammar, has been transferred to Sanaa, where he told Yemeni investigators he belonged to a five-man cell that was planning five, or perhaps eight, operations, including the attack at Jableh and Omar's killing. Kasmel claimed to have helped organise Omar's assassination; he is thought to have links to *Al-Qaeda*.

Jableh was targeted because it was seen as the hub of US missionary activity. Omar was a target because of his vigorous defence of secularism in public life. Also on the list was the local offshoot of the *Al-Makarimah* (or *Al-Batinyah*) Shiite sect, which has a community at Haraz, west of Sanaa.

Many Yemenis seem unconvinced by this apparently simple explanation of the killings. An internet straw poll carried out by the *Yemen Times* attracted 83 respondents (29% of the total) who believed that Islamists of some description were behind Omar's death, while 62 (22%) thought it was the work of elements in Saleh's *General People's Congress (GPC)*.

Omar's funeral attracted tens of thousands of mourners from all over Yemen. A northerner whose socialism took him to exile in the south during the Marxist era, he later played an important role in reunification, serving as culture and tourism minister in 1993-97. Later still he moved firmly into the opposition camp, campaigning on social issues

and enduring a regular *Political Security Organisation* secret police tail. His party's assets had been frozen by the authorities.

Omar was one of several leftist and nationalist politicians attending the *Islah* convention — an exchange of contacts and ideas that hinted at the potential for a realignment to create a broader and more effective opposition to Saleh and the *GPC*.

Parliamentary elections in April will provide a first chance for an invigorated opposition to test the opposition's renewed appeal.

In the 1990s, the *GPC* reinforced its dominance with a limited partnership with *Islah*. But in the past two years this relationship has been soured by the breakdown of a tacit understanding that allowed the Islamists wide influence over education; Saleh has been pressing ahead with efforts to bring schooling fully under state control.

Omar advocated secularism, which in the longer term might pose problems of compatibility between his supporters and *Islah*'s agenda. But in the immediate future a realigned opposition could tap into broad local resentment of Saleh's co-operation with Washington in the anti-terror campaign.

### ISLAMIST PREACHER TURNED GUNSLINGER

The authorities, aware of *Islah*'s potential appeal, wasted no time in stressing the Islamist background of Omar's killer. Hushaishi is a preacher known for his hardline views. Official media initially claimed he was an *Islah* member, but investigators later backed away from such claims in the face of the party's fierce denials.

Hushaishi had studied at the *Islah*-affiliated *Al-Nur University*, but he became disenchanted with the party's moderate line and its failure to demand the expulsion from Yemen of Christians and even secular Yemenis such as Omar. In 2001 he was jailed and banned from preaching after giving a sermon at Sanaa's Mashhad Mosque during which he fiercely attacked both Saleh and parliamentary Speaker **Sheikh Abdallah Bin Hussein Al-Ahmar**. He had also launched a verbal barrage at Omar, going so far as to threaten the Socialist with assassination because of his secularist stance.

*Islah* was fearful of being tarnished by association with Omar's murder. It had spurned an offer of government guards and provided its own security for the conference hall, into which Hushaishi carried two guns and was able to walk over to Omar, who had just sat down after speaking, and request a face-to-face chat before pulling out a weapon and opening fire.

So worried was *Islah* that after seizing Hushaishi its security personnel took him back to the house of

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Speaker Ahmar where he was interviewed by Islah officials about the crime and his possible accomplices. This questioning was videoed and it was only after taking out this insurance that Islah handed Hushaishi over to the authorities.

After the interview Islah announced that Hushaishi had admitted he had also hoped to kill Baathist and Nasserist leaders attending the conference. Islah member **Saeed Shamsan** was also injured, but it is not clear if he was a target.

The authorities summoned Islah General Secretary **Mohammed Al-Yadoomi** for interview over the security lapses.

Ahmar has clashed regularly with Saleh, not just as a leading Al-Islah member but also as leader of the powerful Hashid tribal group. Two of his sons were arrested in an incident outside the UK Embassy in Sanaa on 30 September (GSN 698/6).

#### **AN ALLY, BUT NOT STALWART**

Omar's murder attracted relatively little attention in the conservative Gulf states, except in **Kuwait**, which has its own vigorous pluralistic parliamentary culture. *Kuwait National Assembly* Speaker **Jassem Al-Khorafi** made a special point of sending his condolences to Ahmar.

For a wider audience, the killings highlighted the extent to which almost all developments in Yemen are conditioned by questions of terrorism and

instability. Only a few days earlier, government forces had clashed with supposed Al-Qaeda members outside Mukalla. Western governments are issuing ever more severe travel advisories.

Saleh is again seeking to turn the terrorism issue to his advantage, seeking to present his government as the voice of calm and order. Well before the *Central Intelligence Agency* Predator drone killing of alleged Al-Qaeda planner **Qaed Sinan Al-Harithi** on 2 November, Saleh had become more open in admitting to the extent of co-operation with the USA (GSN 698/5; 685/7; 681/10; 676/4).

Serious security efforts are complemented with almost bizarre presentational measures: the armed forces have been ordered to shave off their beards and refused entry to barracks until they do so.

Meanwhile, Prime Minister **Abdelqader Abdelrahman Bagammal** and his cabinet have been briefing Parliament on the economic cost of terrorism. They told MPs the 6 October attack on the **French**-owned tanker *Limburg* cost \$31m in environmental clean-up expenses and lost tourism.

Tightened money transfer systems abroad have slashed remittances by expatriate Yemeni workers by up to half. Container traffic through Aden Port has suffered and major industrial and tourism projects, including the Zogar Island resort, have been delayed (GSN 700/13; 697/11; 13).

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## Rough Justice For Iranian Reformers

**M**ixed signals continue to emerge from Tehran, amidst the political battle over measures to constrain the blocking power of judicial and clerical conservatives. Liberal victories in social policy — plans to appoint women as frontline police officers for the first time since the 1979 revolution, for example, or the suspension of stoning as a punishment for adultery — are offset by hardline efforts to clamp down on the freedoms fostered by President **Mohammad Khatami**.

A clutch of leading opinion pollsters are on trial after publishing surveys showing majority popular support for improved relations with the **USA**. The reformist *Islamic Iran Participation Front (IIPF)* bloc which dominates the Majlis (Parliament) sees the trials as an indirect attack on itself and the other main progressive party, the *Organisation of the Mojaheddin of the Islamic Revolution*.

Having succeeded in shutting down pro-reform newspapers, the judiciary identified polling groups as another vehicle for the promotion of a liberal agenda. The publication by pollsters *Ayandeh* and *National Society of Public Opinion (NSPO)* of numbers showing 74% of Iranians favoured the resumption of dialogue with the USA strengthened hardliners' determination to crack down.

Three pollsters — Ayandeh's **Abbas Abdi** and **Hossein Ghazian**, and NSPO's Director **Behrouz**

**Gernapayeh** — have spent more than two months in solitary confinement. Among the charges they face is one of seeking to give secret information to foreign governments. The IIPF, of which Abdi is a member, says the men have been denied proper access to legal help.

The judiciary has also charged former culture minister **Ahmad Burqani**, who allocated \$25,000 to NSPO, with illegal use of state funds (GSN 698/11). He insists the allocation fully complied with official expenditure rules.

The three pollsters have admitted to making mistakes, notably contacting US polling agencies, and asked the Court for the chance to correct these. Much may depend on whether the judiciary over reaches itself in trying to punish the pollsters or secure their conviction on implausible charges. Defence lawyers are confident there is no evidence to back up suggestions of spying.

An excessively harsh punishment might provoke a public outcry. In November, the imposition of a death sentence for blasphemy on the academic and journalist **Hashem Aghajari** provoked mass public demonstrations and forced Rahbar (Supreme Leader) **Ayatollah Ali Khamenei** to intervene with a demand for greater leniency.

Like Aghajari — who is a war veteran — Abdi has a *curriculum vitae* that might help to shield him

against the judiciary's assault. He was one of the students who led the 1979 capture of the US Embassy and took American diplomats hostage. Now he finds himself in the dock for revealing the extent to which public opinion has moved away from such hostility to Uncle Sam.

#### GUARDIAN COUNCIL BATTLE

In this climate, the battle over the role of the *Guardian Council* — which has the power to block measures passed by parliament, passing them up to the ex-president **Ali Akhbar Hashemi Rafsanjani's Expediency Council** and Khamenei for a final decision — assumes increased importance.

A reformist bill would curb the Guardian Council's ability to intervene to disqualify election candidates, while a parallel measure would allow the President to suspend judges who over-stepped their prerogatives and acted unconstitutionally.

While these are new measures, they do not so much advance the liberal cause as help it to hold ground against the conservatives' drive to empty Khatami's presidency of real political significance.

IIPF leader and presidential brother **Mohammed Reza Khatami** has repeated his threat to quit government if the hardliners do not desist. Frequent repetition over recent months has emptied this threat of its former shock value, but if implemented, the Islamic Republic would be pushed into uncharted waters. For the first time since 1979 Iran would have a national government that explicitly did not have the support of the elected Majlis, which is one of post-revolutionary Iran's proudest achievements.

This would weaken political cohesion at a time of regional crisis — which may dissuade the IIPF from quitting government and induce Khamenei to intervene to restrain an aggressive judiciary.

Constitutional struggles will remain most significant over coming months. At this stage, there is no sign of a readiness on the part of conservative clerics to abandon or reduce the blocking powers they hold through institutions such as the Guardian Council and Expediency Council.

Prominent conservative Ayatollah **Mohammed Yazdi**, leading Friday prayers at *Tehran University*, argued it was the task of the Guardian Council — of which he is a member — to assess whether new laws are in conformity with the Constitution. It did not have the right to take demands of political expediency into account; it was not entitled to set aside the principles set out in the Constitution and examine proposed new laws with an entirely open mind — that was the role of Parliament. Where the Majlis's more practical approach clashed with the Guardian Council's interpretation, it was then up to the Expediency Council to resolve the matter.

Defenders of the Guardian Council also claim it has not intervened to block bills proposed by the reformist Parliament any more often than it did when the Majlis was more conservative.

#### Social Gains And Cruel Punishments

Evidence of an underlying readiness to persist with compromise and muddling through may be detected in the progress of certain modernising domestic policy measures which fall outside the economic sphere (with its much broader consensus among reformers and moderate conservatives).

More than 400 women have started training as police officers, ready to take up posts as second lieutenants from October onwards. These first female officers of the post-revolutionary era will not have to wear the chador, said police trainer **Mohdaram Masoudmanesh**. Their uniform — headscarves, long coats and trousers — has been designed for practicality.

International pressure appears to be behind the decision to suspend the stoning of those convicted of adultery. In talks over a trade accord with **Iran**, **European Union** officials have been pressing for a moratorium on the practise. Stoning is rare: there were two confirmed cases in 2001 and reports of just one case last year, in which the woman survived after clambering out of the stoning pit. Reformers and some leading conservatives had condemned this form of punishment as backward. But senior Qom cleric **Hojatoleslam Mohsen Gharavian** has cautioned that the halt to stonings remains provisional until Rahbar (Supreme Leader) **Ayatollah Ali Khamenei** gives a definitive ruling on its abolition.

However, it could be premature to conclude that such reforms are an indication of a wider shift in Iran's direction. Like liberal economic measures, they may simply represent pragmatic modernising steps that conservatives are willing to accommodate without surrendering their control of the key levers of power in the Iranian state.

Another interesting test may be posed by satellite dishes, which are illegal but widely sold and installed as Iranians seek to circumvent broadcast censorship. Parliament has been looking at legalisation in the hope that citizens would prefer to avoid the risks of being caught with an illegal receiver in return for the right to legally receive a limited range of broadcasts deemed to be in accordance with religious principles. Conservatives will have to weigh their desire to limit media and social freedom against the pragmatic facts of a technological era in which censorship of electronic, as opposed to print, media is increasingly hard to enforce.

#### A STRUGGLE OVER RIGHTS

Possibly more significant in the struggle between conservatives and Khatami's liberal supporters is the bill that would severely punish officials who infringed individuals' legal and personal rights.

This measure, which covers officials of government and state-owned organisations, was ratified by the Majlis on 1 January. It now has to secure Guardian Council assent and, if necessary, the Expediency Council and Khamenei's approval.

Its prime purpose is to curb the judiciary's power to crack down on political freedoms. The Majlis's Article 90 Commission is examining thousands of complaints against the judiciary.

Conservatives will fight hard to defend the prerogatives of a judiciary which has become such a powerful tool of their resistance to liberalisation.

The reformers' best hope of getting the law approved in a meaningful form may therefore lie in two other key aspects, which conservatives could

be reluctant to oppose in public. The law codifies individual and civil rights in society as an institution which the state is formally mandated to protect. This reform was a key campaign promise when Khatami ran for the presidency in 1997.

In drafting the bill, reformers have cleverly made reference to the widespread abuse of human rights and failings of the justice system under the regime of the late **Shah Reza Pahlavi II** before the Islamic Revolution. The new measure is presented as remedying these defects — and clerical hardliners can hardly afford to be seen defending an absence of rights rooted in the repressive era of monarchy.

Perhaps more important in terms of popular appeal, the bill can be presented as cracking down on laxity and corruption in public life. Under the concept of *dowlat* — which conflates the government or administration in office with the more enduring institution of the state — current law allows a prosecuting judge wide leeway to exonerate officials of wrongdoing. The judge can rule that the alleged offence was carried out in the course of state duty and is therefore not punishable.

Guardian Council assent in any meaningful form would represent a fundamental step forward in the consolidation of democratic accountability and human freedoms in Iran. The measure's best chance of securing such assent may lie in reformers' ability to play down these aspects and instead stress the bill's role in improving good administration and present its enhanced protection of individuals as in the best traditions of the revolution.

### Rezaie Tones Down American Threat

A prominent Iranian conservative pragmatist has sought to tone down fears of external aggression that would play into the hands of hardline nationalists at a time of fast-expanding US military deployment in the Gulf region. Former head of the *Islamic Revolution's Guard Corps (IRGC)* Mohsen Rezaie has gone out of his way to play down paranoid interpretations of his recent warning about a USA targeting of the Islamic Republic.

Rezaie, who could play a potentially influential role thanks to his politico-military past and his post as *Expediency Council* Secretary, is a significant conservative voice of the more pragmatic stream associated with former president and Expediency Council Chair **Ali Akbar Hashemi Rafsanjani**.

Before the last presidential election Rezaie indicated that he would favour a second term for **Mohammad Khatami**, provided the President changed tack — implicitly from his early focus on political liberalisation — to concentrate on social and economic issues.

Rezaie now believes Iran could come under renewed pressure from Washington after a US victory over Iraq. Initially he had said the Islamic Republic would be the next target for the USA. This remark was widely interpreted as warning of an American military attack. After all, Iran was cited

by President **George W. Bush** alongside **Iraq** and **North Korea** in the Axis of Evil.

Subsequently, Rezaie has sought to cool the atmosphere, stressing that Iran could face US threats of some kind, but that there was very little military risk. In the next summer and autumn this challenge will increase. But it is very unlikely to produce a military confrontation, he said during a visit to Gorgan in Golestan province.

The Expediency Council Secretary argued that Iran's best defence against US pressure was to stick to active neutrality *vis-à-vis* the Iraq crisis, refrain from either waging a war with the USA or submitting to it, and maintain its own active diplomatic contacts with international partners.

He was careful to stress that, as long as US leaders remained uninterested in talks with Iran, it was too early to either support or oppose the principle of a dialogue with the Americans.

Although sanctions have only a limited effect, Tehran has significant economic reasons to seek a relaxation of US sanctions, because of the importance of American industry in high-tech sectors. *Iran Air's* Managing Director **Davoud Keshavarzian** has admitted that US sanctions have indirectly prevented the carrier from buying four new European *Airbus* planes for a much-needed fleet renewal. The sale was provisionally agreed during Khatami's visit to **France** in 2000.

There seems little prospect of any shift in the position of the US Administration, which continues to insist that Iran sponsors terrorism. Washington is particularly concerned about Iran's alleged support for **Palestinian** radicals and for *Hizbollah* in **Lebanon** — a point of view strongly encouraged by **Israel**.

During an early January visit to Israel, *Republican* Senator **Arlen Specter** was told by Prime Minister **Ariel Sharon** that IRGC units had held joint manoeuvres with Hezbollah and the **Syrian** army in Lebanon.

### QATAR: Election Year

Only one woman candidate has so far registered to stand in this year's municipal elections. The apparent lack of interest among both sexes may be explained by the more alluring prospect of elections for a first national parliament. Many of the best potential candidates are reserving their energies for this contest, expected after the summer but possibly not until after the late November end of Ramadan.

Emir **Sheikh Hamad's** influential wife, **Sheikha Mouza Bint Nasser Al-Misnad** will push for women to be elected (*GSN 696/1*). At the first 1999 council election six stood but none was elected.

The Al-Misnads are flourishing. Sheikha Mouza's brother **Khaled Al-Misnad** is in big demand among the business community, especially big US corporates, as well as running an office in the Emiri Diwan.

# Hearts And Minds: Washington Seeks To 'Transform The Psychological Environment'

Alongside the escalation of no-fly zone enforcement and the build-up of US and UK forces in the Gulf, Washington has slowly escalated its programme of psychological operations (PSYOP) in the Middle East. The objectives sought by PSYOP are more ambitious than ever before, according to one Pentagon insider, including the transformation of the psychological environment of the Iraqi security state, as well as a broader campaign to reduce antipathy to Washington's Iraq policy in the Arab world and international community.

To achieve these aims the USA has for the first time employed the full spectrum of means to propagate its message, and is likely to maintain its PSYOP effort during and after a decisive military conflict with Iraq.

Although the USA has, in one form or another, maintained constant PSYOP against the Baathist regime since 1990, recent indicators emerging from the Pentagon suggest that US decision-makers have become acutely concerned about rising international animosity towards Washington's Iraq policy. Initial efforts were carried out by the US Department of Defense (DoD), where Secretary of Defence Donald Rumsfeld has long perceived the USA to be losing the information war against foes such as Al-Qaeda and President Saddam Hussein's regime, both of whom have used Arab television stations such as Al-Jazeera Satellite Channel to alarm Arab elite and public opinion.

The first DoD effort — the Office of Strategic Influence — was shut down in February 2002, after only four months in operation, when the US media discovered its mandate included feeding grey propaganda (disinformation) to foreign media.

A subsequent attempt emerged in December, when the New York Times reported that Rumsfeld had supported a change in DoD PSYOP policy, redefining it in the cornerstone DoD directive 3600.1: Information Operations. While previously, DoD policy defined PSYOP as operations to affect the behaviour of adversary decision-makers and populations, the rewording favours foreign decision-makers and populations, including friendly and neutral nations.

Most significantly, Rumsfeld signalled his support for covert PSYOP, including actions to discredit mosques and leaders teaching radical forms of Islam, whilst supporting and funding more moderate religious establishments.

The DoD's experience in 2002 showed there

remained strong sensitivity to military involvement in clandestine PSYOP. As former senior PSYOP officer Colonel Charles Borchini noted on the issue of deception, it's safer to tell the truth.

Since mid-December, the DoD has stepped back from the grey propaganda role, leaving the State Department sole responsibility for strategic PSYOP. These will be limited to white propaganda (overt and civilian communications) but will still reflect US concern that Washington needs a stronger communications strategy on Iraq issues.

House of Representatives International Relations Committee Chairman Henry J. Hyde recently proposed \$225m funding to support State's new non-clandestine public diplomacy initiatives. Undersecretary of State for Public Diplomacy Charlotte Beers is an influential advertising executive, formerly with Ogilvy & Mather.

### CIA OPERATIONS

New money may help to rejuvenate the State Department's US Information Agency (USIA) — historically a key PSYOP conduit for the US — but the majority of PSYOP radio broadcasts entering Iraq are run by the Central Intelligence Agency (CIA) and its Saudi and Jordanian counterparts.

Of the 27 major stations broadcasting into Iraq, USIA only produces Radio Free Iraq, using part of the \$97m allotted to regime change by the Iraq Liberation Act, and Radio Sawa, Voice of America (VOA)'s Jordan-based Arabic service that recently received \$35m in new State Department funding.

As part of its institutional effort to restrict the role of the Iraqi National Congress (INC), the State Department blocked funding that would have

### The INC's Last Hurriah

The Iraqi National Congress's Radio Hurriah, which broadcast between 1992-97, was established by the Rendon Group, a consultancy run by former CIA spin doctor John Rendon, as part of a "strategic communications" effort against the Baathist regime. The INC-aligned station operated as part of the Iraq Broadcasting Company (IBC), using facilities in Iraqi Kurdistan, as well as piggybacking on Voice of America facilities in Kuwait, courtesy of the CIA.

Shortly after celebrating its greatest success — purportedly causing the Iraqi flag bearer to defect at the 1996 Olympic Games — the IBC organisation suffered a reversal of fortunes. During the September 1996 government incursion into Kurdistan, almost all of the 100-strong Kurdish-based staff were captured and executed. In January 1997, the CIA refused to continue transmission of Radio Hurriah from Kuwait.

allowed the relaunch of the INC's *Radio Hurriah* (Freedom) in May 2002 (see box). The CIA continues to operate a number of stations aligned with its favoured opposition grouping, the *Iraqi National Accord (INA)*. These operate primarily from the 50kW VOA transmitter in **Kuwait**.

The main CIA-run stations, *Al-Mustaqbal* and *Voice of the Brave Armed Forces*, primarily broadcast to the Iraqi military, inciting officers to launch coup attempts. The latter station is part-run by Jordanian intelligence. The *Saudi General Intelligence Organisation*, meanwhile, has run the Jeddah-based *Voice of the Iraqi People* since 1991.

These opposition and Western-run radio stations are broadcast from Kuwait, Iraqi Kurdistan, Saudi Arabia, and Jordan, but the US DoD has now added its airborne transmitters to the spectrum.

EC-130E Commando Solo aircraft of the *193rd Special Operations Wing* began radio transmissions into southern Iraq on 12 December, broadcasting to the soldiers of Iraq with news of the US build-up and encouragement to overthrow the government, and to the people of Iraq, with information about the effects of Baathist policies on their standard of living, as well as focus on the unanimous invocation of **UN** Resolution 1441.

In the past, Commando Solo aircraft have broadcast Iraqi opposition radio stations, increasing their propagation range through the aircraft's altitude. Although Commando Solo has broadcast INA stations like *Al-Mustaqbal* in the past, it is likely that since the DoD picked up the funding of the INC, its aircraft will provide a new conduit for INC material. This will lighten the programming load on the *4th Psychological Operations Group* at Fort Bragg.

Opposition figures are likely to assist with the heavy task of generating television programming, which Commando Solo can also broadcast. US military PSYOP are likely to set up television stations after a new military operation, using the same Special Operation Media Systems modules that were deployed to condition the **Bosnian** population to a prolonged US military presence.

#### **SO MANY AIMS, SO MUCH TECHNOLOGY**

Although simple PSYOP leaflet drops in the no-fly zones have been executed, the multi-media, multi-agency effort under way is allowing the USA to undertake a highly complex and ambitious PSYOP campaign. At the strategic level, the USA is attempting to reduce international antipathy to its unpopular Iraq policy. At the operational level, it can use US radio and television conduits to get a range of complex messages across to its targets.

The Iraqi people are first being conditioned to accept the US military and disregard Baathist orders to mount general resistance to an invasion; later, during military operations, they will be ordered to remain at home and avoid Iraqi and US forces for their own safety.

#### **Al-Jazeera Starts English Tests**

The Arabic satellite television station has begun experimental broadcasts using English subtitles in the USA as the first phase in establishing an English language service, through plans unveiled to **GSN** last year (*GSN 685/8; 684/1*). Al-Jazeera has also experimented with Japanese. The move is aimed at generating new sources of revenue, but Editor-in-chief **Ibrahim Hilal** also said that "the historical context is missing" in coverage of the **Israel-Palestinian** conflict and other stories – which Al-Jazeera could provide.

Different parts of the Iraqi military are being targeted according to their role. Air defence operators and general military units are being advised to abandon their equipment, and desist from repairing damaged installations. Weapons of mass destruction operators could redeem themselves by ignoring orders to fire and identifying weapons locations.

Senior officers are being encouraged to prepare to seize control of the state. Perhaps due to this multi-faceted effort, Saddam Hussein stated in December that hostile propaganda was a bigger threat than bombs. Careless talk always costs lives in Iraq.

#### **IRAQ: Goods Review List Enlarged**

The **UN Security Council** on 30 December voted to add some 50 items to the Goods Review List of potential dual use goods that should require approval prior to export to Iraq.

The vote was 13-0, with **Russia** and **Syria** abstaining, following a trade-off earlier in December when the **USA** dropped its demand for only a two-week extension to the UN's Oil-for-Food Programme in favour of keeping the usual six-month rollover.

A range of chemicals, electronics, and trucks (including armour-plated vehicles) were added to the Goods Review List following the US-sponsored resolution, which also included a provision for the **UN Sanctions Committee on Iraq** to review the list every 90 days.

Iraq's Deputy Ambassador to the UN **Mohammed Salman** said the move would create obstacles in the implementation of the Oil-for-Food Programme, which had anyway not responded to the Iraqi people's needs. Instead, the Security Council should have solved the question of the pricing mechanism, over which disagreement remains concerning the way the Sanctions Committee prices contracts for Iraqi oil.

#### **FREE GSN Article Index**

*Gulf States Newsletter* has compiled an index of articles published in *GSN* since mid-2000. This lists country-by-country all articles published, as listed in *GSN*'s front page summaries.

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# Middle East Insider – IRAQ

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## Weighing The Cost Of A War On Infrastructure

Think-tanks and international aid agencies attempting to avert a new war against Iraq are increasingly wearing their hearts on their sleeves by publishing alarming forecasts of civilian casualties, public health crises, and environmental ruin. Although undoubtedly well-intentioned, such forecasts are deceptive and largely outdated, downplaying the lessons learned by US planners since 1991, and failing to note that the single greatest threat to Iraq's population and environment now comes from the regime's possible defensive and scorched earth strategies.

A common theme in the worst-case scenarios favoured by dovish research centres is that US and UK air attacks on Iraq's critical infrastructures will be as bad or worse than similar attacks during *Operation Desert Storm* in 1991. *Medact*, a British chapter of the *International Physicians for the Prevention of Nuclear War*, noted: A fresh conflict is likely to be wider-ranging and use a new arsenal of weapons, and its impact is likely to be more profound.

Similarly, casualty estimates generated by a consultancy, the *Oxford Research Group*, presume the USA will deploy its most indiscriminate and powerful non-nuclear munitions — such as BLU-82B Daisy Cutters, fuel-air explosives, and cluster bombs — in residential civilian neighbourhoods.

Projections of casualties and infrastructure damage reflect these unlikely scenarios. In comparison to the 53,500-135,000 prompt Iraqi fatalities and approximately 110,000 avoidable deaths caused by the Gulf War and post-war public health breakdowns, *Medact* projects 48,000-261,000 prompt Iraqi fatalities and 200,000 post-war avoidable deaths if war occurs in 2003.

It is undeniable that vast overkill occurred during *Desert Storm*, causing unintended levels of infrastructure damage, resultant cascading disruption of Iraq's critical infrastructures and a massive health breakdown that was exacerbated by sanctions.

Yet, recent research undertaken at the Department of War Studies at *London University's Kings College* discovered that even in 1991, the USA had made efforts to avoid such damage. Air campaign planners pinpointed easily replaced transformer yards and refined fuel storage sites to create temporary disruption to oil and electricity supply, but organisational failures prevented the policy from being executed. Instead, unit-level decisions were taken (in accord with Cold War

manuals) to destroy hard-to-replace generator halls and distillation (cracking) towers. Transformer yards struck by carbon filament munitions (to temporarily short out power) were then re-struck with kinetic weapons (bombs or missiles) on subsequent nights, either on purpose or when used as bomb dumps for returning naval aircraft.

Much had changed by December 1998, when the four-day *Operation Desert Fox* was launched. Electrical power, bridges and the civilian communications network — the public telephone exchange — were excluded from targeting. Increasingly sophisticated collateral damage assessment began during the no-fly zones and has heavily constrained targeting in civilian areas.

US air operations are now far more carefully targeted due to the establishment and growing importance of targeting centres led by the *Joint Warfare Analysis Centre (JWAC)* at Dahlgren, Virginia. JWAC is the most important centre of its type; it models infrastructure and cascading effects, studies flow patterns and dependencies, and produces targeting studies on how to create or control impact on target systems. As well as nodal analysis, JWAC models prompt and long-term collateral damage probability and impact.

Uncertainty concerning the military result of *Desert Storm* was a major cause of US overkill in 1991, but with the ghost of *Vietnam* exorcised and a decade of reducing Iraqi military power under its belt, the US military is now more willing and able to take a finessed approach. This entails one kind of risk — that of under-estimating the enemy — but overkill entails the equally serious risk of losing public support and antagonising the international community through excessive collateral damage.

US policy wonks canvassed by GSN suggested that as the USA needed to quickly occupy, stabilise and run Iraq as a viable nation, they are going to spare every piece of infrastructure they can in a forthcoming operation.

### SHORT-CIRCUITING THE GRID

Attacks on electricity remain a central means of causing cascading disruption to other target sets such as command, control, communications and air defence, but US planners are well aware that disruption of the national grid has recognised potential to cause collateral damage. In 1991, loss of electricity in Baghdad caused untreated sewage to be backwashed into the city's water reservoirs as purification plants ceased operation.

As a result, systemic attacks on the grid are likely

to be replaced by more precise nodal attacks at actual military installations, including use of radio frequency (RF) weapons (so-called e-bombs) that use electromagnetic wave effects to damage electrical equipment.

RF weapons may contribute to attacks on government communications infrastructures, which are also likely to be targeted at key nodes, leaving large (but isolated) segments of the system undamaged but functionally dead.

As in 1998, the public telephone exchange is unlikely to be targeted, and attacks on communications may be more limited than those in 1991 when very heavy attacks failed to isolate the Iraqi leadership; Iraq's highly redundant voice and data communications infrastructure has been strongly bolstered since then.

Communications may be left intact, both to prevent knee-jerk release of weapons of mass destruction, which many US sources believe are ordered to fire unless contacted by Baghdad at regular intervals, and to allow internal discourse between possible coup plotters. Television and radio transmitters and jamming sites will be destroyed early in a conflict to facilitate US psychological operations.

Low-key upgrades to Iraqi communications have been under way since 1991, but a number of major projects received a boost when the USA relaxed its obstruction to some communications development last June. The majority of contracts went to **Chinese** firms, including the following contracts listed by the *US State Department*:

¥ *Huawei Technology* — \$28m mobile phone development;

¥ *CMEC International Engineering Company* — \$15m microwave radio development;

¥ *China National Technology Import Company* — \$15.5m general telecoms maintenance contract; and

¥ *Guizhou Import and Export Company* — \$34,000 fibre-optic cable development.

In addition to these, *Alcatel* signed a contract for \$75m-worth of work on the public telephone exchange, including additional digital switching equipment, and microwave relay networks. Over \$333,000 worth of telecoms contracts are blocked by the USA at the *UN Sanctions Committee*.

#### PHYSICAL INFRASTRUCTURE

Recent UN projections stated that road and rail bridge infrastructure were likely to be heavily damaged in a future operation, as in 1991.

Although Iraqi forces may attempt to delay US advances by destroying bridges over the Euphrates, the USA is unlikely to embark on a major bridge-dropping campaign itself. Such bridges are necessary for the passage of fighting and logistical

formations in the advance, and for stabilisation and effective running of a post-war Iraq.

In 1991, in an effort to interdict Scud missile launch instructions, many bridges were destroyed to break the fibre-optic cables that were bottlenecked at river crossings. In 2003, US planners have a better picture of Iraq's communications networks and can avoid bridges, striking at other key nodes. US forces are likely to overrun Scud launch baskets early in any future operation.

#### OIL: PREVENTING THE 'SAMPSON OPTION'

The most vulnerable portion of Iraq's infrastructure remains its upstream oil facilities. The threat is not from US strikes, where the need to strike only at refined oil storage sites is now inculcated. Instead, the Baathist government is the key threat, and requires a relatively small number of loyalists to cause extensive damage to upstream infrastructure once it is rigged with explosives.

A core loyalist, Baath Regional Commander **Samir Aziz Al-Najim**, on 7 January took over from Oil Minister **Amer Mohammed Rashid** in a move interpreted as Saddam Hussein placing totally trusted apparatchiks in key positions. Rashid, a UK-educated engineer was much better qualified to talk oil, but he was also linked to the defence industry at a time when Saddam is manoeuvring with the UN.

If an oilfield Samson option was being considered, Najim will be involved (*GSN 696/11*).

In **Kuwait**, over 800 oil wells, plus pumping stations, tank farms, pipelines, refineries and loading terminals were prepared for demolition in a matter of days. Of 750 wells ignited, 70% burned for a sustained period, 13% were heavily damaged but did not burn, 5% gushed but were lightly damaged, and 12% were undamaged. Most of the burning wells were extinguished in April-November 1991, causing an average daily loss of 4-6m barrels of crude and 70-100m cubic metres of gas. Kuwait also experienced heavy pollution from associated toxic, highly flammable gas from spilled raw sour crude oil from non-burning wellheads.

The USA will act quickly to secure as many oil fields as possible with special and light forces. It understands how to shut down communications nodes that contain the supervisory control and data acquisition (Scada) systems that run oil pipelines, or can physically cut key pipelines (as US air strikes did to prevent pollution of the Gulf in 1991).

In spite of these efforts, a scorched earth policy presents the major human and environmental threat to Iraq's citizens. But even this scenario can be overstated. As **Raad Al-Khadiri** of the Washington-based *Petroleum Finance Company* noted, after two decades of infrastructure damage and compounding foreign debt, any new damage to Iraq represents a drop in the ocean.

### Securing Oil Supplies: What To Do In An Emergency

President **Hugo Chavez**'s current travails might appear to amount to little more than a domestic difficulty, but the impact of the **Venezuelan** stand-off on the *Organisation of Petroleum Exporting Countries* giant's crude exports has been catastrophic — a lesson that Caracas's fellow OPEC members in the Gulf will have taken to heart. *Gulf Co-operation Council* states with significant oil export capabilities are looking into 2003 with understandable trepidation, none more so than the country with the unhappy distinction of sitting directly in Iraq's firing line.

The possibility of a US-led military assault on Iraq precipitating some form of blowback on Kuwait's crude oil output, estimated in Q4 of 2002 to be running at 1.9m barrels a day (b/d), is being taken increasingly seriously in the Emirate. In late December, Acting Oil Minister **Sheikh Ahmed Al-Fahd Al-Sabah** confirmed that contingency plans were in place to ensure uninterrupted oil supplies in the event of war in Iraq spilling over into Kuwait. While local fuel needs would take precedence, Sheikh Ahmed Al-Fahd said it would still be able to meet the commitments made to clients abroad.

Government assurances about the security of Kuwaiti supply are hardly unexpected. As one senior executive at a foreign oil company in Kuwait told *GSN*, The surprise would be if they didn't have an emergency plan in place. But the raising of the issue at a time when oil markets are in turmoil, largely as a result of significant Venezuelan outage, indicates a widespread recognition among key Gulf OPEC players that jittery oil markets will need assuaging — especially as Washington's war drum intensifies.

#### THE KUWAITI STRATEGY

Kuwait's strategy to protect its oil exports is two-pronged. Beefed up security forms the first line of defence for the critical oil industry, which accounts for at least 80 percent of gross domestic product.

Heightened security levels are already visible at Kuwaiti oil and gas installations and at the main port

entry points, with armed patrols escorting and monitoring visiting tankers. News reports suggest that authorities have installed pipelines to move jet fuel between storage tanks and various military aircraft bases used in the Gulf state by US and UK forces.

Isolated attacks on US servicemen throughout 2002 have reinforced efforts to shore up security at its key installations (*GSN* 698/3). The attacks, attributed to *Al-Qaeda* cells, have also underlined the reality that Baghdad is not the only threat on Kuwait's horizon.

Likely US military plans in the event of war are explicitly designed to protect Kuwait from Iraqi missile attack, providing a further layer of comfort to *Kuwait Oil Company (KOC)* and its affiliates.

Photographic monitoring of Iraqi troops is regarded as sufficiently sophisticated that any significant build-up near the Kuwaiti border would elicit a swift response from Alliance forces. Furthermore, the early objectives of any invasion plan by US or UK units would be to secure southern and western Iraq, to deny them access to missile launchers that could possibly strike Kuwait.

Such measures cannot preclude the possibility that retaliatory action from **Saddam Hussein**'s forces could still take out significant chunks of Kuwait's energy infrastructure and with it blow a hole in OPEC's ability to keep markets supplied — this at a time when Iraq's 2.5m b/d output is likely to be severely circumscribed and the stability of Venezuelan production looks far from assured.

#### GCC-WIDE PLAN

A loss of Kuwaiti production would therefore elicit a GCC-wide plan of action to redress any imbalance. Meeting in late October, GCC energy officials agreed to help each other out if — due to any contingency — one country was forced to halt output.

If any member state has a production problem due to an adverse situation in the region, the other members will compensate by producing extra oil for the affected member, said **Oman**'s Oil and Gas Undersecretary, **Salim Bin**

**Mohammed Shaaban**. Omani Petroleum Minister **Mohammed Bin Hamad Al-Romhi** said the fact much of the world's oil originated in the Gulf made it incumbent on them to assure supply.

The mid-December GCC summit at Doha saw the long-standing regional emergency oil plan ratified by ministers.

During the 1990-1991 Gulf war, **Saudi Arabia** and the **UAE** joined forces to compensate for lost supply from Iraq and Kuwait. These two countries — the only Gulf OPEC members with sufficient excess capacity, currently estimated at 3m b/d in the Saudi case and a more modest 600,000 b/d for the UAE — would be in the frame to undertake this role once more.

As an early pointer, the two countries have agreed to supply **Pakistan** with \$1.3bn worth of oil — with payment deferred — to help it build its reserves, due to growing fears of a US-led attack on Iraq.

#### FRAGILE INFRASTRUCTURE

Such contingency measures are not purely intended to keep oil markets stable. Kuwait has more private reasons to ensure its installations are insulated from conflict spillage, not least because large parts of its infrastructure continue to feel the impact of the 1990-91 Iraqi invasion.

Authorities say some 750 wells were seriously damaged by Iraqi troops, while all 26 of its gathering centres were destroyed in the war, making the construction of new gathering centres a key priority in KOC's post-war expansion plans.

Kuwait's oil and gas facilities have also been plagued by a series of accidents in recent years that have cost it dear in terms of lost production. Predictably, local energy supremos are keen to attribute these to the after-effects of Baghdad's vindictive assault on its energy infrastructure 12 years ago.

Last June a broken heavy fuel oil pipeline led to a major spill near the Al-Ahmadi refinery, while the previous April, an explosion at a state-owned ammonia plant injured six employees. In November, a fire at a crude gathering centre in the giant Burgan field caused a brief 110,000

b/d outage. But these incidents pale in comparison with the January 2002 explosion at a gathering centre at the northern Rawdhatain oil field, which slashed output by 600,000 b/d at a stroke, as well as knocking out some 200m ft<sup>3</sup>/d of gas production. The explosion forced the resignation of Oil Minister **Adel Al-Subaih**, who accepted responsibility for the incident, although other Kuwaiti critics suggest inadequate maintenance and a culture of neglect were more at fault. Field production from Rawdhatain has yet to return to its 600,000 b/d peak by late 2002.

The south-west Burgan field is Kuwait's most prolific, with 1.35m b/d capacity.

#### PROTRACTED EXPANSION

The outbreak of conflict in 2003 could also affect KOC's ambitious

plans to expand production capacity to 4m b/d by 2004, although the government's inability to progress the \$7bn Project Kuwait — the delayed plan to enlist foreign investment in doubling production from five northern oilfields — in the face of stiff parliamentary opposition is the bigger obstacle to expanding capacity.

Foreign Minister and Acting Prime Minister **Sheikh Sabah Al-Ahmed Al-Jaber Al-Sabah** reiterated in his end of year address to Parliament that Project Kuwait would be a top priority for the government in 2003.

But the Kuwaiti oil executive told GSN that much would depend on decisive action being taken before this summer's parliamentary recess: The debate is now as to whether they'll have time to look into this

before they adjourn. We hope they will, but I've learned a lesson from having predicted it too many times before.

KOC is now expanding for the first time into the offshore, with a drilling contract expected during Q1 2003 for the Madinah concession, which is located near to Kuwait City and in southern areas of Kuwait bay.

#### NEUTRAL ZONE DEAL

KOC subsidiary *Kuwait Gulf Oil Company (KGOC)* was awarded drilling rights for Kuwait's portion of the neutral zone, effective January 2003. The concession was previously held by *Japan's Arabian Oil Company*, which will now pay up to \$1bn to finance field development in return for receiving 100,000 b/d of neutral zone crude and an option for at least 70,000 b/d more.

## 2003 Economy: Onwards, Onwards Through The Gloom

The art of crystal ball gazing is somewhat easier in the Gulf economies than in other parts of the world. Get the oil price right and for the GCC states at least you can safely predict ball-park figures for GDP and state finances — allowing for the exigencies of Arab governments accounting standards.

Yet gauging the oil price is not always straightforward and looking into 2003 an uncertain global climate means probable, best- and worst-case scenarios vary considerably.

Unsurprisingly, the **Iraq** question looms large in any attempt to project the likely trajectory of oil markets, which remain the lifeblood for all regional economies. But even taking Baghdad out of the equation — likely to be a purely hypothetical exercise, given the near certainty of conflict some time in Q1 2003 — prospects look increasingly bleak.

The recent oil price spike prompted by the slashing of **Venezuelan** output in December and January — which knocked out most of the country's estimated 2.7m barrels a day (b/d) production and provoked a supply crunch among **US** refiners dependent on Caracas for imports — will provide only temporary relief for Gulf finances.

Even without the uncertainty posed by the Venezuelan crisis and looming war in Iraq, the shine could be about to come off *OPEC's* largely

successful four-year price defence strategy. Leaving out the political disruption scenario, *OPEC* has serious problems as demand isn't too good, non-*OPEC* supply is pretty strong and *OPEC's* market share is at its lowest for ten years, said Professor **Paul Stevens** of *Dundee University's Centre for Energy, Petroleum & Mineral Law & Policy*.

With substantial excess capacity and *OPEC* prepared only to legitimise over-production at its December meeting, analysts see worrying parallels with the November 1997 *OPEC* meeting at Jakarta that prompted a startling price collapse to sub-\$10/bbl levels in 1998. Estimates for oil demand growth in 2003 are already beginning to be revised downwards, leaving the *International Energy Agency's* 1.04m b/d forecast increase looking decidedly optimistic. The *Centre for Global Energy Studies (CGES)* is now forecasting just a 650,000 b/d increase — while **Saudi Arabia** has suggested up to 1.5m b/d should flow into the market.

#### RECESSIONARY PROSPECTS

While the *World Bank* is projecting global GDP growth of 2.5% in 2003, it acknowledges the chances of the world economy sliding into recession are real.

The **US** economy, despite some signs of recovery, remains highly vulnerable to shocks both external

(potentially *Al-Qaeda* related) and internal (a re-run of the corporate scandals which blighted 2002).

Against this backdrop, the expectation is that oil demand growth projections will be revised downwards over the year — not least, as a direct consequence of Brent prices in early January hovering unsustainably above \$30/bbl.

Despite growing talk within *OPEC* about releasing up to 2m b/d of new supply to calm market nerves as an early resolution of the Venezuelan standoff appeared elusive, Gulf heavyweights will still be eager to maximise oil revenues in H1 2003 in the knowledge that H2 could see oil prices coming under significant downward pressure. The *OPEC* Secretariat is projecting that prices may weaken in H2, so many *OPEC* members will doubtless want to earn more in H1 to offset the falling value of their oil later on.

#### SHORT-TERM PERSPECTIVES

*OPEC* production strategy will continue to be dictated by Gulf states short-term revenue needs, and there will be a concerted effort to ensure prices average around \$25/bbl for the year.

The likely price spike in the event of war will do some of the work for them, even if its durability cannot be taken for granted.

More troubling for *OPEC* strategists is the realisation that their

price defence strategy appears to have run its course as the inevitable vicious circle effect takes hold. Although the output restraint demonstrated since early 1999 has helped to keep Gulf coffers relatively flush, this has been achieved at the expense of progressively lower demand and rising non-OPEC production. CGES estimates that OPEC market share has declined from 43% in Q2 1998 to 37% at end-2002, significantly impinging on governments revenue bases.

Plug in the near certainty of war in Iraq and OPEC's price conundrum deepens. In the most likely scenario, a US-led assault in February would see lost Iraqi output of some 2.4m b/d quickly replaced by increased Saudi volume. Should the military assault run to plan and be short, sharp and effective — which GSN considers the most likely scenario — a widening of the conflict could be averted as pressure from the Arab street is kept under wraps.

Assuming US/Saudi relations do not deteriorate further, the Kingdom can be expected to assume the mantle of swing producer once more, acting to keep markets supplied and stable (with the added incentive that lower prices would dampen enthusiasm for rival Russian oil).

Much will depend on the USA's ability to obtain prior UN approval for any attack on Iraq. If there is a war that is approved in advance by the UN Security Council, then there will be less of a problem with supply than if the US seeks to go it alone, said CGES senior analyst Julian Lee.

#### BEST-CASE OUTLOOK

A \$25/bbl average oil price looks to be the best-case outlook for Gulf economies in 2003. As Central Bank of Kuwait Governor Sheikh Salem Abdelaziz Al-Sabah said in early January, the prospect of a prolonged conflict is the one that troubles regional governments the most. Gulf states are already reeling from the uncertainty about possible outcomes of military action against Iraq, which has dampened consumer and investor confidence and led to market stagnation.

A prolonged conflict would render the more comfortable assumptions about oil prices meaningless, besides injecting even greater regional instability. But even allowing for a more favourable outcome for OPEC — involving a global economic recovery and a

revival of demand and a slowing of non-cartel output — market sentiment could still wreck Gulf producers best-led plans.

All logic goes down the pan if the price makers decide there's going to be war and the price will go up. If they believe it will push price up, they will push it up. The issue is for how long, Stevens told GSN.

If the conflict is over fairly quickly, the price hiccup should disappear. But if market traders decide that a post-sanctions Iraq could quickly get back to pumping at full volume, a price collapse could still be on the cards — particularly as the USA is likely to release further stocks onto the market once fighting begins. Meanwhile, a resolution to the Venezuelan crisis could result in Caracas releasing the taps and compensating for months of lost output with a flood of new barrels.

#### GSN's VIEW

Given these uncertain conditions, GSN's cautious forecast is for an average 2003 oil price of \$25/bbl — based on Brent averaging more than \$27/bbl in H1 and then falling in H2.

For Gulf planners, this outlook would have the benefit of forestalling significant budget shortfalls and allowing modest oil sector growth.

Most regional budgets are not counting on the war premium on oil prices being sustainable, with Saudi Arabia's 2003 budget apparently based on an average Saudi crude price of \$17.50/bbl. Kuwait has even outdone the Saudis in the conservatism stakes, forecasting a \$7.4bn deficit based on an oil price of just \$15/bbl. CBK's Salem said an average \$27/bbl would be needed to balance the budget in 2003.

GSN remains sceptical about regional governments' ability to stick to their budget commitments in 2003, which are generally based on unrealistic expenditure assumptions and largely fictitious oil price assessments.

Saudi Arabia's budgeted expenditure is forecast to decline 7% on actual 2002 expenditure to \$55.7bn — a remote prospect at best.

While the Kingdom's own \$10bn budget deficit forecast looks realistic, its method of calculating this outcome is contentious and presupposes much lower income and spending than will actually transpire. Recording fiscal deficits at a time of strong oil prices means

there is little scope for retiring some of its ballooning public debt, estimated to be equivalent to more than 96% of GDP.

Most other budgets are forecast to remain in deficit in 2003, with the oil base price in the \$15-20/bbl range

#### PAYMENTS RISKS

Saudi Arabia will be confronted by growing payment risk in 2003. GSN highlighted concerns over payment risk in the Kingdom in 2002 following Crown Prince Abdallah's edict to ministries to clamp down on unauthorised expenditures, the so-called supplementary appropriations. Foreign contractors dealing with Saudi ministries or public authorities who do not have their budgeted expenditures officially sanctioned face payments risk.

Late in 2002, two international banks were forced to resort to the law courts to recover a disputed \$48m in unpaid loan repayments — which GSN's soundings suggested was linked tangentially to the fallout from CPA's campaign for stricter spending. Previously off-budget items have been put on-budget and therefore subject to different criteria.

Payment trends in Iran appear on a more positive trajectory. The Islamic Republic is in the strongest financial position than for a decade, having cleared the worst of a debt hump accumulated in the early 1990s. Major Western export credit agencies have substantially increased their Iranian exposure and others may follow suit. But the political risk climate is worsening as the ideological battle waged between reformists and conservatives intensifies. In this context, payment risk could increase as the likely outcome of Iran's political debate appears unclear.

All regional economies will be sure to feel the heat from the fallout of war in Iraq. This will be felt through deteriorating investment flows, dampened consumer confidence and the deleterious effect of war-induced oil market trends.

Some analysts have forecast increased repatriation of foreign held capital by Gulf investors, but given the state of global stock markets and the fact that investors would be forced to sell at a substantial loss, and the lack of assets to buy in regional markets, GSN is sceptical that this will hold

CONTINUED ON PAGE 18

## GSN Risk Grade – C+/2: Parliament opens amid youth protests, investment bank difficulties

### Political And Social Development

**Overview:** King Hamad Bin Isa Al-Khalifa's new era of democracy began in December with the inauguration of a two-tier parliament. The Assembly must quickly find its feet in an tense political environment. The prospects of war against Iraq and the Palestinian situation have again led to protests against the US presence in Bahrain — some 400 people marched in protest after Friday prayers on 3 January — while the New Year was marked by riots, apparently with an anti-Saudi tone, when over 40 people were arrested. The cause and affects of the riots are being debated by Parliament; a joint government/parliamentary committee could investigate.

**Parliament:** The new National Assembly was inaugurated in December and will sit for four years. In October, 19 candidates representing Sunni groups were returned for the elected chamber's 40 seats, after polls boycotted by the main Shiite opposition. The official (and disputed) turnout was 53%. No women were elected. The 40-member Shura Council (upper house), announced in November, includes six women. The speaker, former health minister Faisal Radhi Al-Mousawi, will have the casting vote when the two houses disagree.

**Government:** King Hamad reshuffled his cabinet in November. Changes include Majid Ali Al-Nuaimi at Education and Majeed Mohsin Al-Alawi at Social Affairs. Alawi was in the UK-based opposition, but now backs Hamad. Royal adviser Hassan Fakhro was appointed Industry Minister. The government must deliver jobs, housing, economic growth and better services.

**Opposition:** Key groups including the Shiite Al-Wefaq boycotted the elections in protest at Hamad's decision to allow an appointed Shura Council to share legislative functions with the elected chamber. Bahrain remains more prone to strikes and public demonstrations than other GCC states.

**External forces:** Home to the US Navy's Fifth Fleet, Bahrain will provide backing to the USA in the event of war with Iraq, but thinking has been tempered by domestic sensibilities, boycotts of US products and anti-US demonstrations over Palestine and Iraq. Close dialogue is kept with GCC states, notably Saudi Arabia, whose leaders are routinely consulted.

### Economic Outlook

**Overview:** Despite a difficult post-9/11 atmosphere, Bahrain continues to develop its capabilities as a regional financial centre. Fitch has placed Bahrain on ratings watch for a positive upgrade due to political and economic improvements. Average 5-6%/yr growth is forecast for 2003-04. Bahrain pumps only 40,000 b/d from its own oil fields and takes 140,000 b/d from a shared offshore field with Saudi Arabia.

**Finance:** To maintain Bahrain's lead as a financial centre, Bahrain Monetary Authority (BMA) plans to develop seven asset classes: debt and equity markets, corporate and private banking, remote services, Islamic finance and insurance. A new International Islamic Financial Market aims to provide innovative instruments such as Sharia-compatible bonds. Plans have been unveiled for a \$1bn financial district in Manama's old harbour area. BMA plans to issue Islamic bonds worth \$670m in 2003 to help develop the market. A debut \$500m ten-year sovereign bond issue is planned for Q1 2003.

**Banking:** Local investment banks have been suffering from the global downturn; Bahrain International Bank has a moratorium on \$640m debts and deposits until end-March after being suspended from the Bahrain Stock Exchange in September. BMB Investment Bank failed to renew or repay a \$75m international syndicated loan facility that matured in December. The BMA is supporting both banks restructuring.

**Budget:** Total BD1.129bn (\$2.99bn) spending is envisaged in the 2003 budget, 8% up on 2002; BD1.152bn spending is forecast for 2004. Allocations for development projects have doubled. The government forecast a BD316.9m budget deficit for 2003 and BD331m in 2004. BD650m-700m/yr foreign investment is required to meet government economic targets. Domestic debt was BD599.1m at end-September.

**Liberalisation:** Privatisation is moving slowly. A Telecommunications Regulatory Authority is being created to oversee sector liberalisation; a second mobile licence is to be issued in 2003, while a new telecom law is expected 2004. Electricity and transport sell-offs are likely, including management of Mina Salman and Khalifa Bin Salman ports.

### Bahrain: Key Projects

**HIDD POWER AND DESALINATION PLANT EXPANSION:** France's Alstom has \$300m contract to install 700MW; a contract for 60m g/d desal capacity is expected early 2003.

**ALUMINIUM BAHRAIN:** Fifth potline for completion in 2005. Five tranche \$1.55bn borrowing completion expected early 2003, includes \$500m from commercial banks, \$250m from Islamic banks, \$200m, BD-denominated bond, \$300m metal-linked facility and \$300m from Japan Bank for International Co-operation. Alstom and Hyundai group shortlisted for 850MW power unit. USA's Alcoa mulling sixth potline to raise output to 1m t/yr.

**BAHRAIN FINANCIAL HARBOUR (BFH):** \$1bn project planned in 202,272 square metre plot. Construction start due in May but investor uptake said to be lukewarm.

**FORMULA-1 MOTOR RACING TRACK:** Scheduled to open in 2004, with long-term F-1 deal secured.

**TOURISM:** Priority renovation of infrastructure including Durat Al-Bahrain and Al-Dana Beach resorts (174-room, four star Novotel for completion February) and \$210m resort north-east of Manama.

### GSN Risk Grades

The GSN Risk Grading is based on GSN's assessment of the outlook for political and payments stability. The political outlook is reflected on a letter rating, where A is most stable and E least. Payments conditions are represented by a number: 1 is most favourable and 5 least. + or - represents a slightly higher or lower than average score.

### Bahrain: Economic Indicators

(\$ million)	1997	1998	1999	2000	2001
GDP current prices	6,330.7	6,166	6,601.1	7,947.3	7,911.7 <sup>p</sup>
GDP growth (percent)	4.1	-2.6	7.1	20.4	-0.5 <sup>p</sup>
Exports	4,370.7	3,260.7	4,350	6,176.3	5,554.5 <sup>p</sup>
of which: hydrocarbons	2,706.7	1,689.2	2,767.7	4,464.3	3,670.6 <sup>p</sup>
Imports	4,014.1	3,555.6	3,686.8	4,619.7	4,281.6 <sup>p</sup>
Trade balance	356.7	-294.9	663.2	1,556.6	1,272.9 <sup>p</sup>
CPI (percent)	1.7	-0.4	-1.3	-0.7	-1.8
Current account	-31	-775.1	-339.7	112.7	182 <sup>p</sup>
Foreign exchange reserves	1,290	1,290	1,369	1,564	—

<sup>p</sup> Preliminary. <sup>e</sup> Estimate. GDP – Gross domestic product. CPI – Consumer price inflation.

Sources: Ministry of Finance and National Economy; Bahrain Monetary Agency; Standard & Poor's

## GSN Risk Grade — C-/3: Political tensions near boiling point, but banks feel comfortable

**Political And Social Development**

**Overview:** Power struggles between reformists identified with elected President Mohammad Khatami and conservative/radical opposition gathered around Rahbar (Supreme Leader) Ayatollah Ali Khamenei will again define politics in 2003 — a year which could see these battles coming to an acrimonious head. High unemployment and sluggish reforms are fuelling popular unrest, and frustration with political in-fighting and the ineffectiveness of Khatami's government. Both sides are seeking to unify public opinion against a potential external threat — from the USA. Revolutionary Guards and Basij militia have been primed to deal with unrest.

**The battleground:** The reformist/conservative struggle appears to be coming to a head with the passage of two Khatami-supported bills; these would give the president greater power to rein-in the reactionary judiciary's and the Guardian Council's power. The first bill was passed by the Majlis (Parliament) on 1 January but needs to pass the Guardians. Conservatives have yet to indicate any willingness to concede on these points, raising the spectre that the President could resign. The less radical Expediency Council is led by wily old campaigner Ali Akhbar Hashemi Rafsanjani, whose Executives of Construction Party could feature large in coming events, while reformists led by presidential brother Mohammad Reza Khatami have repeatedly threatened to pull out of government and the Majlis. There have been some signs of hardline give on soft social and economic policies, but little indication yet of conservatives' willingness to relinquish their hold on key areas of power.

**External factors:** US sanctions remain in place (expiring in 2006) and with increased uncertainty since President George W Bush's January 2002 Axis of Evil speech new conflict with the USA cannot be ruled out. The UK opposes any future military action against Iran, while relations with the EU are strengthening — talks are under way on a new free trade agreement and the promotion of energy co-operation. Commercial and defence relations have flourished with Russia, but tensions over Caspian demarcation remain, with oil industry implications.

**Economic Outlook**

**Overview:** Progress was made in key areas in 2002, including major exchange rate reforms, a new foreign investment law and a successful entry — and re-entry — into the international capital markets. But serious structural problems remain including state domination, a weak banking system and over-reliance on oil. Unemployment is officially 16%. Bureaucracy and corruption are among issues that must be further addressed, as is the dominance of Bonyad revolutionary foundations.

**Finances:** A good recent repayments record has helped stimulate investor interest. Bond issues have helped to reassert Iran's credibility among Western investors. A €375m Eurobond issue launched in mid-December followed a successful debut five-year €500m — increased to €625m — earlier in 2002. A further \$1.1bn in bond issues has been mooted for 2003/04. Firth rates the Islamic Republic B+. Oil prices have helped boost coffers despite, production has fallen from its peak in 2000/01. The debt/GDP ratio is around 7.7%. Foreign investment is regarded as a necessity for reaching job creation targets.

**Budget:** President Khatami has presented a draft budget for 2003/04 (beginning 21 March 2003) based on \$18-19/barrel oil. The budget envisages an 11% rise in spending to \$35bn, with oil revenues expected to reach \$15.3bn and the deficit estimated to be equivalent to 5% of GDP. The government is forecasting 6.1% GDP growth for 2003 and inflation of under 14%. Spending priorities are expected to include commitments for structural reforms. An additional \$4bn has been set aside for job creation, targeting 550,000 new jobs.

**Liberalisation:** The two-tier exchange rate was scrapped in March 2002, with knock-on reductions in other import duties and charges. Import licensing procedures have been streamlined but restrictive elements remain. Privatisation progress has been slow and state bank sales are off the agenda. Urgent reforms are required to the labour and commercial laws, and to regulate securities. Progress has been made in reforming direct taxation, while a value-added tax law has been drafted. A revised Law for the Attraction and Protection of Foreign Investment (Lapfi) was passed in May 2002.

**EQUITIES INVESTMENT BOOM:** Crisis, what crisis? The *Tehran Stock Exchange* was one of the best performing bourses in the Middle East region during 2002, when the benchmark Texpix index rose by 42% to close the year at 5,044.06 points. This is despite an adequate regulatory and other structures. The TSE is still a bourse that attracts local punters looking for a gamble.

**Iran: Key Data and Forecasts\***

(\$ billion)	2001 <sup>p</sup>	2002 <sup>p</sup>	2003 <sup>f</sup>	2004 <sup>f</sup>
Nominal GDP	71,548.1	83,513.7	107,112.2	127,836.6
Exports	28,461	23,716	24,881	25,494
of which: hydrocarbons	24,280	19,339	19,875	19,856
Imports	15,086	18,138	22,726	25,524
Trade balance	13,375	5,578	2,154	-30
Current account	12,634	5,432	1,624	-535
Capital & financial account	-4,897	-552	1,131	3,475
External debt**	8,000	7,200	7,300	9,100
of which: short-term	3,700	2,700	1,700	1,900

\* Years to 20 March. \*\* Public and publicly guaranteed.

<sup>p</sup> Preliminary. <sup>f</sup> Forecast.

Sources: IMF, Washington; Bank Markazi, Tehran.

**Iran: Key Projects**

**SOUTH PARS GASFIELD:** Estimated 259trn ft<sup>3</sup> project in initial 12 phases; work under way on phases one-eight, with TotalFinaElf (France), Petronas (Malaysia) and Gazprom (Russia) for phases two-three, Italy's Eni (four-five), Norway's Statoil (six-eight), and LG Engineering & Construction (nine-ten). BP, Eni, Statoil and TFE have bid for phases 11-12.

**LIQUEFIED NATURAL GAS:** Four projects under discussion or at feasibility. Contracts for TotalFinaElf and Shell-led projects expected during H1 2003. BP's Iran LNG project slower.

**BUSHEHR NUCLEAR PLANT:** Work behind schedule on controversial 1,000MW plant built by Russia; completion by December.

**INDEPENDENT POWER PROJECTS:** State company Tavanir is tendering six 500MW projects, led by Zanjan one and two, followed by Khorramabad one and two, and plants in Mashad and Kashan. Germany's Dillinger Stahl, Italy's Enelpower, Korea Electric Power Corp. and Japan's Nichiman are among prequalifiers.

**PROJECTS WITH KUWAIT:** Include water pipeline, to send 20m g/d 540km from Karkeh dam to Kuwait, and potential joint Dorra offshore field development.

true. Despite some scare stories in 2002, there has been little evidence to suggest a widespread rush to withdraw investment from the USA.

**A BAD YEAR FOR REFORMISTS?**

With regional tension simmering, it is unrealistic to expect Gulf governments to push economic reform and liberalisation in 2003. Saudi Arabia got its \$4bn float of 30% of shares in *Saudi Telecom* out the door just before year end-2002, but other sell-offs appear a more distant prospect — this despite a shopping list of 20 privatisation targets paraded before the public late last year. The list, which covered the sale of state-held shares in major Saudi corporates such as *Sabir*, *Saudi Electricity Company* and mining

conglomerate *Maaden*, as well as privatisation of water desalination, railways and telecoms sectors, was notable for the lack of a timetable — a telltale sign that Riyadh's foot is not on the accelerator.

In the likely event of Saudi leadership having to exert their efforts on patching up relations with Washington in 2003, GSN does not expect the authorities to prioritise liberalisation. A long-awaited capital markets law could finally see the light of day in Q1 2003, but the authorities may be tempted to unveil this critical piece of legislation in less volatile circumstances.

Gulf States further away from the fray could see more progress in the liberalisation stakes. **Oman** is expected to approve a power sector privatisation plan prepared by international consultants — rivalling

**Abu Dhabi** in its progress towards a fully liberalised electricity market. The government is also expected in Q1 2003 to open the local telecoms market to private competition in GSM, internet and private leased line services — presaging the sale of 40% of local operator *Omantel* to a strategic investor. Private sector participation in the Omani wastewater system is also expected some time soon.

**Dubai** will remain largely immune to privatisation's appeal, preferring to stick to its brand of state-led entrepreneurial dirigisme, but Abu Dhabi's pioneering of private power initiatives will continue to make waves in 2003 — putting the Emirate on track to meet its aim of ensuring all electricity will be privately generated by 2006.

**Finance**

**KUWAIT: IMF Sees 'Favourable' Medium-term Outlook**

In its annual Article IV assessment of the economy, the International Monetary Fund on 2 January called Kuwait's medium-term economic outlook positive, while warning of the perennial threat of fluctuating oil prices.

While the medium-term outlook remains favourable... under current policies, the Kuwaiti economy also faces a number of challenges, the IMF said. These include a fast-growing population that could cause unemployment pressures if non-oil growth remains subdued. More training to strengthen the private sector was needed, it observed.

As ever, the IMF welcomed reforms, but pointed to Kuwaiti realities when it said more steps could be taken to encourage private investment, including streamlining rules and regulations, and accelerating privatisation on market-based prices.

The IMF has become bolder in calling on Gulf states — including major Fund shareholder **Saudi Arabia** — to introduce broad based income tax on domestic and foreign companies.

The IMF said it generally supported Kuwait's decision to peg the dinar to the dollar — a move introduced from 5 January to prepare for the GCC monetary union.

Meanwhile prudent monetary policy in an open and free exchange and trading system had resulted in a strong macroeconomic position, the Fund said. This was characterised by large fiscal and current account surpluses, a stable financial system and low inflation, despite wide fluctuations in global oil prices and a difficult external environment.

In the financial sector, the IMF praised Kuwait's effective supervision, continued strong progress towards conformity with the Basel Core Principles, and improvements in stock market regulation. It also welcomed the authorities decision to undertake a financial sector assessment programme exercise — aided by the *World Bank* — and praised the strengthening of the comprehensive

framework to combat money laundering and terrorist financing, a major issue for Kuwaiti institutions.

**Big Flows From Abu Dhabi, IDB**

Soft loans from the *Abu Dhabi Fund for Arab Economic Development* reached \$5.2bn, according to General Manager **Said Khalfan Bin Matar Al-Ramithi**. Some 56 Arab, Asian, African and European states benefited from ADFAED loans and grants, he said.

The Islamic Development Bank plans loans and grants worth \$4bn in its next financial period, between 4 March 2003 and 21 February 2004, 13% up on the last Hijri year (1423). Around \$1.36bn is import finance, \$1bn is allocated to technical projects and \$270mn is export finance.

Gulf Currency Box				
	\$	£	€	¥ (x 100)
<b>Bahrain</b>	0.3770	0.6074	0.3951	0.3174
<b>Iran</b>	7971.0	12,841.3	8354.41	6711.01
<b>Iraq</b>	0.3110	0.5010	0.3260	0.2618
<b>Jordan</b>	0.7096	1.1432	0.7437	0.5974
<b>Kuwait</b>	0.2996	0.4826	0.3140	0.2522
<b>Oman</b>	0.3851	0.6203	0.4036	0.3242
<b>Qatar</b>	3.6411	5.8657	3.8160	3.0655
<b>Saudi Arabia</b>	3.7503	6.0417	3.9305	3.1574
<b>Syria</b>	51.5750	83.0874	52.0558	43.4224
<b>UAE</b>	3.6731	5.9173	3.78496	3.0924
<b>Yemen</b>	177.890	286.581	186.446	149.771

Source: Financial Times.

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## The UAE's Techno Sheikhs Talk Tough And Act On ICT Business

**ABU DHABI/DUBAI** —Open criticism of government policy — even if you are head of the department responsible for it — is rare in the Gulf, but it is not out of bounds for members of the next generation of UAE ruling families, some of whom are prepared to challenge policies and traditional practices forged at home and in other Arab states. The government should not enforce censorship on the individual, Information and Culture Minister **Sheikh Abdallah Bin Zayed Al-Nahayan** told participants at a pan-Arab ministerial level meeting in October. The UAE President's son, who heads the Ministry that censors publications entering the Emirates, said the UAE's sole internet service provider (ISP) should not block access to web sites. If you want *Etisalat*, fine [but] knowledge is the right of the citizen before it is the right of the government to prevent the citizen from the means of acquiring knowledge, he said.

Sheikh Abdallah is outspoken on that traditional taboo subject: the efficacy of pan-Arab meetings, which he argues are too often characterised by hot air and spent podiums. I believe that applies to all Arab meetings, he told a major information and communications technology (ICT) conference in Dubai last year, where he also argued that some senior delegates attended as an excuse to travel and enjoy the opulence of the region's top hotels. Sheikh Abdallah commented that: Working at GCC level is better than working at an Arab level. At an Arab level you will not achieve a lot in the near future. Summing up he observed: We are masters of problem diagnosis — we have to move on.

In an echo of his feisty mother **Sheikha Fatima Bint Mubarak**, Sheikh Abdullah forcefully insisted that women must be included in the knowledge economy — a view shared by Dubai Crown Prince and UAE Defence Minister **Sheikh Mohammed Bin Rashid Al-Maktoum**, who has described women's hesitation to work as a fundamental social issue. The UAE's ruling families are setting an example for women

in government and business. Practice what you preach, is the message to policymakers from **Sheikha Lubna Al-Qasimi**, daughter of Sharjah's Ruler **Sheikh Saqr Bin Mohammed Al-Qasimi**, niece of Sheikh Mohammed and as chief executive of online business-to-business marketplace *Tejari*. Sheikha Lubna is convinced that initiatives such as the UAE's *e-government*, which makes public services available online, and an *e-college* that promotes quality management have stimulated internet penetration in the UAE.

Sheikha Lubna has a BSc from *California State University* at Chico and an MBA from the *American University of Sharjah*; she is known to exchange her *abaya* for jeans and speaks with an unflustered assurance characteristic of an active and thoughtful business leader. *Tejari* claims its online auctions and other B2B activities have put turnover into the hundreds of millions of dollars. It is expanding across borders, with a venture with *Salam International* in **Jordan**, whose **King Abdallah II** is another royal ICT fan.

**Sheikh Khaled Bin Zayed Al-Nahayan** is not as fiery as his brother Sheikh Abdallah but is clearly passionate about his business activities. His *Bin Zayed Group (BZG)* controls interests in several sectors from furniture trading to construction, and now includes seven companies working in the technology sector. Sheikh Khaled is visibly more excited by ventures in what he describes as the wild, wild west of technology, rather than more traditional local business pursuits in oil and real estate. Sheikha Lubna and Sheikh Khaled both take a distinctly hands-on approach to their technology businesses, but they also have wider concerns. Sheikha Lubna frequently speaks about women's roles in business and Arab society. Several of BZG's technology businesses focus on products aimed at smaller businesses, reflecting Khaled's apparently genuine wish to deliver ICT facilities to improve the competitiveness of the small businesses he believes are critical to the region's economy.

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