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G S N

Companies & People

Egyptian Economy Haunted By Spectre Of War In Iraq

Atef Ebeid is a worried man: with a 68 million population rising at 2% and requiring 500,000 new jobs every year just to stabilise unemployment, the last thing Egypt's Prime Minister needs is another war in Iraq to scare off holidaymakers and investors. At the *Global Development Conference* in Cairo, Ebeid would not be drawn on *League of Arab States* manoeuvring to stave off conflict. With President **Hosni Mubarak** (and increasingly prominent intelligence chief **Omar Sulaiman**) handling the diplomacy, Ebeid told *GSN* he was focused on the danger of an investment and tourism slump: "This is my concern. I am trying to figure out what are the risks involved for Egypt."

Unlike the Gulf states – where any investment slump will be offset by oil prices – Egypt struggles to maintain basic development and momentum in its emerging market. Ebeid said his government was contemplating a two-tier education system because it could not afford to raise all school standards to the levels required for modern competitiveness. This suggests a stressed Egypt will approach Gulf and other donors for more support.

Across the Region

Security mandarins are talking tough, and tightened internal control measures are apparent across the Gulf following riots in Bahrain and new shootings in Kuwait. This represents a reawakening of the security state after a decade of relative inactivity as Gulf states liberalised. **PAGE 6**

Saudi Arabia's security establishment has been condemned for responding too slowly after 9/11. Al-Saud turf wars may explain some shortfalls. Leaders are beefing up their security services. **PAGE 6**

Crown Prince Abdallah's Charter for Arab reform suggests political change is coming to Saudi Arabia. Reformist princes are now briefing on the prospects for unprecedented elections. **PAGE 8**

Attention is focused on Interior Minister Prince Nayef, who is a power in the Saudi security and religious establishments. Could he go further still? **PAGE 7**

Amid considerable dynastic speculation, some Saudis are looking to the Al-Faisal wing of the family as a potential line of succession. **BACKPAGE, PAGE 20**

Oman has had to revise plans for a major free zone at Salalah after US developer Hillwood pulled out. **PAGE 14**

Bahraini opposition groups are starting to organise for the new politics promoted by King Hamad. **PAGE 11**

Kuwait's economic reform impasse has been highlighted by FinMin Ibrahim's latest resignation request. **PAGE 15**

Syria is attempting to mould Arab efforts to find a peaceful solution to the current crisis, but is squeezed by the West, its rapprochement with Iraq and perennial conflict with Israel. The strains are showing in its alliance with Iran. **PAGE 12**

President Assad's opening has been undermined by the arrest of Syrian journalist Ibrahim Humaydi. **PAGE 13**

The Qatar-Kuwait gasoline can cross Saudi territory. The Saudi Majlis has blocked an income tax scheme. **PAGE 15**

There has been a further improvement in export credit conditions for Iran. **PAGE 18**

Saudi Arabia was obliged to borrow money for the first time in 25 years in 1988. **PERSPECTIVE, PAGE 2**

GSN's Analysis

The USA and UK would be less isolated with a smoking gun to link Iraq to terrorism or firm evidence of an immediate WMD threat. That smoking gun could conceivably come out of the underworld inhabited by rogue states, criminal business and Islamist ultras at a time when European governments are apprehensive over potential terrorist dirty bomb attacks. **PAGE 3**

Europeans are sceptical about an Iraq policy shaped by a US Administration whose style is so very different from their own. *GSN* analyses the mood and policy preoccupations in France, Germany, Greece, Italy and Spain. **PAGE 3**

The UK government's policy of constructive engagement has created a potential bridge between Washington and countries like Iran, Syria and Libya. This has made London a capital of choice for diplomatic deals, but with US and UK forces building up in the Gulf the price could be high: events in the coming weeks could define for decades Britain's place in the world. **GSN VIEW, PAGE 2**

The British debate over Iraq reflects deep popular concerns and poses complex problems for the government. The extent of the UK deployment shows its commitment to the US alliance, but London has also stressed the link between Gulf policy and the Israel-Palestine conflict, unlike the Bush Administration. This reflects a genuinely nuanced Middle East policy, which however admirable is unlikely to impress a sceptical electorate, the Arab street or the White House. **CENTREPIECE, PAGE 9**

Kuwait is confronted by political paralysis in the run-up to elections and rising tensions as US troops build up. Good news is that Project Kuwait may finally be gaining momentum. **RISK MANAGEMENT REPORT, PAGE 16**

Oman remains on *GSN*'s Risk Grades B and 3, despite growing regional tensions and continued governance problems. Energy continues to draw in investment, while a Eurobond may appear in H2 2002. **RISK MANAGEMENT REPORT, PAGE 17**

Bahrain is launching a \$500m sovereign bond, emboldened by a largely positive investor response. **PAGE 18**

GSN View

UK Prime Minister Tony Blair has invested considerable political capital in some unusual places — committing troops to Sierra Leone to reverse the descent into anarchy of a former colony (by and large successful), rebuilding relations with Muammar Qadhafi's Libya after two decades of conflict (now yielding some diplomatic and economic fruit), and courting Iran and Syria's UK-educated President Bashar Al-Assad in the face of stiff pro-Israeli opposition and US unease. Syria, Iran and Libya are all beneficiaries of a policy of constructive engagement, based on the logic that for all the disappointments — such as Assad's effective dressing down of Blair at their now infamous joint press conference in Damascus (*GSN 679/4*) — there is real potential for bringing these countries back into the international mainstream, and with it securing a major bridgehead in the struggle to bring peace to the Middle East and tackle threats from the region at their root.

This constructive engagement is important to Britain's nuanced Middle East policy, described in *GSN's Centrepiece* article. But ultimately can well-meaning but domestically challenged politicians like Assad and Iranian President Mohammad Khatami deliver? Given Syria's internal dynamics, offering Dr Bashar tea with Queen Elizabeth II is not enough: the new friends seem condemned to regularly falling out — and not just over the presence of Islamic Jihad in Palestine and other groups that so worry the USA and Israel. In mid-January, the Foreign & Commonwealth Office condemned the treatment of journalist Ibrahim Humaydi, with UK Ambassador Henry Hoggert protesting about a case that undermines Assad's glasnost credentials and highlights the realities of Syrian power struggles (*see page 13*).

Such things count in the world of constructive engagement. There are reports that many more Syrian reformists could soon be rounded up, sending out a very negative signal to supporters of rapprochement. Similarly in Iran, for all the positive noise about Khatami's administration and the potentials for business, the perpetual conservative/reformist struggle threatens to submerge the best-laid schemes of diplomats and business leaders.

But what is the alternative? Even a hawkish US Administration turned to the United Nations when confronted with geopolitical realities over its Iraq policy. However, signs of real impatience in the last week from President George W Bush at Iraq's non-co-operation with UN weapons inspectors suggests that time could be running out on this approach, despite growing opposition to a new UN resolution or any other move that leads to an early war from European governments. Arab states have already made clear their reserves.

So far, Blair has helped to tone down the most hawkish US policy — including some real victories such as finessing Washington back to the UN — by keeping close to Bush and proving that the UK should be listened to as the USA's staunchest ally. For countries like Iran, Syria and Libya, London has become a capital of choice to deal with as it provides the potential bridge to a new working relationship with Washington.

As *GSN* has long argued, this is a difficult balancing act from a Premier who faces his own personal Suez in Iraq. The coming weeks could define for decades Britain's influence in the Middle East and wider World.

Perspective: Fifteen Years Ago

For the first time in 25 years, the Saudis will be obliged to borrow money in order to pay for their now chronic budget deficit. Even so, spending has been slashed for 1988 and government outlays do not offer much encouragement for the prospects of business activity in the Arab Gulf's largest economy. The recession is not over yet — but there are signs that the economic downturn may have finally bottomed out

While the government probably got its estimate of the likely oil revenue right last year, it was still little more than the Kingdom earned from oil in 1986 when prices slumped disastrously — and only one-fifth of what it brought in during the early 1980s. It was able to earn the sum it did because oil prices remained remarkably buoyant during the year, but most oil industry observers expect that OPEC will have great difficulty in staying close to its \$18 reference price in 1988. The Saudis are in a real dilemma: if prices look as if they might fall through the floor the Kingdom will be expected to resume its role of OPEC's swing producer. Saudi Arabia has publicly declared it would do no such thing, while at the same time announcing the \$18/bbl reference price is sacrosanct. The government's ad hoc solution appears to

be some very discreet discounting to its major customers. This presumably means it wants to maximise export earnings by retaining its market share while minimising the impact on oil prices of doing so. The oil market's fortunes are notoriously hard to predict, but it seems a distinct possibility that oil revenues will fall quite considerably below the budgeted projection

For the past four years, Saudi Arabia has met its deficits by drawing down on foreign reserves [Now] the government has finally decided enough is enough and this year the reserves will be called upon for deficit assistance only to the tune of SR8bn (\$2.1bn), compared to a projected SR52.7bn in 1987. Instead, the government will take the unusual step of borrowing up to SR30bn, probably from the domestic market, probably in the form of treasury bonds. This is a momentous step — partly because the Saudi government has proudly been able to abstain from borrowing for some 25 years, and partly because it raises the delicate question of interest charges which are forbidden by strict Islamic law — which would only have been undertaken in the event of serious concern about the state of financial reserves.

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'Smoking Gun' May Rise Out Of The Underworld

European opposition to early military action against Iraq appears to be hardening, as many of the EU's leading political figures refuse to be persuaded of the need for war by the discovery of 11 empty chemical warheads and thousands of new documents, and public opinion appears solidly against a war launched on US President George W Bush's terms.

The USA and its main European ally, UK Prime Minister Tony Blair, would be much less isolated if evidence of a smoking gun to link Iraq with Al-Qaeda type terrorism came to light or firm evidence of an immediate weapons of mass destruction (WMD) threat came out of UN inspections in Baghdad.

Ever since September 2001 GSN has been consistently sceptical that any smoking gun existed to link President Saddam Hussein's regime to Al-Qaeda and other ultra-radical Islamist groups — through 9/11 pilot Mohammed Atta's links with Iraqi intelligence in the Czech Republic or the Ansar Al-Islam movement in Iraqi Kurdistan.

But the Islamist underworld could yet produce the sort of *cassus belli* sought by Washington hawks — which could shake sceptical Western governments into lining up behind the USA.

With European governments apprehensive over potential terrorist attacks using toxins or some other form of what UK Home Secretary David Blunkett called, in an unguarded moment, a dirty bomb, the smoking gun could come out of an international underworld inhabited by agents of rogue states, criminal business and ultra Islamists.

This demi-monde's geopolitical significance, with which intelligence services and their political masters have become much more familiar over the past year, was referred to by Blair when he commented: Every single day I am faced as British Prime Minister with information about how chemical and biological weapons are being freely traded by groups and individuals right across the world. Blair believes it is only a matter of time before terrorism and WMD come together.

This linkage is reflected in the British scare over the poison ricin, used during the Cold War to assassinate Bulgarian defector Georgi Markov in London and now in the possession of knots of Islamist radicals, many from Algeria — which is finally being acknowledged as a major source of recruits for the international Islamist movement (as well as for the North African country's domestic conflict), along with Egyptians and Saudis.

A genuine link has yet to be made between any of this and Iraq, but reports focusing on operatives

such as Egypt-born Abu Musab Al-Zarqawi (also known as Ahmed Fadil Al-Khalayleh) should be watched with care. Zarqawi is a favourite target for intelligence agencies: gauge the extent of his profile from <http://abumusabzarqawi.newstrove.com>.

Bush in October referred to him (if not by name) when he suggested, without providing evidence, Al-Qaeda leaders were to be found in Baghdad. US and UK officials claimed Zarqawi visited Baghdad last summer, possibly for a medical treatment after losing a leg to US bombing in Afghanistan.

Zarqawi worked with toxins in Afghanistan and is also said to have spent time with Ansar Al-Islam — which defectors claim received chemical weapons and other logistical support from Iraq — and possibly in Georgia's Pankisi Gorge, the Caucasus capital of Islamist underworld activity.

As ever when it comes to linking the war on terrorism with Iraq, the defining piece of intelligence is missing. But with the threat of chemical and biological attacks rising, agencies such as Scotland Yard's SO13 anti-terrorist branch and Special Branch, France's Direction de Surveillance de Territoire (DST) and Germany's Bundesnachrichtendienst (BND) are all focused on Zarqawi and foot soldiers in the Arab diaspora.

Should this produce a find linking Saddam to these groups, the mood would change in Europe, making the prospects of a war with substantial international backing much greater.

Sceptical Old Europe

For now, a majority of Europeans are sceptical about an Iraq policy shaped in Washington by an Administration whose style is so very different from most of their own leaders — a point made by the European Union's High Representative for the Common Foreign and Security Policy, Spain's Javier Solana, who must articulate an EU position.

This suggests the USA (and probably EU member the UK) would be relatively isolated should war break out before the inspections/UN routes has been fully explored.

German Defence Minister Peter Struck is among the latest to make clear his scepticism, although official spokesmen played down his stance as a personal view — which could return Chancellor Gerhard Schröder's government's standing in Washington to the lows it plumbed last year.

Germany counts as Europe's biggest economy and because it has just taken up one of the rotating seats on the United Nations Security Council. It does not have a veto — unlike France, whose opposition to an early attack is becoming firmer.

The conflicting claims provoked by the warheads find have strengthened European sceptics determination to insist on the central importance of a clear assessment from chief weapons inspector **Hans Blix**.

The toughening mood across the EU has added to domestic pressures on **Tony Blair**. Without Security Council approval for military action, the British Prime Minister will struggle to persuade the UK public that its troops should participate in an attack on Iraq (*see Centrepiece*).

Other EU leaders must deal with the Iraq issue against the background of a difficult domestic political context — and most do not like President **George W Bush**'s approach, sharing more in common with the Gulf states' view that a peaceful solution should be brokered, than with US hawks.

But this could change with the discovery of a smoking gun or genuine WMD potential in Iraq — and also if a war whose outcome is likely to be definitive regime change in Baghdad becomes likely. European governments and corporates are far from immune from the transforming power of realpolitik and profit.

GREECE LOOKS LEFT

Greece holds the EU's rotating presidency until June. Prime Minister **Costas Simitis** has to balance the pressure from a strongly anti-American public opinion — especially among his own supporters in the leftist Pasok — against his temporary job of presenting the consensual Union stance.

Iraq will command European attention during a period when Athens had hoped to focus efforts on unemployment, migration, **Cyprus** and the consolidation of peace in the Balkans. It also raises the strategic profile of Greece's old rival, **Turkey**.

GERMANY: FAR FROM WASHINGTON

Germany's Schröder is also in an awkward position. Last autumn, after being forced on to the defensive over bread and sausage domestic economic issues, he infuriated the USA by exploiting the public's strong anti-war feeling to revive his fading re-election prospects. This opportunistic move trashed the credibility that well-regarded Foreign Minister **Joschka Fischer** had built up through German participation in the UN-approved **Kosovo**, **Macedonia** and **Afghanistan** interventions.

Schröder has since worked to rebuild relations with Washington, but the weapons inspectors failure to find firmly incriminating evidence against **Saddam Hussein** has revived pressure from members of his **Social Democratic Party (SPD)/German Green Party** coalition for a more strongly anti-war stance. Defence Minister Struck is only the most prominent sceptic, declaring that basically, a yes to war is no longer imaginable.

For the German government and party leaders, exile for Saddam is the preferred option, at least in private discussions.

Some 44 ruling coalition MPs have signed a petition calling for a German vote in the Security Council against war. Two key leaders of Fischer's Greens, **Angelika Beer** and **Reinhard B tikofer**, SPD ministers **Manfred Stolpe** and **Heidemarie Wieczorek-Zeul**, and SPD parliamentary leader **Wilhelm Schmidt** have taken this line.

Schröder and his official spokesmen insist no final decision has been made. But there is growing pressure from the public: opinion polls show 76% of Germans opposed to military action in any circumstances. This comes at a sensitive time for Schröder, with the economy tottering into recession and difficult regional elections in prospect in the important states of Lower Saxony (the Chancellor's political base) and Hesse.

US Secretary of State **Colin Powell** has tried to shift opinion the other way, briefing journalists from the five countries that have just joined the Security Council and playing on European fears that the UN could be marginalised if it fails to back Washington. He made clear to the *Sddeutsche Zeitung* that the USA was ready to disarm Saddam by force, if need be, whether or not the UN agrees.

FRANCE: PRINCIPLES AND REALPOLITIK

French President **Jacques Chirac**'s position in insisting that action against Iraq should be decided through the Security Council is bolstered by strong cross-party opposition to unilateral American action. Chirac argues that peaceful disarmament, without war or regime change, is a victory. Unilateral action against Iraq would be against international rules.

It was up to Baghdad to provide indisputable evidence of its active co-operation. But war would be the worst of solutions and an admission of failure, Chirac said.

Anglo-Saxon critics point to France's substantial oil interests in Iraq as leavening such a principled stance with a healthy dose of French realpolitik. **TotalFinaElf** is in line for two of the biggest new concessions, the 10-30bn barrels Majnoon and 6bn bbs Bin Umar fields. This compares with just 1bn bbls in the Ratawi field earmarked for **Royal Dutch/Shell** with **CanOxy** and **Petronas**, and 2bn bbls in Nassiryah for **Italy's Eni** and **Spain's Repsol**.

But oil is a double-edged sword. If Paris were perceived as a friend of Saddam, TotalFinaElf could lose out if his regime is eventually deposed.

France will almost certainly be a central voice in shaping opinion in the UN — and could score big points in Washington by leading the Security Council into war. For all his reservations Chirac knows this, and may yet join in.

According to some calculations, France was the second largest supplier of air power for Kosovo and Afghanistan, after the USA.

But France has heavy commitments elsewhere, including peacekeeping in **Bosnia** and Kosovo. It has a substantial force in **Cote d'Ivoire**, in a rapidly

deteriorating situation that has become a focus of attention for Foreign Minister **Dominique de Villepin** and big spending Defence Minister **Michelle Alliot-Marie**, a Gaullist politician unafraid of taking on US thinking. Commitments in West Africa could limit the number of troops available for assignment to the Gulf.

Chirac has the comfort of his fat parliamentary majority. But he would probably face opposition criticism to war. In government in 1990-91, the Socialist Party joined the war to liberate **Kuwait** — although a few leftists dissented and Defence Minister **Jean-Pierre Chevènement** (a longtime friend of republican Iraq) had to step down. This time the Socialists insist the situation is quite different: they are united in opposing war.

SPAIN PROVIDES A BRIDGE

After the UK, Washington's most sympathetic European ally is Spain — also a current Security Council member. Despite this identification Prime Minister **Jos-María Aznar** may feel he enjoys room for manoeuvre in terms of Arab opinion due to Madrid's longstanding support for the Palestinians. Spain is a major financier of infrastructure in the West Bank and Gaza, and of its rebuilding after Israeli assaults.

Aznar has stressed his belief in the primacy of Resolution 1441 on Iraq, recently arguing: If the Iraqi regime does not hold to these instructions, it must hold itself ready for serious consequences — and this document does not indicate that there will have to be another resolution.

Opposition parties have fiercely criticised this position. The **United Left (IU)** has asked whether the government has given the USA permission to use Spanish airspace or bases without parliamentary approval. The **Spanish Socialist Party (PSOE)** complained that Aznar was one of the few EU leaders to back Bush unconditionally. The PSOE is also angry at Aznar's reluctance to explain his stance to Parliament.

Until recently, such criticism might not have bothered the popular centre/right Premier, but his government's public standing is more vulnerable following its much criticised handling of a tanker sinking which polluted the north-west coast, hitherto a loyal area for the ruling **Popular Party**.

ITALIAN COMPROMISE

Like France's President Chirac, Italian Prime Minister **Silvio Berlusconi** is spared immediate political pressure because his left wing opponents, although against war, are preoccupied with internal reconstruction after election defeat. But he too is now cautious about military action — as is the public, with 61% against war according to the latest Cirin poll, compared with 53% in October.

Italy has a potential opt-out should it decide not to make a big commitment to the Gulf: like France, its forces are stretched, with the equivalent of two brigades in the Balkans — which analysts in Rome

says means at least six brigades engaged in some way, due to the demands of rotation, training and other pressures. A battle group of 1,000 Italian troops is leaving for Afghanistan (representing another brigade knock-down) and Italy has several other minor engagements worldwide.

As one military analyst told GSN: If you consider that we have nine fully manned brigades, but two of them are still being transformed from conscripts to volunteers, we really lack resources for credible participation in a ground offensive.

Italy could send a dozen Tornado bombers, but from the political point of view, the cost would be too high, while the perceived benefit is too low — so, very likely we will mainly provide logistical support and rear-area protection. This would be based on the Navy operating in the Gulf and eastern Mediterranean, plus the free use of bases and airspace.

Berlusconi has been broadly sympathetic to the USA and his Defence Minister **Antonio Martino** has authorised US overflights. There will always be the suspicion that Saddam Hussein is lying, as he did for many years, not abiding by the repeated UN resolutions, Berlusconi said in mid-January, after the discovery of empty chemical warheads.

But Berlusconi also argued against the need for an early decision on war. The inspections were starting to prove fruitful, he maintained. It would be best to grant the inspectors more time, extending the 27 January deadline. It shouldn't be too difficult to allow them to carry on for the whole of February.

He added: We reckon the solution should be reached within the UN and, if it should come to military attack, it should be up to **NATO**.

Italian and other EU forces could play a role in the less politically contentious post-conflict phase, when a fast-moving and rigorous policing function will be needed. But Italy's probable participation in peacekeeping is not likely to be large-scale.

Opposition to war has brought leftists and Catholics together — the latter mindful of **Pope John Paul II**'s solid opposition to the conflict.

Italian companies will be looking for contracts in Iraq's reconstruction phase, but the mobilisation of a military/diplomatic machine to promote hydrocarbons giant **Eni** and other major players is now restricted compared to the golden age of post-war Italy's political/business elite.

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GCC Raises The Drawbridge And Calls Out The Guard

The Gulf's security mandarins were in no mood to dismiss the New Year rioting in **Bahrain** as simple hooliganism when they gathered at two key meetings in early January (*GSN 701/4*). An impromptu meeting between GCC intelligence and security ministers in **Kuwait** on 4 January set the scene for further discussions at the sidelines of a scheduled meeting between Arab interior and information ministers in **Tunis** on 14 January.

According to members of the **UAE** security establishment, the meetings discussed evidence of rising anti-**American** activism in GCC states, including violent attacks on US servicemen in **Kuwait** in October and November (*GSN 698/3*). Another major incident followed on 21 January (*see page 16*). Projecting the trend so far, GCC security chiefs concluded that attacks and demonstrations will increase as US forces deploy in greater numbers and to more locations across the Gulf states.

The response is visible in tightened internal control measures across the Gulf — representing a reawakening of the security state in most GCC nations after a decade of relative inactivity. During the 1990s, Gulf states' security apparatus coped with new and novel challenges, particularly the diffusion of the internet, leading analysts to focus on soft security issues such as censorship.

The current round of contingency planning serves to remind Gulf watchers that the GCC states retain considerable internal security forces focused on physical keypoint protection of the GCC's royal families, economic and political infrastructure.

Contrary to doom-laden scenarios stressing the oil monarchies' fragility, even if popular discontent were to translate into civil resistance or militancy, the signs are that Gulf rulers would have more than a fighting chance of holding on to power due to their security structures.

This article will focus on how **Saudi Arabia** is coping with these challenges. Security in the smaller GCC states will be analysed in *GSN 703*.

A CHANGING THREAT PROFILE

During the latter half of the 1990s and particularly since 11 September 2001, the threat profile facing GCC internal security forces changed considerably despite certain enduring concerns. The old threats from tribal and secessionist currents diminished once diffusion of largesse extended across tribal and regional lines. Coups or Islamist revolution have remained threats, as has the presence of large foreign communities in the GCC.

Foreign communities represent an estimated 10.2m of the GCC's 27.7m population, but the political threat they pose has considerably declined

since the 1990-91 Gulf crisis, when large and restive **Palestinian** and **Yemeni** expatriate communities were sharply reduced through mass deportation.

As this threat diminished, others have proliferated: radical Islamist cells carry out attacks in the Gulf and beyond; there are scattered violent and non-violent protests at US and **UK** policy on **Iraq**, **Israel-Palestine** and local rulers' policies. These threaten to coalesce into more serious civil disobedience — and this broadening of threats to internal security means that GCC states must assure keypoint security of their own installations and those of foreign presences while they prevent the export or import of terrorist groups across their borders.

Elemental Failure In Saudi Arabia

Saudi Arabia's security establishment has been roundly condemned for its slow realignment to this broadened responsibility, which played a role in the success of *Al-Qaeda's* operations on 9/11.

This failure did not stem from a lack of resources — the Kingdom is estimated to spend \$7bn on internal security each year — nor from any lack of capacity for change. Saudi Arabia has seen the most drastic transformation from tribal society to sophisticated security state, and has boasted a security and intelligence bureaucracy since 1926.

The failure appears to be one of imagination and mental agility. Perceptions of the Islamist threat to the Saudi state remain conditioned by the 1979 seizure of the Grand Mosque in Mecca by Islamist elements associated with the *Moslem Brotherhood*. Hajj security remains strong, evidenced by the massed presence of security forces at last February's celebrations and again this year.

Religious militants have launched few attacks against the Saudi state, leading some observers to presuppose a degree of connivance between *Al-Qaeda* and the state. Even as bombing and shooting attacks on US military bases and Western expatriates increased in the second half of the 1990s, the Saudi security state continued to look away from the problem. This was reflected in the authorities' insistence on blaming attacks on expatriates on turf wars between alcohol bootleggers.

Turf wars between senior **Al-Sauds** explain some security shortfalls. The intelligence failure cannot be traced to the *General Intelligence Directorate (GID)*, which reports directly to **King Fahd**. Under the service's long-standing chief — and new Saudi Ambassador to the UK — **Prince Turki Bin Faisal Al-Saud**, the GID warned the leadership that an unspoken compact with Islamist groups was

unravelling through these group s activities within Saudi Arabia. Turki was defeated when he tried to convince his royal peers that Saudi Arabia must co-operate with the US *Federal Bureau of Investigation (FBI)* over the Khobar Towers bombing (where 19 US personnel were killed). This sowed the seeds of his dismissal in 2001.

Although ostensibly relieved due to his untimely links to the *Afghan Taliban*, Prince Turki s dealings with **Mullah Omar** merely provided the opportunity that Interior Minister **Prince Nayef Bin Abdelaziz** had been waiting for.

The powerful Prince Nayef — who a number of observers believe fosters increasing ambitions to eventually succeed **King Fahd** and **Crown Prince Abdullah** (CPA) — opposed Turki s initiative to open up the security state through greater co-operation with the FBI. Analysts believe Nayef s conservatism is a significant element in the Kingdom s slow reaction to the changed internal security environment. His apparent underestimation of the threat posed by Al-Qaeda did not cease on 9/11 and the Interior Minister continues to take controversial positions in interviews; he continues to support the *Saudi Committee for the Al-Qods Intifada*, which helps the families of Palestinian suicide bombers.

As recently as early 2002, Prince Nayef queried Al-Qaeda s ability to carry out the 9/11 attacks, giving credence to conspiracy theories about Israeli involvement or blaming the Moslem Brotherhood — a group he has harboured deep resentment towards since the 1979 Grand Mosque seizure, which happened early in his long tenure as Interior Minister. Giving an insight into Saudi Arabia s unsuccessful policy of engaging extremist groups, Nayef noted: All our problems come from the Moslem Brotherhood. We have given too much support to this group.

THOUSANDS OF RADICALS

While Nayef continues to maintain there are no longer active or dormant Al-Qaeda cells in Saudi Arabia, and that the role of Saudi citizens in the underground Islamist movement is exaggerated, his Ministry is in the midst of an extensive internal security reassessment. This is based on the premise that some 8,000-15,000 Saudi citizens have had close ties to extremist groups during the last decade.

Three cells are said to have been uncovered in the last year, including the arrest of 11 Saudi citizens in July 2002. Of 700 Afghans — Saudi citizens who served in Afghanistan during the Soviet occupation — 100 are still held, including 40 prisoners on hunger strike since early January. The annual surveillance budget of the Interior Ministry s *General Security Service (GSS)* is believed to total around \$267m.

The *National Information Centre* maintains extensive records on all Saudi citizens and residents, linking eight intelligence centres to 1,000 terminals in 250 locations nationwide. Saudi Arabia remains far more capable of tracking physical targets than

Prince Nayef Looks Beyond His Fief

The Interior Ministry is dominated by the personality and patronage of Prince Nayef Bin Abdelaziz, a Sudairi full brother of **King Fahd** born in 1933. He has held the minister s post for over 30 years. According to Westerners with experience of Saudi s security state, Nayef s hold over the Interior Ministry is so strong that even **Crown Prince Abdallah** cannot issue orders directly to ministry personnel without a nod from the Minister. The secret of Nayef s success partly lies in his judicious distribution of largesse; the Interior Minister has a reputation for financial probity, allowing financial inducements to trickle down to his lieutenants, contrasting with the reputed greed of many other princes such as Defence and Aviation Minister **Prince Sultan** and his son **Prince Khalid Bin Sultan**. If his health holds, Nayef could be a force in future succession struggles against rivals such as the **Al-Faisals** (see page 20).

While keeping one hand on the reins of state security, Prince Nayef has built up the Interior Ministry into a powerful source of economic leverage. It controls government real estate ownership, including housing development and planning permission; Ministry databases provide the most up-to-date picture of demographics for urban and rural developers; it plays a leading role in health insurance control through the national ID system.

Prince Nayef s Vice Minister and Assistant Minister are his sons **Prince Ahmed Bin Nayef** and **Prince Mohammed Bin Nayef** respectively. Key Nayef loyalist, Under-secretary **Ahmed Al-Salam** runs the Ministry s day-to-day operations. As well as calling on the *General Security Service* s intelligence section for information, Nayef keeps former heads from the **Jordanian, Moroccan, Syrian, and Egyptian** security services on retainer, serving on his personal staff. Through the Interior Ministry, Prince Nayef provides the Sudairi Seven with guile, complimenting Prince Sultan s muscle.

terrorist funding.

Although CPA s high-profile foreign policy advisor **Adel Al-Jubeir** recently unveiled new controls and boasted that \$5.5m had been frozen in 33 terrorist accounts, major questions remain over the use of charity and other funds. Former **French** intelligence officer **Jean Charles Brisand**, expert witness to the American families seeking to prove Saudi culpability in 9/11, continues to downplay the effectiveness of Saudi measures in arguments that chime with Western agencies views.

Prince Nayef has also exercised influence over security policy aimed at reducing clerical support for radical forms of Islam, stating baldly that: Imams are employees of the government and whoever does not work in accordance with the official way must find another job and be replaced by another one who is able to understand the orders of God. Nayef and other cabinet members, such as Islamic Affairs Minister **Saleh Al-Sheikh**, have reined in the Ulema through qualifications boards (licencing clerics according to their religious credentials) and funding bodies.

DIRECT ATTACK CAPACITY

Saudi Arabia remains better equipped to deal with tribal uprisings, coup attempts and other direct attacks on the government than the nefarious threat

of terrorism. The Interior Ministry is capable of dealing with small-scale or politically sensitive contingencies, calling on 35,000 public security police for keypoint security, and the *Mubahith* (GSS Secret Police) and *Special Security Force* (GSS Special Forces) for direct action missions.

For larger or more threatening scenarios, Crown Prince Abdallah's *Saudi Arabian National Guard* (SANG) is available, handling all serious internal security issues in cities and oilfields (which the *Royal Saudi Land Forces* are not permitted to enter). SANG has 57,000 personnel, including 25,000 combat troops and 1,117 heavily armed Piranha wheeled armoured vehicles purchased from *General Motors Canada* in a \$3.4bn deal.

A highly capable combat force battle-tested at Khafji in 1991, SANG may be expanded up to a 80,000-100,000 personnel with increased funding, reflecting its status as CPA's personal force.

SANG is developing forces to intervene in less serious cases of public disorder. The British Military Mission in Saudi Arabia has co-operated with the *Metropolitan Police*'s Public Order Training Centre in Hounslow — Riot City — to train a 200-strong SANG mounted riot control unit.

Former Met Chief Inspector **Alan Bingle** and Major **John Dalziel**, now SANG's Riding Master, played key roles. Dalziel reported that Arabian mares performed surprisingly well. As Dalziel noted, mounted police in Britain are seen as the last option before the use of tear gas and rubber bullets. This unit's development shows that SANG foresees a need for non-lethal force and a greater role in the internal security tasks.

Crown Prince Abdallah retains the National Guard's fierce loyalty; many SANG operatives are

drawn from the rural tribal groups that CPA calls his strength from. The SANG Intelligence Directorate is an increasingly important source of information, especially since CPA's grasp on the GID has receded. The Crown Prince supported Prince Nayef over Prince Turki's removal in 2001 on condition that his old ally **Prince Nawwaf Bin Abdelaziz** was appointed to head the GID. But Nawwaf was soon out of his depth in the complex environment of the GID — an organisation Prince Turki nurtured and made his own. When Nawwaf suffered a stroke in 2002, he slipped even further out of control.

If Saudi Arabia does allow Western forces based in the Kingdom to take part in operations in Iraq, or even allows further deployments, the Saudi security establishment is readying for a return to major terrorist incidents and the beginning of new and unprecedented levels of civil disobedience.

Although the probability is low, Saudi Arabia's security mandarins are acutely aware that the impact of serious opposition to the government would be high. All the while, royal princes continue to arm up their parallel security forces to prevent shifts in their own balance of power.

The Reshuffle To Come

With princes vying for power, attention is turning to the prospects for a reshuffle in May. Oil Minister **Ali Naimi** is said to have asked to go — much to the relief of international oil companies who believe he is instrumental in blocking their investment plans.

As GSN has argued before, Naimi is firmly in **Prince Sultan**'s camp in the Sudairi branch, as well as being a staunch *Saudi Aramco* man.

Competition to replace him will be intense as princes seek to influence the crucial next stage of the stalled Gas Initiatives Project.

New Saudi Approach To Governance

Supporters of political liberalisation in the Gulf region are hopeful that **Crown Prince Abdallah**'s planned Charter for Arab Reform, setting out a goal of internal reform and political participation across the region, signals that advocates of modernisation within the Saudi royal family are gaining the upper hand. There are reports that this initiative could be accompanied by elections — first to proposed municipal councils and then, “within two years” for an elected Majlis Al-Shura (Consultative Council). That 120-member advisory body has been appointed by **King Fahd** since its creation in 1993, but has been gaining in authority thanks to its more independent-minded members.

CPA's draft charter, currently being circulated among national leaders in advance of a March Arab summit in **Bahrain**, aims to promote moderate reforms that would help defuse pressure for radical change — the existence of which it openly acknowledges, as do the reformist princes now advocating pluralist politics.

The draft charter suggests that Saudi Arabia's *de facto* ruler has been persuaded of the case for change, and that he now feels sufficiently strong at home to set out a public agenda for Arab reform. “The Arab heads of state decide that internal reform and enhanced political participation in the Arab states are essential

steps for the building of Arab capabilities, and for providing the conditions for a comprehensive awakening and development of Arab human resources,” it says. In remarkably blunt terms the draft talks of “paralysis” and “lack of recourse” in the Arab world. It calls on Arab leaders to stop ignoring an “explosive situation” — an apparent reference to the political and socio-economic frustrations that fuel support for radical Islamism.

The Charter's promise of change might ward off a further clash with the **USA**, where such powerful congressmen as Republican Senator **John McCain** are pushing Secretary of State **Colin Powell** to put new pressure on Saudi Arabia over its record on religious freedoms (a hot issue of the Hill), human rights and governance record. This could potentially put the Kingdom on a similar footing to **North Korea**, **Burma/Myanmar** and **China**. The official *US Commission on International Religious Freedom* has recommended that Powell should name Saudi Arabia a “country of particular concern”, opening the possibility of diplomatic or economic sanctions.

The prospect of war in **Iraq** highlights the extent to which the Kingdom's alliance with the USA continues to expose the Al-Sauds to radical Islamist critiques. The London-based *Committee for the Defence of Legitimate Rights*, effectively run by shrill exiled dissident **Mohammed Al-Masari**, has recently been talking up notions of “global and total Islamic revolution”.

Nuanced British Positions Lost On Arab Street

As the Iraq crisis enters a critical period, a cacophony of views emerging from the public, the *Labour Party*, cabinet ministers, the *Foreign and Commonwealth Office (FCO)* and the *Ministry of Defence (MoD)* have combined to hold something akin to a national debate on British Middle East policy. Iraq policy represents a crucible on which to test the big questions, but British diplomats and mandarins are keen to maintain focus on the broader issue of relations with the Islamic world by stressing the connectedness of Gulf policy and the **Israel-Palestine** conflict.

Maintaining this connection is one of many ways in which UK policy contradicts the **Bush** Administration's priorities. British regional policy is genuinely nuanced, but recognition of this fact is unlikely to develop on the Arab street, among a sceptical British electorate or in the White House — unless the UK publicly risks a major breach in the special relationship, which Prime Minister **Tony Blair** seems loathe to countenance.

Blair has refused to confirm or deny that Britain would enter a war against Iraq without the backing of another *UN Security Council* resolution (UNSCR). This is a practical measure: it is uncertain that **Russia, China** or **France** would not issue an unreasonable veto of a new resolution — Blair's way of describing a veto that blocks UN-backed action even after a material breach of UNSCR 1441 through obstruction of inspections or the discovery of a smoking gun — probably undeclared weapons of mass destruction (WMD).

It also underlines the delicate balance London maintains in attempting to amend US policies without either rejecting or endorsing them.

When push comes to shove such balance may not be possible in dealing with the straight-talking Bush Administration, which has become used to overcoming objections in the war on terrorism — as with the scenario now unfolding, in which **Saudi Arabia** has hinted it will provide basing, France has suggested it may provide troops and Russia has indicated it may support a new UNSCR.

POODLES CAN BITE TOO

The poodle theory of Anglo-American relations — which sees Blair's UK slavishly following US policy to maintain the special relationship — is overly simplistic, but Britain's deployment will result in the fielding of a very substantial force that will contribute a greater share of combat power and undertake more critical military roles in the Anglo-American alliance than its counterpart did in 1990-91 (see box).

Disappointing those commentators who are fond of deriding Britain's military contribution to US operations, the force package being sent to the Gulf will be very useful if hostilities occur.

In an era when the USA accepts military allies for political benefit at the cost of reduced operational freedom and capability, the UK is one of the few countries that can contribute forces without reducing a US-led coalition's military effectiveness. This is achieved by fielding balanced, self-supporting force packages that do not drain US resources.

When the USA balances the military costs of integrating coalition partners against the benefits, the overall quality of British units (if not always their equipment) argues in their favour. UK *Special Forces* and refuelling, intelligence, surveillance and reconnaissance aircraft are genuinely welcomed by the overstretched US military. UK cruise missile submarines and long-range strike aircraft are

Anatomy Of A Deployment

The scale of the **UK** deployment announced on 20 January shocked elements of the British public and media but had been planned for weeks. The 26,000-strong force (including naval personnel) represents a very potent addition to **US** forces. Britain may provide four brigade-sized units plus supporting naval and air forces — a commitment not much smaller than in 1991 but at a time when total UK forces are smaller and the US contribution is greatly reduced. The effort, including the majority of Britain's core combat units, represents a major strain on the **MoD**, as Chief of the Defence Staff Admiral **Sir Michael Boyce** noted recently, to the horror of Defence Minister **Geoff Hoon**. Key elements include:

- more than two-thirds of 1 Armoured Division, including 7 Armoured Brigade and 4 Armoured Brigade (deploying from **Germany**) and elements of 14 Infantry Brigade (deploying from the UK). The first of up to 120 "desertified" Challenger II tanks were due to embark freighters at Hamburg and Bremen on 20 January;
- an amphibious task force, including Britain's largest aircraft carrier, *HMS Ark Royal*, and helicopter carrier *HMS Ocean*, will serve as **Royal Marine** helicopter assault ships. The task force carries over 3,000 Royal Marines of 3 Commando Brigade. Three amphibious assault ships and two minesweepers will join two UK minesweepers already in the Gulf;
- the rapid deployment 16 Air Assault Brigade has been ordered to the Gulf, leading to one if its **Parachute Regiment** battalions being withdrawn from fire-fighting duties during the current UK fire service strike; and
- 15 **Royal Air Force** combat aircraft recently exercised in **Jordan**, adding their numbers to an equivalent number of aircraft stationed in **Saudi Arabia, Kuwait** and **Turkey**.

regarded as almost interchangeable with US forces.

Britain's planned deployments mean it will field a balanced force capable of semi-autonomous operations. One part of the theatre of operations — such as the Western Desert — may thus become the focus of UK operations. Although operating under an ostensibly US air umbrella, UK Special Forces carried the initial burden for suppressing Scud launches in the Western Desert in 1991. Britain's light armoured division might be ideal for this role, linking up with an airmobile carpet of light troops from 3 Commando Brigade and 16 Air Assault Brigade after these formations saturate Scud launch baskets and key airfields.

Alternatively, UK forces may be parcelled out to US commands in capability blocks; 16 Air Assault Brigade is tailor-made for operations in northern Iraq, 3 Commando Brigade could assist in amphibious and airmobile operations against Basra, and 1 Armoured Division could protect the flank of US armoured formations.

The unhurried pace of Britain's deployment programme and initial mobilisation of only 1,500 reservists was an indication that Britain was not slavishly adopting US policies as her own.

In hinting that clear rules of engagement should be arranged to prevent US commanders from using British troops in ways that did not reflect UK policy, Chief of the Defence Staff Admiral Sir Michael Boyce implicitly recognised the difference between Washington and London's immediate objectives in Iraq. One of the key differentiators that the Blair government has emphasised concerns regime change, with Hoon and UN Ambassador **Sir Jeremy Greenstock** at pains to emphasise that **Saddam Hussein's** removal was not UK policy.

The UK government recently signalled a more fundamental difference over Iraq, and has sought to change the trajectory of US policy by seeking to slow down events and dampen speculation over war. In early January, Foreign Secretary **Jack Straw** spoke against the inevitability of conflict and stated that the odds had dropped from 60/40 in favour of war to 40/60 against war over the Christmas break. Ambassador Greenstock then echoed No. 10 by downplaying the 27 January date that will see UN inspections chief **Hans Blix** report to the Security Council. Blair noted that UN inspectors would need time and space to undertake their task.

THE UN ROUTE

Blair's 17 January meeting with Blix demonstrated Britain's apparently unambiguous commitment to the UN route. This commitment is based in a belief that weapons inspectors will either be obstructed or discover a smoking gun if given enough time.

This belief has been bolstered by recent **UNMOVIC** activity — uncovering undeclared empty chemical artillery shells and quizzing Iraqi scientists — and Blix's tough line in rhetoric.

The commitment is backed by a belief that if a

material breach or smoking gun were documented, Security Council members would not register an unreasonable veto against a new resolution authorising the use of force — the quid pro quo that Blair has publicly stated underpins the Anglo-American decision to take the UN route.

Britain's increasing commitment to the UN route is an indicator that vision and strategy are driving Iraq policy at least as much as government reaction to backbench and public unease over the issue.

INACTION NOT AN OPTION

UK policy appears to have developed from a keen appreciation of the dual threat posed by inaction — leaving Iraq's aggressive weapons programmes unchecked — or action relying on brute force alone. This view has informed an increasing number of thoughtful, on-target statements originating from the British leadership.

The Prime Minister is closer to Bush than most world leaders on the threat of Iraq's ambitions to develop WMD. The gloomy message at the first Prime Minister's parliamentary question time of 2003 is an indicator that Blair believes Britain will be the target of a major terrorist attack — a perception strengthened by the discovery, perhaps unrelated to *Al-Qaeda*, of ricin poison in the possession of a suspected terrorist cell in London and the killing in Manchester of a Special Branch officer investigating the same group.

Blair shares Bush's by no means a widely held belief that rogue regimes with WMD present an unacceptable threat as potential suppliers to terrorist groups. Taking that train of thought to conclusion indicates that Blair shares Bush's belief that rogue states must be disarmed — a perception that influenced the two men's personal chemistry.

...WITHIN A HOLISTIC POLICY

Blair shares Bush's proclivity for feeling his way through issues, but the UK government has shown greater ability than the USA to think through the consequences of Anglo-American activism. In reaction to rising anti-Americanism, the US government is willing to change the style — with new public diplomacy communications strategies — but not the substance of its policy. The British government is unconvinced this will work.

Speaking to over 100 UK ambassadors on 3 January, Blair ventured that anti-American forces tapped into pent-up feelings of injustice and alienation, from divisions between the world's richer and poorer nations. Stating that Iraq crises were the best recruiting ground for anti-Americanism, he mentioned global warming and the Palestinian conflict as key issues threatening to make change through disorder a more likely course than globalisation in the 21st century.

Recent UK policy on Israel-Palestine is significant, reflecting a deeply held conviction in the FCO that Iraq policy must be counterbalanced by well-publicised and even-handed action in the Levant. In his speech to British ambassadors, Blair

explicitly stated that a significant degree of opposition to intervention in Iraq was prompted by the perception of double standards over Israel.

But Blair's attempt to broaden the horizons of the USA on this issue have abjectly failed, forcing Whitehall to adopt a more bullish approach. This was typified by Blair's appeal to Israeli Prime Minister **Ariel Sharon** to allow Palestinian delegates to attend an FCO-organised conference in London on 14 January about reforming the *Palestinian Authority (PA)*, and Straw's subsequent spat with Israeli Foreign Minister **Benjamin Netanyahu** over the issue.

The recent Downing Street visit of Israeli opposition *Labor Party* leader **Amram Mitzna** — who favours direct negotiations with the PA — drove home Britain's stance on the subject.

It remains unclear whether such nuanced steps will have sufficient impact to counterbalance the UK's deployment to the Gulf. Some voices in the FCO remain convinced that Britain must do more to counterbalance its Iraq policy, both on support of the UN route and by making gestures unrelated to the PA reform conference — which at heart places the burden of change on the Palestinians.

Different wings of government are out of sync. For all his commitment to the job, Hoon has struggled to maintain a convincingly hawkish

facade, while Straw and other government spokesmen have downplayed the likelihood of war — and have received official snubs. But perhaps most significant, colleagues say the government's most prominent dove, International Development Secretary **Clare Short** — a leftist/humanitarian totem who is not a politician to be under-estimated — complains in Cabinet about details, but not about overall policy.

This is not the case for the Labour Party in the country, but it does suggest Blair's key political support will hold unless things go badly wrong.

With resolution of the Iraq crisis entering a critical period of rapid change, maintaining and communicating a single message will be difficult.

This recognition was one of the drivers behind recent meetings of Britain's ambassadors and the foreign policy community. The UK has already made the choice to back the UN and even-handed treatment of the Israel-Palestine conflict; now Whitehall must work out how to communicate this.

In contrast to the White House's focus on style over substance, Her Majesty's Government faces a difficult task in rebranding its policy without breaching the special relationship, thus bringing the style and substance of its Middle East policy into balance.

Bahraini Opposition Reorganises

Bahraini opposition groups are starting to organise for the new politics promoted by **King Hamad Bin Isa Al-Khalifa**. After boycotting last October's elections they are unrepresented in the new National Assembly and appointed Majlis Al-Shoura (*GSN 697/8*). **Al-Wafaq National Islamic Society**, the main Shia group, and the left/liberal **National Democratic Action Society (NDAS)** were holding internal elections as *GSN* went to press, intended to reinforce their internal legitimacy and bring forward a new generation of younger leaders.

Al-Wafaq and NDAS plan to take full advantage of the new freedom of speech to campaign on a wide range of issues, providing what one activist calls a "shadow parliament", engaging in the public debates with prominent government supporters that are now a regular feature of political life on the island. King Hamad shows no sign of softening his determination to operate with the new parliamentary institutions, but he is maintaining a climate of free speech — in which new independent newspaper *Al-Wasat* has been able to report extensively on opposition views — and a fair degree of government contact with the refusenik opposition.

The King's self-confidence has been bolstered by a Parliament where the Majlis Al-Shoura is filled with royal supporters while the elected, Sunni Islamist-dominated Chamber of Deputies has adopted a strikingly compliant tone. **Al-Asalah** leader **Sheikh Adel Al-Moawdah** has reassured King Hamad that he can count on the Assembly's support. There could be a price to pay for this later on — in the form of Islamist demands for more conservative rules on issues such as alcohol use — but at this stage, with widespread anger among young Shia at Bahrain's Western allies, the Assembly's compliance is much appreciated.

Recent incidents suggest that the establishment bureaucracy

remains nervous of opposition and civil society groups' determination to develop a wider political life beyond the National Assembly's confines. Officials told Wafaq and NDAS that, as societies rather than registered parties, they could not hold official conferences (at which the internal elections were planned). They got around the ban by finding other societies to host the meetings: the **Bahrain Medical Society** hosts Wafaq's 23 January election gathering, while NDAS is hosted by the **Bahrain Society of Engineers** on 24 January.

Some opposition activists fear the police's failure to prevent New Year riots may give conservatives an excuse to press for restoration of state security legislation, albeit in a new form (*GSN 701/4*) — reflecting the return of the security state (*see page 6*). To allay official suspicions, the opposition wants to carry out its new activities in a public and transparent manner.

NDAS is keen to modernise its appeal and develop a new leadership generation to succeed the current leading secular progressives, who grew to political maturity during the 1970s. It wants to develop contacts with the European centre/left — green, liberal, social democrat and socialist parties — and plans to send young activists to study camps, to discuss new thinking and broaden their contacts — in an unimpeachably open manner.

Meanwhile, a broad coalition of religious and secular women's groups has run into bureaucratic obstacles in their effort to set up a national federation. The government has kept them waiting 14 months for approval and insisted that only those groups that are officially named "associations" can legally be allowed to form a federation. The women's organisations now plan to appeal direct to King Hamad, whose wife, **Sheikha Sabika Bint Ibrahim Al-Khalifa**, chairs a grouping of women's leaders and has developed contacts with women's societies, including grassroots Shia groups (*GSN 696/1*).

Middle East Insider

Syria Caught Between Iraq And A Hard Place

Mood swings in Damascus are becoming more marked as President **Bashar Al-Assad**, and the Alawite hardliners and reformist allies that vie to influence his government's behaviour come to terms with a probable US-led invasion of Iraq. Squeezed by the West, its rapprochement with Iraq and perennial conflict with **Israel**, Syria is attempting to mould Arab efforts to find a peaceful solution, not necessarily in concert with the initiative promoted by **Saudi Arabia's Crown Prince Abdallah Bin Abdelaziz**.

Deputy Premier and Foreign Minister **Farouk Al-Sharah** visited Ankara on 13 January to try to make common cause with key US ally **Turkey**.

The next day Vice President **Abdelhalim Khaddam** paid a high-profile visit to Moscow for talks on Iraq, energy deals and rebuilding bilateral ties with President **Vladimir Putin**. Few former Soviet clients feel the loss of a close **Russian** alliance as much as Syria.

Assad was due in **Iran** on 15 January but the visit was cancelled at the last moment. Officially this was due to timetabling problems, but differences of approach to the USA and Iraq have complicated relations between the two traditional strategic allies. Syria is concerned that Tehran is courting the Iraqi opposition with suspicious fervour.

Policy positions such as Foreign Minister **Kamal Kharrazi's** statement to the Majlis (Parliament) indicating that Iran would not back **Saddam Hussein** if Iraq came under attack do not sit well with Arab nationalist traditionalists. Syrian power brokers are also angry at Iranian efforts to persuade **Hizbollah** to tone down its rhetoric and operations during a period of intense pressure in the region: Syria likes to be consulted on these issues.

Syria fears negative economic consequences from a US-led war on Iraq and the potential for a breakaway **Kurdistan** — which some in Damascus fear Iran is flirting with by promoting Iraqi opposition groups. Talk of regime change from hawks in Washington and Syria's candidate status to join the **Bush** Administration's Axis of Evil, enthusiastically promoted by Israel, are chilling reminders of Assad's failure to reposition Damascus since his father's death in June 2000.

The regime is limited in its scope for manoeuvre over Iraq. Syria's **UN Security Council** vote on inspections may represent the limit of its commitment to discomfiting Saddam.

Syria remains stuck in a cold war vision of international politics. Assad has tried to reform,

but the rapid change advocated by the technologically savvy President and his allies remains hostage to traditionalist elements across Syria's pervasive state structures (*GSN 690/3*).

US critics believe Syria is incapable of change — a dangerous perspective if a successful campaign in Iraq puts regime change in the Middle East firmly on the agenda. Dr Bashar thus treads a tightrope, seeking to maintain Syria's Arab nationalist credentials and, above all, its primacy in **Lebanon**, while courting the West.

Syria is likely to maintain links with Iraq, despite its crucial yes vote on 8 November, which allowed for Security Council consensus on Resolution 1441 calling for Iraq to disarm.

Syria abstained in the 30 December Goods Review List vote, along with Russia (*GSN 701/10*). Its representative said that Iraq's co-operation with UN weapons inspectors should lead to sanctions being lifted.

This is hardly the stuff of which US-led coalitions are made. But Syria has an eye to the main chance — as the late **Hafez Al-Assad** showed by joining the coalition in 1990 — rather than an agenda that might prop up Saddam long-term.

This opportunism was reflected in **Syrian Petroleum Company** Managing Director **Mohammed Said's** suggestion that SPC would partner any Russian company that would replace **Lukoil** in the huge West Qurna concession.

Pointing to Syria's position in the no-man's land between Washington and Baghdad, Saddam's cousin and **Revolutionary Command Council** member **Ali Hassan Al-Majid** used a 17 January visit to Damascus to broadcast the Iraqi President's rejection of any formula that would lead to exile in a sympathetic state — such as Syria.

MORE FROM WASHINGTON

Like other radical states that have sought to do post 9/11 business with the USA, Syria has expressed frustration at a lack of recognition for its efforts. Officials complain that the yes vote on the Goods Review List received no *quid pro quo*. Neither did the security services opening of files on Sunni Islamist opponents to the **Federal Bureau of Investigation (FBI)** yield sufficient rewards, they say — although Syria seems to have given up some jewels. Assad privately claimed Syrian intelligence thwarted a major **Al-Qaeda** plot.

But US congressional leaders in mid-November dropped plans to submit the **Syria Accountability Act** to a House of Representatives vote. This

apparently popular legislation would be damaging to Damascus, and the Administration lobbied for a delay so as not to upset President George W Bush s Iraq policy and coalition building efforts.

Meetings in Damascus on 6-8 January of the Syrian-American Dialogue initiative — headed by Deputy Foreign Minister **Walid Al-Muallim** (a former ambassador to the USA) and **James Baker III Institute of Public Policy** Director **Edward Djerjian**, a former US Ambassador to Damascus and Israel — showed Assad holding the door to rapprochement ajar. Senior US delegate, Republican Senator **Arlen Specter**, met Assad and Al-Shara, with US Ambassador **Theodore Qattouf**.

But with Dr Bashar a hostage to regime traditionalists — including his powerful sister **Boushra Al-Assad**, married to Deputy Military Intelligence Chief **Assef Shawkat** (see box), Syria is likely to further upset the USA in coming months, whatever the President personally wants.

This was reflected in the November refusal to bow to US demands and close the *Islamic Jihad in Palestine (IJP — Al-Jihad Al-Islami Fi Filastin)* Damascus office — which pointed to a potential future flashpoint when the US war against terrorism enters a new phase.

Syria s growing dependence on Iraqi oil and re-export trade will be a problem for the USA until Saddam departs (*GSN 699/12*). The State Department is highlighting human rights abuses and the *Central Intelligence Agency* remains very interested in potential weapons of mass destruction (WMD) programmes. The CIA s arms proliferation report, sent to the US Congress on 7 January, placed Syria on the list of its countries of concern — also including Iran, Iraq, North Korea, Libya, Sudan, India and Pakistan.

The CIA noted: Damascus already holds a stockpile of the nerve agent sarin but apparently is trying to develop more toxic and persistent nerve agents. Syria remains dependent on foreign sources for key elements of its [chemical weapons] CW programme, including precursor chemicals and key production equipment. It is highly probable that Syria also is developing an offensive [biological weapons] BW capability.

Khaddam s visit to Moscow focused attention on Syria s nuclear ambitions. The Russian Foreign Ministry said in a statement — subsequently withdrawn, underlining the political sensitivities — that agreement had been reached to supply a nuclear reactor and desalination plant. Atomic Energy Minister **Alexander Rumyantsev** insisted no such deal was in the offing. Problems include financing as well as geopolitics, but talks are expected to quietly continue.

Syrian (and Iranian) support for Hizbollah in Lebanon remains a hot issue. By supporting Hizbollah, *Hamas* and IJP, Syria is — from a US perspective — the main Arab state supporter of terrorist groups. This point has not been lost on

SYRIA: When Security Chiefs Fall Out

The arrest of London-based daily *Al-Hayat* s Damascus bureau chief **Ibrahim Humaydi** has triggered protests from journalist groups the USA and UK about a case that undermines President **Bashar Al-Assad** s glasnost credentials but says much about the balance of power in Damascus. Syrian citizen Hamidi was arrested by Military Intelligence officers on 23 December after publishing a detailed report on contingency plans to receive some one million Iraqi refugees in the event of war. An interview with veteran *Communist Party Political Bureau* chief **Riyad Al-Turk** also upset Alawite traditionalists, analysts told *GSN*. Hamidi faces trial in the State Security Court and up to three years' imprisonment plus a hefty fine. "He's been arrested before — sometimes it seemed he was used like a ping-pong ball — but this time it's much more serious," a friend said.

Like other journalists in Damascus, the popular Humaydi enjoyed the protection of General Security chief and presidential advisor **Bahjat Sulaiman**. Although close to Dr Bashar, Sulaiman s star has waned — he is said to be on notice to leave his post very soon — and this may be reflected in crackdowns on journalists and civil society activists who he shielded during a cautious opening up of Syria s stifling media scene. Hardliners have since consolidated their positions.

The first parliamentary elections of Assad Jnr. s rule will be held on 2 March, but these are unlikely to yield significant changes in the balance of power. More significant perhaps was the appointment in October of veteran security forces chief in Lebanon General **Ghazi Kanaan** — a senior Alawite power broker — to head Military Intelligence. Presidential brother-in-law **Assef Shawkat** is Kanaan s very powerful deputy and a long-time rival of Sulaiman s. Shawkat is married to **Boushra Al-Assad**, hawkish keeper of the late **Hafez Al-Assad** s flame. There are reports that more opinion formers and potential reformist allies could soon be rounded up.

many congressmen, nor on pro-Israeli lobbyists. Libya s **Muammar Qadhafi**, by contrast, has made a point of distancing himself from groups he long sponsored in a concerted effort to keep Tripoli out of the firing line.

Aman (Israeli Military Intelligence) has evidence these groups co-ordinate in Damascus, with funds channelled from Iran to bank accounts run through the Syrian capital. The *Israeli Defence Force (IDF)* has released documents seized during operations against **Yasser Arafat** s *Fateh* and other groups that show **Ramdan Abdallah Shallah** and other IJP leaders operate from Damascus with operatives in the West Bank. The Jenin-based **Tarek Azzaldin** was the link to the movement s central headquarters in Syria, said one IDF report quoted by the online *Middle East Intelligence Bulletin*.

IDF debriefers also claimed that IJP operatives received terrorist training in *Popular Front for the Liberation of Palestine General Command (PFLP-GC)* camps south of Damascus.

Washington is unlikely to act before the Iraq issue is resolved. This gives Damascus a window of opportunity to normalise its relations, helping to create the sort of Syria to which Assad aspires. But for as long as hardliners retain the whip hand, the threat of a future confrontation will persist.

Southern Discomfort Leads Omanis To Rethink Free Zone

Although among the angels when it comes to the American categorisation of friends, allies and rogue Arab states, Oman has found that unfavourable political factors can still undermine some of its more cherished industrial projects.

Plans for a 6,000-acre free zone at Salalah, due to be developed in the southern port by private investors led by *Salalah Port Services Company (SPS)*, suffered a serious setback in September when the major investor, the US *Hillwood Strategic Services*, quietly pulled out of the project on the eve of signing an agreement with the government.

The Omanis are now pressing for other solutions to carry through the scheme.

The eleventh-hour withdrawal took place before the terrorist attack on the French oil tanker *Limburg*. Although in Yemeni waters, the attack was uncomfortably close to Salalah, which has placed great stock on its insulation from regional turmoil. But political risk factors played the major role in forcing Hillwood's decision to rethink the project, in which it was due to take a 40% stake.

Ironically, the main factor was not the worsening state of US relations with the Arab world but the fallout from the intensification of India's war of words with Pakistan in H1 2002. Oman's strong commercial ties with India and the fact that a large proportion of the port's business is with the sub-continent injected too much uncertainty for Hillwood.

There remains the suspicion that Hillwood, owned by maverick billionaire and former US presidential candidate **Ross Perot**, is cast in isolationist colours. In a tense regional climate, the Texas-based company may have sought to rein in its Middle East operations and concentrate on its core US market. But Hillwood remains the world's largest operator of free zones and retains other Middle East interests.

Oman hands reckon Hillwood's relative inexperience in the Gulf may have provoked the withdrawal.

SPS Chief Executive **Jack Helton** — the American executive who

previously delivered the successful Salalah transshipment port and is an unofficial adviser to **Sultan Qaboos Bin Said** — told GSN that Hillwood had become disenchanted with the length of time the free zone project had taken.

Unlike us, they didn't have any major Middle East operations. The time factor didn't mean that much to us, said Helton. Then Afghanistan came along. But the so-called nuclear crisis between India and Pakistan may have been the straw that broke the camel's back.

DHOFAR MASTERPLAN

The departure of the major US investor is unlikely to prove fatal to the free zone project, which is central to the wider regional masterplan for the southern Dhofar region. Plans call for at least 500,000 square metres of new distribution and light manufacturing product for customers, with the eventual build-out of the free zone allowing larger areas of new distribution, light manufacturing and high tech product. The aim is to increase the level of cargo moving through the port, stimulating economic growth and development in the southern region.

The government now intends to turn the project into a 100% state-owned venture. At this point SPS won't be involved, though we may be in the future, said Helton. For the purposes of expediency, the government has decided to go ahead and get the company [to be known as the *Salalah Port Free Zone Company*] started.

Quoted in the Muscat monthly *Business Today*, National Economy Minister **Ahmed Bin Abdunabi Macki** confirmed that an international consultant had been appointed to review financing of the agreements.

A Singapore-based FTZ specialist has been invited to participate in the Salalah project. *PSA Corporation* operates *Aden Container Terminal (ACT)*, the nearest rival to Salalah.

Helton, whose company is a joint venture with the Oman government and Danish shipping line *Maersk-Sealand*, set up in 1998 to manage

and operate Salalah's container transshipment hub, is confident the free trade zone will happen. It's a good development. Our only concern all along has been to get it done, because without something like the free trade zone it's not likely that economic growth and development will happen in that region. There's just no catalyst for it there, he said.

SPS had recommended to the government that it take over the project as a state-owned scheme, despite a wider commitment in the Sultanate towards privatisation. As long as the port benefits, we welcome and encourage the government to do that. And if we can participate in some way, we will, said Helton.

Setting up the FTZ will improve Salalah's aims of becoming one of the world's six major ports, tapping into potentially 1.6bn customers in the region. Target companies for the FTZ are logistics firms, consumer goods producers, trading conglomerates, industrial producers, computer peripherals makers and spare parts makers.

SPS plans to expand port facilities at Salalah include two new berths and the creation of a deepwater harbour with a 900-metre turning basin that will be able to handle new 400-metre-long freight vessels. The current turning cycle is 500 metres, with a 16-metre harbour depth.

COMPETING WITH DUBAI

Muscat's promotion of Salalah port is also aimed at luring more shipping business away from Dubai's Jebel Ali free port and Aden. It still has some way to go to match Jebel Ali's 4 million 20-foot equivalent units (TEUs) throughput in 2002 — Salalah's throughput is estimated at 1.2m TEUs.

Jebel Ali's success is buttressed by its large industrial prowess, including a world-scale aluminium smelter, as well as the Jebel Ali Free Zone, which hosts more than 2,000 firms, whose business feeds into increased transshipment flows. This is Jebel Ali's bread and butter income. Oman is looking to follow its template.

The FTZ will play a critical role in Oman's efforts to attract more shipping lines to Salalah — which explains the decision to take up the cudgels and ditch the private sector model for now.

Salalah's lead over Aden seems assured, with the ACT struggling to reach its target throughput of 400,000 TEUs amid justified security fears. Salalah is busy profiting from Aden's misfortunes. The Singapore-owned **APL**, the world's fifth largest container shipping operator, opted to relocate to Salalah after a stiff rise in insurance costs operating in the Red Sea area following the *Limburg* attack. Since 10 October APL mainline vessels have been making five calls a week at the Omani port (GSN 697/13).

But Oman's sights are set eastwards, competing for regional transshipment business with Jebel Ali. The sooner the FTZ progresses, which along with the new airport will provide the kind of infrastructure a world class port requires, the better its ambitions can become reality.

Saudis Back Qatar-Kuwait Pipeline

Riyadh has put aside its differences with Qatar to give the green light to

a planned \$2bn pipeline to supply Kuwait with North Field gas (GSN 696/15). **Qatar Petroleum's** Director of Oil and Gas **Nasser Jaidah** told a mid-January conference the Saudi government had given its approval to the pipeline, which passes through its territorial waters.

The way is clear for a sales and purchase agreement to be signed for the 1bn ft³/day pipeline to Mina al-Ahmed in Kuwait.

Despite its continued anger at Qatar over a range of issues, Riyadh is unlikely to have risked frustrating Kuwait's ambitions to source Qatari gas from 2005 (GSN 701/1; 699/6; 695/3). As with the unused oil weapon, Saudi Arabia is unwilling to use economic muscle to enforce its writ in the region. But the move is unlikely to presage an easing of bilateral ties with Qatar.

Meanwhile Kuwait is progressing with plans for a 590km gas pipeline from **Iran**, with Acting Oil Minister **Sheikh Ahmed Al-Fahd Al-Sabah** due to discuss legal aspects in February and a final deal beckoning. The two sides have reached broad agreement on pricing, volumes and construction. Iran and Kuwait also plan a water pipeline from south-west Iran's Karun and Karkheh rivers to Kuwait.

Saudi Tax Plan Torpedoed by Majlis

The Majlis Al-Shura has thrown out draft measures to tax expatriate staff, confirming suspicions that the Saudi authorities were not serious about pursuing the plan to levy a 10% tax rate on foreign workers earning more than SR3,000 a month.

Riyadh sources told GSN that such a move would have precipitated an exodus of vital foreign staff. The authorities also had deep qualms about the measure as it was originally intended as a dry run for the wider imposition of tax on Saudi nationals — which would inevitably meet stiff popular resistance, besides forcing the secretive authorities to open up their books to public scrutiny.

Insiders say the Majlis may revisit the plans later, but a veto now spared the government the embarrassment of itself having to abandon the tax plans.

Majlis members rejected the bill ostensibly because it was not accompanied by a new tax regime and stood in the way of **World Trade Organisation** accession. On a more positive note, WTO chief Supachai Panitchpakdi said he wanted to revive the stalled negotiations.

KUWAIT: Al-Ibrahim Resigns Again

A new resignation bid from reformist Finance Minister Youssef Al-Ibrahim has cast uncertainty over Kuwait's modernising economic agenda just months before parliamentary elections and at a time of intense security worries. In the hope that Ibrahim could be persuaded to change his mind, the official report of the 19 January cabinet meeting chaired by First Deputy Premier and Foreign Minister **Sheikh Sabah Al-Ahmed Al-Sabah** made no mention of the subject. Sheikh Sabah and Prime Minister **Crown Prince Sheikh Saad Al-Abdallah Al-Salem Al-Sabah** have tried to postpone any decision.

An exasperated and exhausted Ibrahim decided to quit after parliamentarians launched yet another attempt to drive him from office. It is only eight months since he survived a no-confidence motion by a single vote. Reformers are angered by repeated attacks on Ibrahim by Islamists and populists over often marginal transparency questions for which he has little direct responsibility. They suspect the real motive is an attempt to weaken the *de facto* alliance to promote economic modernisation, the curbing of subsidies and the introduction of market reforms between the government and parliamentary liberals. Ibrahim has been the main architect of this policy (GSN 688/6; 9). The mild-mannered Finance Minister often seems more comfortable in quiet discussion with technocrats than pugilistic public debate with parliamentary foes.

"Youssef Ibrahim has taken more insults that he can handle and can take no more," admitted Sheikh Sabah, for whom the

resignation would be a big personal setback. It was he who last February persuaded a cautious Sheikh Saad to appoint Ibrahim and reformist Islamist **Adel Al-Subaih** to the oil portfolio. Subaih left after only a few months, frustrated at parliamentary obstructionism. Ibrahim's departure would be an even more damaging blow. "Al-Ibrahim has played an outstanding role in devising economic reform plans and we will miss him as an active person who has a unique perspective," conceded Information and Acting Oil Minister **Sheikh Ahmed Al-Fahd Al-Ahmed Al-Sabah**. "We wish that Al-Ibrahim will be part of our march," he added, clinging to the hope that he might stay on.

Facing continued obstruction, and with Parliament set for dissolution in July, Ibrahim may have judged it pointless to fight on now. The Trade, Public Works, Justice and Social Affairs Ministers are all expected to step down soon, to contest seats in the forthcoming election.

The Finance Minister seems to have concluded that he might as well take a break from the combative public stage, at least until the elections are over. The poll will show whether his Islamist and populist opponents are still on the up — or whether his allies in the newly united liberal block have succeeded in their campaign to claw back ground lost in recent years. Liberal success would create a friendlier context for Ibrahim's return to office — as Sheikh Sabah hinted by noting that another minister could temporarily replace him for now. But such a comforting prospect is far from assured. Many observers believe the election will confirm or reinforce Islamist strength and that liberals are deluded about their chances of success.

GSN Risk Grade – C/2: Domestic tensions, infrastructure risks mount in pre-war atmosphere

Political And Social Development

Overview: The 21 January shooting by an unknown gunman, which left one US civilian contractor dead and critically wounded another, between the main US army camp and a McDonald's restaurant underlined tensions as Kuwait fills with Western troops ahead of a possible war with Iraq. An upsurge of anti-Americanism — with 15,000-plus US troops now in the Emirate — and operations by Islamists point to a deeper malaise in Kuwaiti society and places expatriates at some risk, even though Iraqi President Saddam Hussein remains a hate figure.

Government: Several senior leaders among the ruling Al-Sabahs are infirm, leaving reform-minded Acting Prime Minister, Foreign Minister Sheikh Sabah Al-Ahmed, to make the running. With much speculation about the health of Emir Sheikh Jaber Al-Ahmed and Crown Prince Sheikh Saad Al-Abdallah, succession issues are more openly discussed. This hinges on a complex system of alternation within the Al-Sabah family. Renewed conflict with Iraq is further complicating the progress of reforms, which have problems in the opposition dominated National Assembly, for which elections are expected in July. Some younger generation Al-Sabahs are raising their profile, notably acting Oil and Information Minister Sheikh Ahmed Al-Fahd.

Social forces: Most Kuwaitis would be happy to see the back of Saddam, underlined by the fractious Parliament's unity in condemning Saddam's recent apology for the 1990-91 invasion. But popular attitudes to the West are ambiguous: the presence of Kuwaitis among Osama Bin Laden's closest aides shows Islamic radicalism's hold (*GSN 698/3*). Unevenly distributed wealth, Palestine and the US military presence are sensitive issues. Progress on women's political rights is slow.

Defence: Raytheon Patriot missile systems and early warning systems to detect a WMD strike have been installed. Kuwait's civil defence forces have held mock chemical attacks and evacuation drills.

External factors: Full UN backing would make war more politically acceptable for Kuwait, but its absence would not prevent the USA from launching an attack from the Emirate. Kuwait's army is likely to provide only logistical support.

Economic Outlook

Overview: Oil wealth is channelled into public (notably Kuwait Investment Authority) and private investment. The government wants to create non-oil private sector growth and introduce market reforms, but a Parliament is a significant hurdle and Kuwait's strategic position remains an unavoidable drawback for investors. Oil output under OPEC quota was raised by 120,000 b/d to 1.966m b/d in mid-January — close to Q4 2002 output when Kuwait was some 12% over quota.

Finance: National Bank of Kuwait has forecast a KD200m-470m budget surplus in 2002/03 (to March). NBK expects total revenues to reach KD5.1bn-5.57bn, with total expenditure of KD4.9bn-5.1bn. A new IMF Article IV assessment saw a positive medium-term outlook but warned of unemployment pressures if non-oil sector growth did not increase. The IMF noted a strong macro position, with fiscal and external current account surpluses, and low inflation, at under 2% in 2001.

Liberalisation: The IMF praised the Kuwait Stock Exchange's regulatory improvements, financial sector supervision, moves towards Basel core principles and efforts to tackle money laundering and terrorist financing. However, it urged further steps to encourage private sector investment and revitalise the privatisation programme. Insurance and other financial services sectors are closed and property ownership is restricted. The Kuwaiti dinar was pegged to the US dollar on 5 January in preparation for GCC monetary union.

Energy: Kuwait plans to raise oil capacity to 4m b/d (from 2.4-2.7m b/d) with much of the expansion through the northern oilfields included in the delayed Project Kuwait — whose delayed launch is a government priority for 2003. There are oil supply concerns over a possible Iraqi strike; the authorities have responded by increasing security at key facilities; securing Kuwaiti infrastructure is a priority for US-led forces. Kuwait Oil Company is entering the offshore with plans for the Madinah concession. Plans are progressing to import gas from Qatar (*see below*) and Iran (from 2005). Iran may supply water. Domestic gas development is envisaged, possibly in partnership with Saudi Arabia in the offshore Al-Dorra field.

Kuwait: Key Projects

KUWAIT-QATAR GAS PIPELINE: Saudi consent given mid-January for a \$2bn undersea pipeline (passing through Saudi territorial waters) to supply Qatari North Field gas to local power stations from 2005-06. Formal sales and purchase agreement set to follow with initial 750m ft³/d volume rising to 1.4bn ft³.

PROJECT KUWAIT: The \$7bn scheme to develop oil fields near the Iraqi border is blocked in the National Assembly. Progress possible from H2 2003.

AL-ZOUR NORTH POWER PLANT: Ministry of Electricity and Water could opt to develop the 2,500MW plant as a build-operate-transfer project for power in 2006. UK's PB Power is consultant.

REFINERY UPGRADES: Bidding extended to 4 February for the Al-Ahmadi oil storage and export project's estimated KD270m EPC contract. Further renovation planned at other refineries. Bidding for a vacuum distillation unit contract at Mina Abdullah and a new acid gas treatment unit at Shuaiba under way.

SHUAIBA CALCINED COKE PLANT: Bids due mid-February for estimated \$105m 300,000 t/yr facility for Kuwait Santa Fe for Engineering and Petroleum Projects Company.

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.

KUWAIT: Selected Economic Indicators

(Kuwaiti dinars billion)	2000	2001	2002f	2003f
Domestic economy & finance				
Real GDP growth (%)	1.9	-1.0	1.4	1.2
Consumer prices*	1.8	1.7	2.4	2.5
General govt. balance (% of GDP)	31.8	17.6	13.8	9.1
General govt. debt (% of GDP)	38.6	37.4	34.5	31.4
External situation				
Current account balance (\$ billion)	14.7	8.6	6.5	5.8
Current account balance (% of GDP)	40.8	26.1	19.2	16.5
Gross external debt (\$ billion)	14.9	16.4	17.0	16.9

f = forecast. * Annual average % change)

Source: Fitch, Central Bank of Kuwait, IMF Ratings

GSN Risk Grade — B/3: Investment sluggish with governance and geopolitics issues to resolve

Political And Social Development

Overview: Sultan Qaboos Bin Saeed Al-Saeed is committed to Western alliances but is sensitive to public opinion and prefers negotiation to war in Iraq, although the USA is likely to use Thumrait air base and other facilities. Student demonstrations show many Omanis are unhappy at the prospect of conflict but the threat of civil disturbance is relatively low. Gradual democratisation continues although at a slower pace than in Bahrain and Qatar.

Democracy: Sultan Qaboos, although regarded as one of the Gulf's more enlightened rulers, retains a tight grip on policy and security. A decree issued in November allows all citizens over 21 to vote in Majlis Al-Shoura (Consultative Council) elections. Previously only 25% of the population in each wilaya (governorate) could vote. The 82-member Majlis has no formal powers, but provides an increasingly assertive forum to question ministers; it was directly elected in September 2000. The next elections are due on 9 October.

Local sensitivities: Low-key support will be provided for US and UK forces during a war against Iraq, although more student demonstrations are likely and security will be further tightened. Reports that Oman was supplying jet fuel directly to US forces were sufficiently sensitive to be denied by Oman Refinery Company. Diplomats claimed Oman had been supplying jet fuel to the US military since 2001 and will double its supply to 3m ltr/d in the event of war.

Defence: Close military contacts are kept with traditional ally the UK and other Western powers. The USA's renewable ten-year agreement (since 1980) enables it to use ports and air bases in a relationship of increasing importance. Defence spending has risen sharply with big orders for US suppliers including Lockheed Martin F-16s. To support these, a new airbase is planned (for first phase completion by mid-2004) at Al-Musanaa in the northern Al-Batinah governorate.

External factors: Oman maintains ties with a huge range of states. It has a close relationship with Japan and many Western countries but also has commercial relations with Iraq, with a free trade agreement signed in 2002.

Economic Outlook

Overview: The government is targeting non-oil growth — particularly tourism, fishing and natural gas-based industries. Oil price volatility and negative investor sentiment are countered by a prudent monetary policy, while a fast-developing gas-based industry offers real promise. The non-oil sector accounted for 57% of GDP at the end of 2001 and should rise to 65% by 2005 under Oman's sixth five-year plan (2001-05). GDP growth of 2.9% is estimated for 2002 and around 1% in 2003, with zero or negative inflation.

Hydrocarbons: Investment is needed with average output falling to 763,000 b/d in 2002, from 909,000 b/d in 2001; it could reach 703,000 b/d in 2003 before rising again to a target 724,000 b/d in 2005 and 800,000 b/d in 2007. A licensing round for offshore blocks 18A, 18B and 41 has opened; bidding closes 15 July. With an estimated 5.6bn bbls reserves Oman can rely on oil income through to 2020, but gas is the growth industry.

Finance: After a torrid period, the Muscat Securities Market grew by 26.2% over 2002 to end the year at 191.86 points, with trading volume up 41.3% at OR231.4m. A five-year OR80m government bond issued in December was over-subscribed by 39% at OR111.43m. Borrowing of OR150m is expected in 2003, with a five-year Eurobond mooted in H2. Banking sector consolidation is under way but structural weaknesses remain, highlighted by scandals in big provisions.

Budget: OR3bn 2003 budget includes OR400m deficit, based on \$20/bbl oil (\$18/bbl in 2002). Revenue projected to rise 4% to OR2.6bn. Petroleum Development Oman will get more funds to reverse oil production decline. Military and national security spending is set to increase 8% to OR938m.

Privatisation: Preparations to sell a strategic stake in Oman Telecommunications Company await a global telecoms market upturn. Alternative options, including a local share offer, are being considered prior to finalising strategic partner. Electricity sector restructuring is expected with the first sale of generation assets. Oman is a WTO member and is expected to allow wholly-owned foreign subsidiaries in banking, IT services, insurance and securities in 2003, and telecoms from 2005.

POWER REFORM: Since the Al-Manah development, Oman has led in Gulf private power. This programme slowed and a new sector law is still awaited, but it is planned to privatise the grid by 2004. Restructuring is underway to create three generation, one transmission and three distribution companies. An advisory tender is out for a 400-500MW and 40m g/d desalination independent water and power plant at Sohar.

Key Data and Forecasts*

	1998	1999	2000	2001 ^p
(\$ million)				
GDP current prices	14,067.3	15,585.2	19,668.5	19,786.5
GDP growth (percent)	-11.1	10.8	26.2	0.6
Exports fob	5,514.3	7,228.6	11,303.9	11,168.8
of which: hydrocarbons	3,714.3	5,524.7	9,363.6	8,831.2
non-hydrocarbons	1,800	1,703.9	1,940.3	2,337.6
Imports fob*	5,207.8	4,293.5	4,587	5,714.3
Trade balance	306.5	2,935.1	6,716.9	5,454.5
Current account	-2,989.6	-368.8	3,329.9	2,311.7
Capital & financial account	1,475.3	62.3	-397.4	-896.1

^p - preliminary * Includes unrecorded imports

Source: Central Bank of Oman, Ministry of National Economy

Oman: Key Projects

OMAN LNG EXPANSION: Japan's Chiyoda Corporation and Foster Wheeler were awarded the third train construction contract January 2003 for LNG shipments from 2006. Two more trains are expected later. OLANG continues to line up customers, recently including Tractebel LNG Trading, which will take 600,000 tonnes of LNG.

AMMONIA/UREA FERTILISER PLANT: MoU signed October 2002 by OOC and Engro Chemical Pakistan for 850,000 t/yr plant; detailed feasibility study to follow.

OMAN INDIA FERTILIZER COMPANY: France's Technip-Coflexip and Italy's Snamprogetti have \$770m turnkey contract to build Omifco complex. A \$32.5m sub-contract for equipment went to India's Larsen & Toubro.

SALALAH FREE TRADE ZONE: Government technical committee working on implementation after Hillwood pulled out (*see page 14*). Project delayed but international consultant now appointed to advise on financial aspects and draft terms for project manager.

SOHAR REFINERY: A Japanese consortium of JGC Corporation and Chiyoda Corporation was awarded an \$879m contract in early January. Completion of the 75,000 b/d plant is expected in Q2 2006.

TOURISM: Work is to start on Muscat's \$140m Marsa City in mid-2003. Development of the \$200m Bar Al-Jissah resort, and Seeb and Salalah facilities (due in 2003-06) continues.

Bahrain Defies Regional Worries To Launch Sovereign Bond

Manama is limbering up for an end-January launch for its estimated \$500m debut sovereign bond, sufficiently emboldened by a largely positive investor response to a lengthy roadshow programme to issue the paper in the face of heightened regional tension.

Some bankers do not rule out a significant over-subscription given regional investor demand, but the government's decision to go ahead with the issue in January — safely before the anticipated US-led military assault on Iraq — may yet affect its marketability. The bond's down-grading from a ten-year to a five-year tenor is a clear sign of subdued market appetite for Gulf paper, even if it is issued by a state in as relatively a stable and financially strong condition as Bahrain.

Bankers suspected that war risk would affect the pricing, at least by a few basis points, as it would the spread of appetite for the paper.

Early roadshow indications suggested that investor demand would be strong, although largely confined to the Gulf aside from a few European investors.

US demand is likely to be non-existent, analysts said.

The island's approach to the debt market comes on the back of an unexpectedly high initial sovereign rating by *Standard & Poor's*, which placed it on an A- long-term foreign currency rating — the same as energy-rich Qatar. Further bolstering confidence, *Fitch Ratings* in mid-January raised the long-term foreign currency rating to A- from BBB.

In contrast, *Moody's Investors Service* has Bahrain at Baa3, the same as the Cyprus-based *CI Ratings* (GSN 697/15).

The decision to tap the bond market underscores a wider shift in Bahrain's approach to debt. With *Aluminium Bahrain* in the midst of securing a \$1.55bn loan and a \$600m sovereign loan sealed last year, Bahraini strategists appear ready to ditch a careworn reputation for low debt levels as it confronts growing external competition and an expanded shopping list of capital spending requirements.

The ratings agencies decision to put Bahrain on a par with Qatar has also allowed the former to capitalise on a coat tail effect, profiting from an association with Doha's mini economic miracle.

Bahrain is becoming slightly more aggressive, says CI Ratings analyst **Darren Stubing**. They're trying to raise their international profile and establish themselves as the major regional financial centre, where they've been coming up against stiff competition from Dubai. This is partly what's prompted this issue and slightly higher debt levels.

BORROWING STRATEGY

Given its low indebtedness, the raising of cheap finance on the international market by Bahrain will not cause too much consternation among investors. But the mix of war risk fears, volatile oil markets, US investor fright from the Gulf and Bahrain's split rating may yet affect its ability to reach its target figure of \$500m from the issue.

Even so, said Stubing, the five-year maturity will be the best option for regional investors.

A further approach to the bond market is not expected this year, although a positive response to the current issue might prompt another sortie in 2004. The island is already in the throes of developing its corporate and Islamic bond market, which form a major plank of its strategy to boost Bahrain's status as a centre for the burgeoning global Islamic investment industry.

Islamic and corporate issuance will definitely increase, predicted Stubing.

BNP Paribas and *Schroder Salomon Smith Barney* are joint lead managers for the bond. The roadshow hit most Gulf capitals, as well as Frankfurt, Zurich, Paris and London.

IRAN: ECGD Eases Up

The UK's Export Credits Guarantee Department has further eased terms for some contracts, underlining the Islamic Republic's appeal to European export credit agencies (ECAs) during a period when Iran's risk rating has steadily improved.

ECGD is now prepared to support UK-based exporters to *National Petrochemicals Company* for contracts worth up to \$20m, without NPC having to run the transaction through a structured finance arrangement. Italy's *SACE* and Germany's *Hermes* have previously backed pure NPC risk (GSN 700/15).

ECGD Chief Executive **Vivian Brown** said that current structured security arrangements were better suited to higher value contracts.

Asian ECAs continue to be very active. *The Export-Import Bank of China* has signed a \$143.91m buyer credit agreement with *Bank Saderat Iran* to support the Shenzhen-listed *China Nonferrous Metal Industry's Foreign Engineering & Construction Company's* work on the Arak aluminum plant project.

Bank Saderat is to be privatised in the next round of reforms.

Gulf Currency Box

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

Source: Financial Times.

INSTITUTIONS

Aden Container Terminal	14
Al-Hayat	13
Al-Qaeda	3, 6-7, 10, 12
Al-Wasat	11
Al-Watan	20
Aluminium Bahrain	18
Aman (Israeli military intelligence)	13
Ansar Al-Islam	3
APL	15
Arab Thought Foundation	20
Asalah, Al-	11
Bahrain Medical Society	11
Bahrain Society of Engineers	11
Bank Saderat Iran/BNP Paribas	18
Bundesnachrichtendienst (BND)	3
Business Today (Oman)	14
CanOxy	4
Central Intelligence Agency	13
China Nonferrous Metal Industry	18
CI Ratings	18
Committee for the Def. of Legitimate Rights	8
Communist Party Political Bureau	13
Direction de Surveillance de Territoire (DST)	3
ECCGD	18
Egypt	1, 3, 7, 20
Eni	5
European Union	3-4
Export-Import Bank of China, The	18
Fateh	13
Federal Bureau of Investigation (FBI)	7, 12
Fitch Ratings	18
Foreign and Commonwealth Office	2, 9, 10
Foreign Engineering & Construction Co	18
GCC	6
General Intelligence Directorate (GID)	6, 8
General Motors Canada	8
General Security Service (GSS)	7
German Green Party	4
Hamas	13
Hillwood Strategic Services	14
Hizbollah	12-13
Islamic Jihad in Palestine	13
Israeli Defence Force (IDF)	13
James Baker III Institute of Public Policy	13
Kuwait Investment Authority	16
Kuwait Oil Company	16
Labour Party	11
Labor Party (Israel)	9
League of Arab States	1, 20
Lukoil	12
Maersk-Sealand	14
Metropolitan Police	3, 8
Ministry of Defence (MoD)	9
Moody's Investors Service	18
Moslem Brotherhood	6-7
Mubahith	8
National Democratic Action Society	11
National Information Centre	7
National Petrochemicals Company (NPC)	18
NATO	5
Olayan Financing Company/Olayan Group	20
Oman Refinery Company	17
OPEC	2, 16
PB Power	16
Petronas	4
PFLP-GC	13
Popular Party (Spain)	5
PSA Corporation	14
Qatar Petroleum	15
Raytheon	16
Revolutionary Command Council (Iraq)	12
Royal Air Force (UK)	9
Repsol	4
Royal Dutch/Shell	4
Royal Marines	9
Royal Saudi Land Forces	8
SACE	18
Salalah Port Free Zone Co/Services Co	14
Saudi Arabian National Guard	8
Saudi Aramco	8
Saudi Committee for the Al-Qods Intifada	7
Schroder Salomon Smith Barney	18
SO13/Special Branch (Metropolitan Police)	3
Spanish Socialist Party (PSOE)	5
SPD	4
Special Forces (UK)	9
Special Security Force (Saudi)	8
Syrian Petroleum Company	12
Standard & Poor's	18
Taliban	7
TotalFinaElf	4
United Left (IU)	5
United Nations (UN)	2-5, 9, 10, 12, 16
UNMOVIC	10
US Com. on Intl Religious Freedom	8
Wafaq National Islamic Society, Al	11
World Trade Organisation	15

PEOPLE AND PLACES

Afghanistan	3-5, 7, 14
Algeria/Atta, Mohammed	3
Alliot-Marie, Mich lle/Aznar, Jos -Mar a	5
Arafat, Yasser/Azzaldin, Tarek	13
Assad, Bashar Al-	2, 12
Assad, Boushra/Hafez Al-	12-13
Bahrain	6, 8, 11, 17-18, 20
Beer, Angelika	4
Berlusconi, Silvio	5
Bingle, Alan	8
Blair, Tony	2-4, 9-10
Blix, Hans	4, 10
Blunkett, David	3
Boyce, Sir Michael	9-10
Brisand, Jean Charles	7
Brown, Vivian	18
Bush, George W	2-5, 9-10, 12-13
B tikofer, Reinhard	4
Chev nement, Jean-Pierre	5
Chirac, Jacques	4-5
C te d Ivoire	4
Cyprus	4, 18
Dalziel, John	8
Djerjian, Edward	13
Dubai	14, 18
Ebeid, Atef	1
Fischer, Joschka	4
France	3, 7, 9, 14
Georgia	3
Germany	3-4, 9, 18
Greece	4
Greenstock, Sir Jeremy	10
Helton, Jack	14
Hoon, Geoff	9-11
Humaydi, Ibrahim	2, 13
Ibrahim, Youssef Al-	15, 16
India	13-14, 17
Iran	2, 12-13, 15-16, 18
Iraq	1, 3-6, 8-13, 16-18
Israel	2, 5-7, 9, 11-13
Italy	4, 5, 18
Jaidah, Nasser	15
John Paul II, Pope	5
Jordan	7, 9
Jubeir, Adel Al-	7
Kanaan, Ghazi	13
Khaddam, Abdelhalim/Kharrazi, Kamal	12
AL-KHALIFA: King Hamad/Sheikha Sabika	11
Crown Prince Salman Bin Hamad	20
Khatami, Mohammad	2
Kuwait	5, 6, 9, 15, 16
Lebanon	12-13
Libya/Qadhafi, Muammar	2, 13
Macki, Ahmed Bin Abdulnabi	14
Majid, Ali Hassan Al-	12
Martino, Antonio	5
Masari, Mohammed Al-/McCain, John	8
Mitzna, Amram/Moawdah, Adel Al-	11
Moussa, Amr	20
Muallim, Walid Al-	13
Mubarak, Hosni	1, 20
Naimi, Ali	8
Netanyahu, Benjamin	11
North Korea	8, 13
Olayan, Lubna	20
Oman	14-15, 17
Pakistan	13-14, 17
Palestine	5-7, 9-11, 16
Panitchpakdi, Supachai	15
Perot, Ross	14
Powell, Colin	4, 8
Putin, Vladimir	12
Qatar	15-18
Qattouf, Theodore/Rumyantsev, Alexander	13
Russia	9, 12, 13
AL-SABAH: CP S.Saad/S. Ahmed Al-F.	15-16
Sheikh Jaber Al-A/Sh. Sabah Al-A.	15-16
Saddam Hussein	3-5, 10, 12-13, 16
Saeed, Sultan Qaboos Bin	14, 17
Said, Mohammed/Sharah, Farouk Al-	12
Salam, Ahmed Al-	7
AL-SAUD: CP Abdallah	7-8, 12, 20
King Fahd/Turki Bin Faisal	6-8
Ahmed Bin Nayef	7
Khalid Al-F./Salman B. A./Saud Al-F.	20
Khalid B. Sultan/Mohammed B. Nayef	7
Nawwaf Bin Abdelaziz	8
Nayef Bin Abdelaziz	7, 20
Sultan B. Abdelaziz	7, 8, 20
Saudi Arabia	2, 6-9, 12, 15-16
Schmidt, W./Stolpe, M./Simitis, Costas	4
Schr der, Gerhard	3-4
Shallah, Ramadan Abdallah/Shawkat, Assef	13
Sharon, Ariel/Short, Clare	11
Singapore	14-15
Solana, Javier	3
Spain	3-5

G S N

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Specter, Arlen	13
Straw, Jack	10-11
Struck, Peter	3-4
Stubing, Darren	18
Subaih, Adel Al-	15
Sudan/Sulaiman, Bahjat	13
Sulaiman, Omar	1
Syria	2, 7, 12-13
Turk, Riyadh Al-	13
Turkey	4, 9, 12
UAE	6
UK	2-4, 6, 9-10, 13, 16-18
USA	2, 4-9, 11-14, 16-18
Villepin, Dominique de	5
Yemen	6, 14
Zarqawi, Abu Musab Al-	3
Zeul, Heidemarie Wiczoreck-	4

