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G S N

Companies & People

Turkey's 'Pristina' Play?

Still haggling with the USA for an aid-for-military assistance deal, is Turkey planning an operation similar to the Russian Kosovo conflict coup, when Moscow's forces took Pristina airfield? Kurdish sources report increased Turkish special forces activity in northern Iraq. US planners say Ankara may be planning to "plant flags" in economic and political keypoints in the Kurdistan Regional Government (KRG) zone. The Turkish General Staff may even be tempted to push for Mosul if a conflict is declared (see page 6).

US Special forces are already in KRG territory, seeking out evidence of the Al-Qaeda/Ansar Al-Islam link with Saddam Hussein's regime Washington craves, and providing backing for Patriotic Union of Kurdistan (PUK) allies. PUK leaders including Peshmerga commander General Shawkat Haji Mushir were killed in an 8 February Ansar sting operation that reminded observers of the September 2001 slaying of Afghan Northern Alliance chief Ahmed Shah Massoud in its timing and audacity.

Kurdish officials say Ansar – some of whom were negotiating a surrender with Mushir – is divided. Only hours before Mushir's death a faction was showing Western journalists around its base.

Across The Region

As US and UK forces build up for a new Gulf war, GSN reports on Kuwait's emergency planning. Turf wars and political sniping continue, but a sense of national purpose is emerging in a population keen to see Saddam Hussein's removal. PAGE 3

Contingency plans are being made for foreigners to leave Kuwait. Meanwhile Saudi Arabia wants to cut the number of foreign residents to below 20% of the population within a decade. PAGE 5

Policy planners and parliamentarians in Kuwait are confident of implementing regulatory reforms in months. PAGE 14

Farsi satellite television and US neo-conservatives are paying increasing attention to Reza Pahlavi of Iran. GSN looks at his support base and asks if the 'Young Shah' has a future. PAGE 11

The USA leapt to Qatar's defence after *The New York Times* linked a devout Al-Thani family member with a most-wanted Al-Qaeda operative. BACKPAGE, PAGE 20

Bahrain discovered an underground cell potentially linked to Al-Qaeda. PAGE 7

A senior official was assassinated in Saudi Arabia's Al-Jawf province. PAGE 7

Political developments in Iran and Oman, and a UAE soccer threat. PAGE 9

The Gulf lacks an effective regional emergency system to deal with oil spills, a senior UAE planner told GSN. PAGE 10

Environment policy counts in the UAE, where ERWDA is beginning to wield greater planning clout. PAGE 10

RAK plans a 'British University'. PAGE 15

Both chambers of Bahrain's Parliament are expected to vote over a \$500m bond programme. FINANCE, PAGE 18

Dubai's Emaar Properties announced a big increase in revenues. 'Posh & Becks' and other UK celebs like Mohammed Alabbar's message. The Emaar Chairman hopes the London Stock Exchange will like it too. PAGE 18

Central Bank of Kuwait will approve licences for Islamic finance institutions; the authorities have still to design a regulatory structure. PAGE 18

GSN's Analysis

Saudi Arabia and Kuwait have spent the 'phoney war' battenning down the hatches, securing oil installations and shutting off production at exposed wells. With insurance premiums rising and risk ratings falling, the double-whammy threat of Saddam Hussein and Osama Bin Laden is proving increasingly costly for Gulf economies reliant on uninterrupted hydrocarbons exports. PAGE 13

Moody's has confirmed its downgrade on Qatar's RasGas, with banks very sensitive to the issue of terrorism cover. But it reaffirmed Oman LNG's AAA rating. Meanwhile, Standard & Poor's told GSN it ruled out taking any action on Gulf projects in response to heightened war risk. PAGE 13

Kuwait is beset by doubts and wrangling over leadership and governance issues, and preoccupied with struggles between Islamists and liberals. According to GSN's soundings, corruption allegations could undermine the government's hopes of securing acceptance for economic reforms. POLITICS AND SECURITY, PAGE 8

Turkey continues to mull a range of military options for operations in northern Iraq. Kurds fear this includes 'securing' a significant chunk of their territory, signalled by recent special forces activity in the region. The Turks are powerful players, but there are limits to what they can do. PAGE 6

The UAE is quietly battenning down the hatches in the run up to a new conflict. Extraverted economies like Dubai's may suffer but the Emirates should emerge from coming troubles stronger than most. GSN's Risk Grade remains B+/2. RISK MANAGEMENT REPORT, PAGE 16

Yemen remains a battleground in the 'war against terrorism', with President Saleh squeezed between Washington and radical Islamists. GSN maintains its D political risk rating, but a commendable payments record means the economy gets a respectable Grade 3. RMR, PAGE 17

Iran's inclusion, one year ago, in President Bush's "Axis of Evil" added to the gulf in understanding between Europe and the USA, threatening the Western alliance. PERSPECTIVE, PAGE 2

Millions marched in Europe, and while significant anti-war protests failed to register large in the US media, they served as a reminder that President George W Bush does not have a total mandate to bring war to the Middle East. Bush's closest ally Tony Blair certainly does not – and the UK Prime Minister's appearance of rapid ageing may reflect a realisation that his alliance with Bush could prove an act of political suicide, rather than sealing the diplomatic triumph that seemed his in the wake of 11 September 2001.

Confronted by widespread public scepticism that 'facts' and threats delivered up as intelligence may be no more than spin to win support for Bush's war with Iraq, Blair is cornered; his policy of constructive engagement in the Middle East is damaged (*GSN 702/2*); his recourse to privileged intelligence as a *cassus belli* is undermined by the childish activities of government spin doctors. Even before it was revealed that a No 10 Downing Street team had passed off student research as intelligence, ill-conceived efforts to tar Iraq with the Al-Qaeda brush were having negative consequences (*GSN 703/2*).

The big winners in this round of the so-called 'war on terrorism' are thus Saddam Hussein – an unpardonable dictator who can turn the Western peace movement to his advantage – and Osama Bin Laden, still at large to show Bush and Blair the limits of their post 9/11 success. Meanwhile French President Jacques Chirac has repositioned Paris as a key European power and interlocuteur with Arab opinion.

But the 'war on terrorism' is long, and far from endgame. The European peace movement impressed with its scale and diversity, but that does not mean Arab governments can sit easy in the prospect that the war option has

passed. In the UN, Hans Blix has questioned the veracity of some US claims but he has not given Iraq a clean bill of health. A new, negative report could help Washington to get its projected war timetable back on track.

The preferred option among those most influential in the White House remains a pre-emptive, "preventive" war, to be followed by major reconstructive surgery – not just in Iraq, but across the Middle East. Much attention has been paid to a 1996 briefing paper drawn up for the incoming Israeli Prime Minister Benjamin Netanyahu by a group of neo-conservatives headed by Richard Pearle and including the now Under-secretary of Defence for Policy Douglas Feith and State Department hawk David Wurmser. A *Clean Break: A New Strategy For Securing The Realm* thought the unthinkable for their Likud ally. Wurmser has gone farther still since then – seeing the seeds of the Iranian theocracy's downfall in Shiite participation in a democratic Iraqi government. Hawks have been playing with ideas such as a "Hashemite" Iraq, "Palestinian" Jordan and "Israeli" Palestine.

The road to this future passes directly through Iraq. No wonder that sage observer of Middle East geopolitics, former Jordanian Crown Prince Hassan Bin Talal, has been so anxious to warn of the dangers of domino theory (presumably ruling out another change of country for the Hashemites). Other potential players in the neo-conservative regime change game like Reza Pahlavi of Iran are keeping their distance (*see page 11*). The Iraqi opposition is appalled at the prospect of a US general managing their country. But while Washington's hawks have had their feathers ruffled by the past fortnight's political storms, their eyes remain focused on the Iraqi prey. Peace is back in fashion. War may yet ensue.

Perspective: One Year Ago

Iran's inclusion in President George W. Bush's "Axis of Evil" has added to the gulf in understanding between Europe and the USA, perplexing casual observers of US Gulf policy and threatening a damaging breakdown in the Western alliance. A number of bridges have been burnt, from Iran's efforts to join the World Trade Organisation to its efforts to engage over Central Asia.

As the final analysis in *GSN's* series on the Iranian military suggests, contemporary Iran does not manifest all the signs of an aggressive power seeking to project its forces (conventional or "terrorist") across its borders. It does show that missile and other procurement from Russia and China could provide equipment which might seriously inconvenience US-led operations in the Gulf.

In Republican Washington, the renewed demonisation of Iran has caused little shock. Bush's National Security Council suffers a dearth of Iranian expertise – forcing the Administration to fall back on Israeli intelligence, conservative think-tanks and the prejudices of its Cold Warriors. Prejudices that are almost a quarter of a century old ignore developments in Iran's fluid politics but have had a big influence on recent events... Three

sources of "expertise" threw themselves into the breach as the State of the Union address was being formulated. Richard Perle's Defense Policy Board, a high-profile conservative think-tank, gave advice said to have chimed perfectly with Defence Secretary Donald Rumsfeld's preconceptions about Iran. Rumsfeld himself has strong thoughts on the Islamic Republic: he was made President Ronald Reagan's Special Envoy to the Middle East two weeks after the October 1983 bombings of the US Embassy and Marine Barracks in Beirut; Rumsfeld visited the bombed sites in Lebanon the day after he was appointed. In 1998, the Rumsfeld Commission on ballistic missile threats highlighted three nations that presented threats to the USA – Iraq, Iran and North Korea...

Rumsfeld's predilections are closely mirrored by Israeli statements on Iran. With impeccable precision, Israeli spokesmen pressed both buttons guaranteed to trigger a response from US conservatives. As *GSN* has reported, southern Lebanon remains a key preoccupation for Israeli military intelligence (*GSN 675/3*).

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Kuwait Prepares Uncomfortable Front Row Seat

As US and UK forces build up for a new Gulf war, no country other than Iraq has more at stake in this stage of the conflict than Kuwait. In Kuwait City the sense of waiting, almost of expectation, is palpable. The usual turf wars and political sniping continue, but there is also an admirable sense of national purpose, with civil society groups playing an important role.

For this wealthy but intensely political Gulf oil state, the gathering crisis is an altogether more mixed experience than for other Arabs. The prospect of war stirs few jingoistic impulses – despite understandable bitterness towards an Iraqi regime that remains fundamentally unrepentant about the 1990 invasion and still fails to reveal the true fate of more than 600 missing prisoners of war.

Kuwaitis are well aware that a new conflict would not only bring fresh civilian suffering in Iraq but could also expose them to retaliatory chemical or biological attack. But they are desperate to see the removal of **Saddam Hussein's** regime, whose threatening proximity has held in check their development aspirations (with the effective closure of the northern frontier region) and self-confidence.

Given the strength of Saddam's internal dominance and repressive security apparatus, the impending American invasion offers the best prospect of a change of government in Baghdad. Understandably, Kuwait does not feel engaged in the ferocious international diplomatic tussle over whether to move ahead to military action.

The government does not want to mark itself out from the rest of the Arab world as a cheerleader for President **George W Bush**. But, in contrast to many other Arab governments, it cannot pretend it would prefer to see Saddam survive, “de-fanged” of his weapons of mass destruction (WMD) through an intensified **United Nations** inspection programme.

Privately, almost everyone wants to see Saddam go, including Islamists and anti-government liberals and nationalists canvassed by *GSN*, as well as the ruling **Al-Sabahs**. They hope regime change will be achieved smoothly, through a quick war or Saddam's removal through exile or a coup.

However, many believe that even when the USA's awesome firepower is taken into account, the conflict may not go as easily as many armchair generals predict – and that Iraq could fragment into unstable regional and political interest groups.

A refugee crisis is possible: there are plans for tented camps within the demilitarised zone along the border; the cabinet has ordered the formation of a committee to streamline and co-ordinate relief efforts, led by retired General **Ali Al-Moumen**.

The mood of fatalism about the crisis evident across the Arab world is, to some extent, felt in Kuwait. A final decision on whether there will be a war is in the hands of Washington and Baghdad, the weapons inspectors, **UN Security Council** and possibly other players like UN Secretary-general **Kofi Annan**, Russian President **Vladimir Putin**, **China**, UK Prime Minister **Tony Blair** and a handful of West European governments. The Middle East is almost a spectator in the argument.

But Kuwait has other perspectives too. In other Arab countries there is a sense of powerlessness and resignation, but also of anger at the Bush Administration's desire to drive forward to war. In many places, military action will be perceived as a Western attack on Muslims.

This is a good reason for Kuwait to distance itself from Bush – and explains why the official **Kuwait News Agency (Kuna)** issues statements such as the one reported by Assistant Under-secretary to the Crown Prince/Prime Minister **Diwan Sheikh Faisal Al-Hamid Al-Malik Al-Sabah** that Acting Premier **Sheikh Sabah Al-Ahmed Al-Sabah** had assured a visiting **Jordanian** delegation that Kuwait was not a “party in the current conflict between the United States and Iraq”.

In Kuwait City, this is accompanied by a quiet but deeply felt hope that, however it comes about, coming weeks bring the Baathist regime's ejection from power – and its replacement with a leadership committed to peaceful and civilised co-existence with its neighbours.

The US build-up is fanning the flames of radical Islamism. Kuwaiti Islamist **Mohammad Al-Mulaifi** said attacks on US nationals will get worse in the event of a war with Iraq, because “**Al-Qaeda** and its sympathisers believe the blood of American soldiers is fair game in Kuwait”. An Islamic Endowments Ministry employee, Mulaifi was arrested in October for making inciting statements following the killing of a US soldier. There have been several killings since (*GSN* 703/6; 698/3).

INVOKING THE PENINSULA SHIELD

Kuwaitis are preparing for the possible conflict amidst a curious mixture of apprehension and normality. They can draw some reassurance from the decision of other **Gulf Co-operation Council (GCC)** states to assign troops, probably from the common Peninsula Shield force, based at Hafar Al-Batin in northern **Saudi Arabia**.

The decision was taken at an 8 February emergency GCC ministerial meeting in Jeddah chaired by Saudi Deputy Prime Minister, Defence and Aviation Minister **Prince Sultan Bin**

Abdelaziz. Kuwaiti Defence Minister **Sheikh Jaber Al-Ahmed Al-Sabah** said these units would arrive “as soon as possible” to assist national forces in assuring the security of Kuwait’s frontiers.

Indirectly, this will facilitate a US attack on Iraq by freeing up US and UK troops that otherwise might have to remain behind to protect Kuwait.

But the reinforced GCC support will offer only limited comfort.

For everyone in Kuwait is aware that the real Iraqi threat is not a 1990s-style land attack – which is a remote possibility – but some form of “non-conventional” retaliation with WMD.

The Eid Al-Adha was celebrated as usual, with a three-day public holiday. Families went to their beach chalets; others slipped off for a leisure break in **Dubai**. Playgrounds and beach promenades were bustling, while café tables outside the old Mubarakia souk downtown were still crowded with late evening socialisers as everyone tried to just carry on with everyday life as usual.

Some businessmen will tell you there is no danger. They have heard the latest US technology is so advanced that ‘no missile could reach Kuwait’, that the hit-and-miss Patriot air defences of Tel Aviv and Riyadh in 1991 were of ‘stone age’ effectiveness compared with the protection against Iraqi retaliation the USA will provide this time.

Others argue that even a desperate Saddam will refrain from any counter-strike on Kuwait because that would swing Arab public and government opinion towards greater support for the USA.

MISSILE THREAT

Kuwait’s emergency planners are not so sure. They believe there is a real threat, whatever air defence technology the US deploys.

The risk of missile attack is taken seriously. No system can provide fool-proof protection against incoming projectiles, Kuwaiti officials believe. “You cannot defend Kuwait 100% – the threat is real,” one planner said.

Another senior official visited by *GSN* was jotting down a shopping list of precautionary purchases, including an in-home water purification unit, on his notepad as he chatted.

Chemical or biological weapons (CBW) pose the main threat. It is not thought likely that defences could be penetrated by sufficient conventionally-armed missiles to cause widespread damage – although a strike against oil or petrochemical facilities could have a significant environmental impact. But even one CBW projectile getting through – or being shot out of the air, but dispersing its deadly cargo as it fell – could have a major impact.

There is also concern that Iraqi agents already in Kuwait might try to release such substances. “We have ricin here, I am sure,” said one analyst, making a cross-reference to the recent discovery of a terrorist poison laboratory in London.

Alternatively, Iraq could engage in eco-

Kuwait's Emergency Planning

The Kuwaiti government machine is well protected. Alternative locations and back-up communication links for all departments have been set up; emergency task forces are ready. Arrangements to protect against “non-conventional” attack and continue key operations are in place. A “Countdown” plan for strategic management of the crisis has been ready since September. Also in place are contingency plans for the oil industry (*GSN 701/13*).

There is a clear emergency civil defence command structure, with rules about how practical responsibility will be devolved to local and junior levels where necessary. Crisis legislation on key issues such as financial planning, the declaration of a state of emergency or martial law and use of the media has been prepared.

However, planners concede that the population’s welfare is proving much more difficult to assure. More than half of Kuwait’s 1.7m inhabitants are foreign, and many do not speak fluent Arabic or watch Kuwaiti domestic television. Officials worry about how to get emergency messages across to unskilled foreign labourers. The authorities have been issuing regular television advice on taking shelter, what to do when air raid sirens sound and so on. Gas masks and other equipment have been stockpiled. But it remains unclear how far the message has got across, especially in ensuring awareness of the CBW danger.

Questioned by *GSM*, some Kuwaitis and foreigners insisted they clearly knew what to do and where to take shelter. But many others were uncertain or had no idea. Non-governmental planners, supported by some government departments, have begun to embark on a programme of public training, with briefings and videotape instructions on how householders should seal their houses to prevent any inward leak from contaminated air outside.

But even the best-laid precautions cannot offer full protection in a highly urbanised country such as Kuwait. Any strike on the capital or its suburbs will inevitably threaten a large population surrounding the immediate site. Kuwait faces the possibility of becoming the world’s first major urban laboratory test in coping with modern bio-chemical warfare. This is already proving a serious challenge for the government machine (*see below*).

terrorism by releasing poisons into the Shatt Al-Arab, to be washed down into the northern Gulf.

There is also a danger of air pollution from bombed Iraqi facilities, particularly in the industrial zones around Basra. “There is no defensive system that can stop a cloud,” pointed out one defence planner.

IN-FIGHTING

Kuwait has undertaken substantial emergency preparations (*see box*), but these have been hampered by turf battles between rival departments and squabbles over the allocation of resources and equipment.

Matters are not helped by Kuwait’s long-running political difficulties, with an ageing leadership seemingly unable to settle the succession line and set out a clear vision for future development.

Behind the façade of inter-departmental co-operation, rivalries for political kudos are being fought out, undermining overall effectiveness. There are complaints of empire-building, red tape and sluggish decision-making by some senior officials. Concerns are also expressed about a lack

of transparency. A \$300m emergency budget has been allocated for the Interior Ministry, but it is not clear how much of this has so far been spent, and on what. This creates a risk of equipment wastage in some areas and shortages in others.

...AND NATIONAL UNITY

But against this must be set the strength of national determination among ordinary Kuwaitis. By the time any conflict takes place, some of these problems will have been overcome, not least thanks to the enthusiasm of individuals and the strength of civil society groups.

People with specialist expertise are rallying round. Volunteers are offering to help. Beneath the surface there is panic, but it is increasingly purposeful panic. This is perhaps most evident in the widespread determination not to be forced abroad by the threat of an Iraqi attack or terrorism.

With the northern third of a smallish country now a closed military zone, much of the desert still closed to civilians because of landmines left from 1990-91 – almost impossible to clear in shifting sand – and few provincial towns well away from the capital, Kuwaitis have no obvious safe areas to retreat to. Faced with this situation, locals are torn between an attempt at a phlegmatic determination to press on with everyday life as normal, and the inevitable fear of the risks they face.

Many have asked themselves if they should seek safety in Dubai, Saudi Arabia or Europe, or whether to sit the crisis out at home. The Eid Al-Adha holiday period was a curious test. Some people took their families abroad, often to Dubai, on the assumption that travel might soon become difficult.

Many Kuwaitis prefer not to leave if it means they cannot then get back in because of wartime precautions and flights bans. When Iraq attacked in August 1990, one-third of the national population was abroad, escaping the fierce midsummer heat. Another third fled, usually driving through the desert to Saudi Arabia. About 200,000 Kuwaitis – one-third of the national population – remained during the seven-month occupation.

Many of those who found themselves trapped abroad “last time around”, or who then fled, feel strongly that they should stay on this occasion.

Asked about plans to send their children to the Lower Gulf or Europe, they insist that, at least at this stage, they intend to keep their families here.

There is a strong feeling that Kuwait should not allow Iraqi threats to force people to abandon their normal routine any more than is absolutely necessary. Most people recognise that their views could change if there was a serious attack. But at this stage, most are determined to stay.

THE MIGRANTS' DILEMMA

For the army of foreign workers, matters are rather different. Already, many US civilians are leaving and American schools are closing – much to the annoyance of the Kuwaiti middle class parents who patronise them.

Asian countries have drawn up evacuation plans for their citizens and set aside aircraft to fly them out if necessary. But it remains unclear whether they will automatically do so if war begins in Iraq, or only if Kuwait itself is then attacked.

Indian Airlines and *Air India* are involved in a plan to evacuate more than 50,000 Indian nationals, with aircraft diverted from normal routes expected to evacuate around 3,500 a day.

Sri Lanka's Foreign Minister **Tyronne Fernando** and Labour Welfare Minister **Mahinda Yapa Abeywardena** have set up a task force to evacuate some 170,000 nationals employed in Kuwait if war breaks out. **South Korea** has urged its nationals to leave Kuwait, Iraq and **Israel**, and has pledged to mount a similar evacuation operation as that planned by India.

Philippine President **Gloria Macapagal Arroyo** flew in to meet the Kuwaiti leadership and boost the morale of her 60,000 citizens living here. She and other Asian leaders have to balance the difficult task of protecting their citizens with the need to ensure that their jobs and share of the future peacetime employment market are secure for the future.

Many individual foreign workers are reluctant to leave unless there is an official evacuation. If they leave early they jeopardise their jobs and have to pay their air fares – and they simply cannot afford to risk losing their Kuwait salaries unless they are forced to.

Saudis Decree Drop In Migrants

Interior Minister Prince **Nayef Bin Abdelaziz**, who among his many responsibilities chairs the Manpower Council, has announced that within a decade the number of foreign residents in the Kingdom will be reduced to just 20% of the indigenous population, with any one nationality limited to only one-tenth of the total.

This marks the launch of a decisive effort to transform the demographic balance and free up more jobs for nationals. Some 6m-7m foreign workers and dependents now live in the Kingdom, alongside an estimated 17m indigenous population. Local male unemployment tops 20%.

The new policy could force a sharp reduction in the number of south Asian and Arab workers – or it could merely signal an attempt to hold their number stable, while the national population continues to grow rapidly.

But effective operation of controls could prove difficult: in a crackdown last year, the authorities discovered almost half a million illegal migrants.

The UAE authorities have decided that expulsion is a waste of time, when many of the illegals are gainfully employed. It has declared an amnesty for them to register although, in the first few weeks of the new policy, most were too fearful of deportation to come forward.

Turkish Military Mulls A Range Of Iraqi Options

Against a background of stalled basing negotiations with the USA, the Turkish General Staff (TGS) continues to mull a range of unilateral and bilateral options for military operations in northern Iraq. Kurds fear this includes 'securing' a significant chunk of their territory, as has been signalled by recent special forces activity in the region.

Despite strong petitioning by the USA, UK and Kurdish parties, the TGS has stuck to a typically muscular line on its future role in Iraq, stating that it reserves the right to carry out a range of actions, including a full-scale military operation that could penetrate Iraq to a depth of 170km – the distance between the Turkish border and the oilfields and city of Kirkuk.

According to *Kurdish Democratic Party (KDP)* officials interviewed by GSN, Kurdish groups have made some progress in instituting confidence-building measures, despite the mutual suspicion that attends discussions between the TGS, the Kurds and Western militaries. In recent meetings in Ankara and at Silopi on the Turkish/Iraqi border, both KDP and *Patriotic Union of Kurdistan (PUK)* leaders have stressed that a Turkish incursion on humanitarian grounds remains "unacceptable", while attempting to assuage Turkish fears of a refugee crisis.

The senior KDP representative in Washington **Farhad Barzani** told GSN that the two Kurdish parties had "guaranteed Turkey that not one refugee would cross the Turkish border", citing the differences between 1991 – when 4,000 villages lay destroyed and no central authority existed in northern Iraq – and 2003, when the *Kurdistan Regional Government (KRG)* and a dozen UN and international aid agencies have advanced contingency plans in place.

US Special Envoy **Zalmay Khazildad** attempted to broker Kurdish acceptance of a 15km Turkish military buffer zone in Iraq – which already exists – and to counter Kurdish fears of a deeper, more permanent Turkish incursion by stating that any joint Turkish/US forces penetrating Iraq would fall under US command (GSN 703/11).

KURDISH CONFIDENCE-BUILDING

According to KDP and PUK representatives, Kurdish confidence-building measures at the Silopi meeting succeeded in breaking down some of the distrust displayed by TGS delegates. This distrust had previously been accentuated by Turkish dismay over the prominent role played by the Kurdish parties in the London opposition conference in December.

Although TGS delegates in close contact with the Kurdish factions appear to have recognised the new pragmatic vision of federalism exhibited by the KRG, senior TGS officers in Ankara remain

unwilling to gamble on the Kurdish parties' willingness and capability to control the ambitions of their populations.

The TGS has also exhibited its deep-seated unwillingness to place Turkish troops under foreign command. As GSN previously disclosed with reference to no-fly zone operations from Incirlik airbase, the TGS obsessively monitors Western military activity in the country to allow it to control every aspect of operations, down to a very low-level of tactical granularity (GSN 691/4).

Delegation of control is not in the character of the TGS, which would require extensive inducements to enter such a scheme. The issues of command and control and the basing of 30,000-80,000 US (and perhaps British) troops in Turkey may hinge on the scale of the compensation package currently in its final stages of negotiation: this could total as much as \$30bn according to Turkish sources – although US analysts believe Washington will not go that far.

Such a deal would allow the US easier access to northern Iraq, allowing the use of Turkish airbases; if such a deal is not brokered, the USA could simply downplay the importance of the north, or – more likely – form an air transportation bridge directly from Italy to northern Iraq, utilising less controversial over-flight rights through Turkey.

A compromise solution is likely, with Turkey gaining around half the desired \$30bn and countering with scaled down support.

TGS STRATEGY IN THE NORTH

Whichever solution is found, the TGS will initiate a three-tiered programme of military activity in northern Iraq, only later questioning how the USA can be integrated into these activities.

- **SECURITY ZONE:** The first and least sensitive form of activity will be the bolstering of an enhanced security zone along the Turkish/Iraqi border, building on the existing 15-30km deep zone occupied by the Turkish army. A low-quality mechanised brigade (around 5,000 personnel) is already deployed along the border, with strong points on the Zakho-Amadiyah ridge – into which has been carved an enormous Turkish crescent.

Despite Turkish reports that 12 refugee camps were under construction in the existing security zone (with another six further back inside Turkey), the KDP's Barzani said no camps were yet ready for use. The Turkish military is likely to institute martial law within the security zone.

- **SPECIAL FORCES:** The TGS will initiate new levels of special forces activity throughout northern Iraq, which may already be starting. Currently, one special forces regiment carries out offensive patrolling and intelligence-gathering activities along the security zone, but GSN has learned from

US special forces planners that a second Turkish special forces regiment has been deployed to push forces further south, to liaise with Turkish military intelligence cells – *Milli Istihbarat Teskilati (MIT)* – in Dohuk, Arbil and Sulaymaniyah.

According to US planners, this may cause serious de-confliction and co-ordination problems with the *US 10th Special Forces Group*, whose battalions are operating throughout the area. Turkish special forces continue to be airlifted into the security zone, where special forces helicopter units provide tactical transport, operating from Barmani airfield and other cleared strips. These forces may be critical in what US planners term 'planting flags' – seizing control of economic and political keypoints in the KRG zone – through operations similar to the Russian *coup de main* at Pristina airfield in Kosovo.

- **HEAVY ARMOUR:** The most problematic form of military intervention planned by the TGS is the projection of heavy, armoured columns into Iraq. Whether this occurs under joint Turkish/US command or as a unilateral Turkish action, it will be a sensitive and problematic operation. Although reportedly involving two armoured divisions, this operation would probably utilise a smaller force of two or three brigades (10,000-15,000 personnel) that is being assembled at the Cizre railhead, on the Turkish/Syrian/Iraqi border. At least 80-100 military vehicles had crossed the border before the recent mobilisation, with 20-30 tanks stationed at Bamerni airbase. A further 15 tanks and 50 other armoured vehicles arrived at Cizre recently, while 40 armoured vehicles and mobile bridging equipment await forward transportation at Diyarbakir. The most likely axis of advance runs Zakho-Dohuk-Arbil.

According to Farhad Barzani, the Turkish military is most likely to push out towards the outskirts of Arbil and Sulaymaniyah, but will not enter either of these cities or immediately push further south towards Kirkuk. Either of these further steps would depend on what MIT and special forces reported.

KURDISH HARE, TURKISH TORTOISE

Turkey's lumbering armoured forces are not capable of preventing a Kurdish seizure of key points in northern Iraq. To reach Kirkuk would take Turkish armoured vehicles three to five days without any opposition or other complications, particularly as Mosul – a defended Iraqi stronghold – must be bypassed.

Even if government forces in Mosul and Kirkuk were to collapse immediately – as seems likely on past form – the Turkish columns would face serious uncertainties and dispersal if they succumbed to the 'urban draw' of such large cities.

Kurdish groups, meanwhile, would almost instantly inherit the cities. Although the Kurdish groups are practical about their inability to

militarily stop a Turkish thrust, they are counting on a strong reaction from the citizenry of the KRG, who are likely to clog the streets and vital transport links in protest at overt Turkish action.

The KRG's deft use of media may also prove an impediment to Turkish military moves.

A further complicating factor in the eastern areas north of Sulaymaniyah will be **Iranian** sensitivities, which are becoming more pronounced as the crisis wears on.

This graduated programme of military insurance will provide Turkish decision-makers with the minimum necessary assurances.

The TGS will plan for a full incursion to a depth of 170km but look unlikely to make Kirkuk their immediate objective. Instead, under intense US pressure, the TGS will strengthen its security zone and flood northern Iraq with MIT and special forces teams. Conventional ground forces may immediately push out the security zone by up to 30km, overshadowing the key transport hubs of Zakho and Dohuk. These actions will most likely be followed by a period of evaluation, which may result in a further push to the edges of Arbil and – less likely – Sulaymaniyah.

A final push on the Kirkuk oilfields would await further intelligence and, would probably falter under the full glare of US objections.

BAHRAIN: Guns Across The Causeway

An arms cache discovered by national security forces – who arrested five men in connection with the find of four AK-47 assault rifles, two pistols and ammunition – were smuggled over the King Fahd Causeway from **Saudi Arabia**, according to defence lawyer **Abdallah Hashim**, representing one of the five arrested, a 37-year-old Bahraini national identified as **Bassam Yussef Abdelkarim Ali**. "The authorities say they were then brought in piece-by-piece over the causeway," Hashim was quoted as saying by *Gulf News*. "They believe that they were bought from a Saudi." The authorities have drawn up a 60-page investigation dossier, which may contain details of the CDs and videos seized in raids on the suspects' homes. According to the Information Ministry, the group were planning to target "national interests in Bahrain". However, other sources have suggested their targets were American. *Reuters* quoted a Gulf source saying that two of the arrested men were from the Bahraini military. The daily *Alayam* newspaper said the authorities had confiscated videotapes of **Osama Bin Laden** and other **Al-Qaeda** leaders from **Jamal Hilal Mohammed Al-Balooshi**'s home. Another of those arrested, **Mahmoud Mohideen Khan**, had previously been expelled from Saudi Arabia; he had fought in **Afghanistan** during the 1980s, his lawyer **Fareed Ghazi** told *Reuters*.

SAUDI ARABIA: Al-Jawf Official Shot Dead

An unidentified gunman shot dead the northern Al-Jawf province's Deputy Governor **Hamad Bin Abdelrahman Al-Wardi** on 17 February, the Interior Ministry said. The official was driving his private car to work when it was riddled with gunfire at around 06:45. In September, a judge was shot dead in Al-Jawf as he left a mosque following Friday prayers. A Saudi national was quickly arrested for that assassination but the authorities did not subsequently reveal his motive. Further details are awaited.

Kuwait, Wracked By Doubts, Awaits New Blood

Doubts, uncertainty and political wrangling over leadership and corruption beset Kuwait on the verge of a potentially transforming period in its history. Regime change in Iraq would allow a rich, well-equipped and intellectually open country to diversify away from its reliance on oil and emerge as a service hub and trade gateway for the northern Gulf. But there is concern that, preoccupied with internal struggles between Islamists and liberals, and hampered by uncertainty over the line of succession in the ruling Al-Sabah family, Kuwait may fail to fully seize this chance.

Disillusion runs deep among opinion formers, many parliamentarians and even some senior officials. They are frustrated at their country's seeming inability to achieve consensus around a clear development route forward and concerned that the integrity of the democratic system is being undermined by a mushrooming pattern of financial patronage.

According to GSN's soundings in Kuwait, allegations of corruption and other abuses of power are surfacing as a major source of grievance. This threatens to undermine the government's prospects of securing popular and political acceptance of the case for key economic reforms.

Matters are clearly not helped by the strategic situation or domestic political timetable. The prospect of war in Iraq, while opening up some long-term opportunities, creates huge short-term pressures for the government (*see page 3*).

The crisis coincides with the awkward run-up to this summer's parliamentary elections, whose outcome remains uncertain. Small gains by either Islamists or liberals are possible, although no fundamental shift in the balance of power within the National Assembly seems likely.

Usually around half of all deputies lose their seats in Kuwaiti elections, and the present incumbents are therefore reluctant to approve unpopular reform measures this side of the poll.

LEADERSHIP PRESSURES

The government's effectiveness is undermined by the huge workload now falling on the shoulders of its remaining members, as some ministers resign for political reasons or to contest National Assembly seats (*GSN 703/7; 702/15*).

Deputy Foreign Minister **Sheikh Mohammed Sabah Al-Salim Al-Sabah** is now Acting Finance Minister too, while Information Minister **Sheikh Ahmad Al-Fahd Al-Ahmed Al-Sabah** also takes care of the Ministry of Oil in short-term caretaker arrangements that highlight the longer-term

leadership problem. Emir **Sheikh Jaber Al-Ahmed Al-Sabah**, although recovered from the most damaging effects of his stroke, is frail and feeling his age.

The Emir takes little role in frontline politics or decision-making. The once ebullient and vocal Crown Prince and Prime Minister **Sheikh Saad Al-Abdallah Al-Salem Al-Sabah** is seriously ill and distant from the day-to-day management of affairs.

This has thrown the burden of effective government leadership on to the shoulders of First Deputy Premier and Foreign Minister **Sheikh Sabah Al-Ahmed Al-Sabah**. He too is in his seventies and in uncertain health, yet Sheikh Sabah is doing the work of three men.

Parallels can be drawn with Crown Prince **Abdallah of Saudi Arabia**, the acknowledged de facto ruler of the Kingdom because of **King Fahd's** illness. But Sheikh Sabah's position is more difficult: he is taking the key decisions yet he is having to act without the sort of formalised role that Crown Prince Abdallah enjoys.

Because the line of succession has not yet been decided, the next generation are jockeying for position. This is a rivalry that is played out day-by-day in routine decisions about projects and budgets, as rival candidates seek to present themselves in the best light.

Kuwaiti analysts warn that this is hampering the effectiveness of government, even of safety preparations for the war in Iraq, as ministers seek to "empire-build" and associate themselves with successful programmes at the expense of others.

The most prominent ministers at the moment are probably Sheikh Ahmed Al-Fahd, Sheikh Mohammed Sabah Al-Salim and Interior Minister **Mohammed Khalid Al-Hamad Al-Mubarak**. The latter's profile is raised by the importance of his department's role in preparing for the Iraq war.

A decision on the succession line will lie with the Al-Sabah family. But it will not be settled while all the current three most senior figures remain alive. That is adding to uncertainties, because the potential successors vary widely in their attitudes to key issues.

KUWAITIS WANT DIRECTION

Many Kuwaitis feel their country lacks clear direction and an effectively articulated vision for reform and development. In economic terms, one respected columnist told GSN, that Kuwait was "booming," with oil prices high and the stock market buoyed by hopes of post-war business opportunities in Iraq. But as the political situation was "terrible", he said, commenting: "This is the

only country in the world without leadership.”

This is hyperbole certainly – but not an unfair reflection of the pessimistic mood among many Kuwaitis. There are widespread complaints that the government is failing to set a clear sense of national direction while internal family rivalries are played out indirectly through politics.

At least one prominent Al-Sabah who wanted to weaken Sheikh Sabah Al-Ahmed is said to have been an influential force behind the repeated parliamentary assaults that eventually drove finance minister **Youssef Al-Ibrahim**, the deputy premier’s protégé, to resign last month.

These are not uniquely liberal concerns. Some Islamists too complain that their leaders’ energies would be better employed in mobilising parliamentary support for key economic reforms. It is suggested that reformist ministers are often “hung out to dry” and left without full and assertive cabinet support, if the new policies they have developed run into significant parliamentary opposition.

At the least, the government is accused of courting popularity and lacking the courage to press forward with difficult measures – although many acknowledge that it is difficult for Sheikh Sabah to deal with this situation given his interim status.

...BUT NOT MANIPULATION

More extreme critics suggest the government may not really want to reform. They fear the Al-Sabahs would prefer to water down Kuwaiti democracy and nudge the country towards a more controlled system similar to that recently established in Bahrain – where the elected National Assembly can express views but cannot ultimately settle policy.

There is concern about a proposed new information law which has raised the financial penalties for defamation to levels that could drive some newspapers out of business if they lost a case.

There is already widespread concern at the extent of electoral manipulation. It is alleged that a small minority of members of Parliament are effectively “bought”, with financial support for their election machines or, more commonly, through the allocation of public sector jobs to their voters.

Sunni Islamists – some of whom were prominent in attacking liberal ministers – have helped to derail a move by the Shia MP **Hussein Al-Qalaf** to secure a ministerial grilling over “jobs for the boys” allegations, despite the fact that his claims were supported with detailed evidence.

It is widely expected that attempts by nationalist **Abdallah Naibari** to secure a parliamentary investigation into questionable allocations of prime development land will also be blocked with Islamist help.

Nevertheless, thanks to the assured “payroll vote” of up to 16 ministers, the government has a reasonable base on which to build a parliamentary

People, Not Policy, Shape Parliament’s Direction

Kuwaiti parliamentary politics is still heavily influenced by non-policy factors – and this complicates the task of moving forward with a coherent programme of measures. In casting their vote, electors typically give heavy weight to their tribal and family ties with a candidate, his ethnic background and any particular religious sect they belong to. Also important are questions of personal friendship and whether the candidate or deputy has visited the voter personally.

Incumbents are measured mainly by their ability personally to provide public services for the individual voter, or find jobs for the voter’s relatives. A number have become known primarily as “service MPs” for their effectiveness in doing this. This approach generally dissuades them from asking tough questions of the ministers who have the power to provide or withhold particular services from their constituents. Thus behind a facade of combative opposition activity, many parliamentarians act as a tool of individual ministers engaged in turf battles. With a few exceptions, deputies are rarely assessed mainly on their qualifications, track record as legislators or their political action in the national – rather than voter’s personal – interest.

majority, should it choose to exploit this. It only needs to win the backing of just over one-third of the remaining 50 elected deputies to get a measure through and its powers of patronage give it serious clout over a number of parliamentarians.

Critics complain that if the government really wanted to drive the reform programme forward it could do so, whether on economic issues or on contentious social matters such as women’s political rights. But they feel it is opting instead for a quiet life while elements of the Al-Sabah family are focusing their energies on family rivalries and the promotion of their sons into key posts.

IRAN: Aghajari Reprieved

The judiciary has climbed down in the case that threatened to spark major new clashes, by lifting the death sentence for blasphemy passed on **Modarres University of Tehran** historian and journalist **Hashem Aghajari**. **Ayatollah Mohammad Sajjadi** said three of the four appeal judges had agreed the move.

OMAN: No To War

Foreign Affairs Minister **Youssef Bin Alawi Bin Abdallah** on 17 February reiterated Oman’s view that: “We cannot allow ourselves to join or participate in any way in supporting any effort against **Iraq** or any other Arab state.” He was speaking at a joint news conference with visiting Iranian Foreign Minister **Kamal Kharrazi**, who stressed the need to find a peaceful solution to the Iraqi crisis – which has sparked some protests in Oman with **US** forces building up in the Sultanate. Oman has sent a battalion to **Kuwait** to join the Peninsula Shield force.

UAE: Sporting Threat

The World Under-20 soccer championship, scheduled to start in **Dubai** next month, could be postponed if military action starts against Iraq, **FIFA** President **Sepp Blatter** said.

UAE Seeks More Robust Regional Approach

The Gulf lacks an effective regional emergency system for dealing with major oil spills, a senior UAE environment planner has warned. There is no proper co-ordination or clear system for giving orders in a crisis, *Environmental Research and Wildlife Development Agency (ERWDA)* Secretary-general **Majid Al-Mansouri** told *GSN*. Although **Iran** and the *Gulf Co-operation Council* states have drawn up plans to cope with a deliberate oil release by **Iraq**, in retaliation for a US-led attack, Mansouri feels such *ad-hoc* arrangements for special situations are far from adequate. A regional scheme for coping with oil spills exists, "but it's not effective," Mansouri said: "There is no proper Gulf crisis oil spill contingency plan."

UAE officials want to see the **Kuwait**-based *Regional Organisation for Protection of the Marine Environment (ROPME)* taking a bigger and more practical role in establishing clear crisis management procedures, and lines of authority and command. ROPME's current activities are too oriented towards "feel-good" diplomatic and administrative contacts, the UAE believes.

"We need somebody to look at how this could be dealt with. They are trying – but it doesn't work," said Mansouri, who was interviewed at the *Environment & Energy 2003* exhibition and conference in **Abu Dhabi**.

Mansouri said the *Prestige* tanker sinking off **Spain**, which has produced a continuous flow of oil slicks for many weeks, highlights the dangers of poor preparation for spills. The Gulf's almost closed waters, with their fragile shallow water ecosystems, are particularly vulnerable to damage.

ERWDA is so worried about the inadequacy of existing crisis arrangements that it has decided to break with traditional inter-governmental niceties and speak out on the record. Mansouri wants to shake up regional thinking.

His agency is already carrying out detailed research and planning for any spills within **Abu Dhabi** and this is now being extended to cover the whole of the UAE.

ERWDA has produced a detailed coastal atlas, which has been distributed to all the oil companies, so they are properly informed about the configuration of the coastline and water depths. It is working with companies to build up a detailed action plan, so that in the event of an accident, every player knows exactly what it should do. Disaster management control rooms have been established, Mansouri said.

Iran is also worried about the risk of a spill and it has contributed to the Emirates' planning. The

two countries' long-running diplomatic rift over small Gulf islands has not been allowed to get in the way of these preparations. But ERWDA remains concerned about the inadequacy of contingency arrangements at a Gulf-wide level.

Mansouri is also worried about more routine threats to the marine environment. Gulf governments lack the legal powers to properly police tankers that discharge dirty oil-tinged ballast water into the sea outside the narrow 12-mile band of sovereign coastal waters. This is a particular problem in the Gulf of Oman, outside the Straits of Hormuz, but it also occurs inside the Gulf.

Rubbish dumping from ships is another major problem. Governments need to ratify the MRRPO Convention, which would formally register the Gulf as a sensitive area and empower governments to impose penalties on polluting tankers even when the vessels are in international waters.

Mansouri also believes that a better ecological database is needed. "We are not yet satisfied that marine systems are working well," he said. "We need a research programme on marine habitats, species and water quality in the Gulf."

Only now is the Gulf environment starting to be fully appreciated. The island of **Qarnein**, an important breeding site for turtles, has been accorded Gift to the Earth status by the *Worldwide Fund for Nature*.

Environmentalists Impact On Policy, Projects

The **UAE** is one Gulf country where environmental policy counts. The *Environmental Research and Wildlife Development Agency (ERWDA)* – chaired by **Abu Dhabi Crown Prince Sheikh Khalifa Bin Zayed Al-Nahayan** – is beginning to wield greater development planning clout, helped by new rules that require all public and private sector projects to undergo an environmental impact assessment. The Dolphin project to bring **Qatari** gas to the UAE is one of the first to be reviewed under this new procedure.

ERWDA will soon conduct an air quality study, as a prelude to the drafting of an air quality strategy. Air pollution is not yet at dangerous levels, early action is needed to avoid worse problems later. "The major source of air pollution in **Abu Dhabi** is the cars," ERWDA Secretary-general **Majid Al-Mansouri** observed. The agency is trying to encourage the greater use of public transport, but this will not be easy. In the meantime, to mitigate the impact of car use, all petrol stations have been switched over to unleaded fuel.

ERWDA has developed a five-year environment strategy for **Abu Dhabi** and launched an education programme which has already reached two-thirds of the emirate's schools. A survey of coastal birds is under way and the agency is also working on a water resources management plan – which could have potentially far-reaching consequences for future development planning and decisions on the siting of new housing projects.

Middle East Insider – IRAN

Satellites Bring ‘Young Shah’ To New Audiences

Farsi satellite television channels such as the US-based *Azadi TV* – founded in September 2001 and now building an audience among expatriate Iranians and viewers in Iran – are giving increasingly regular coverage of a 42-year-old exile, who goes by the name **Reza Pahlavi of Iran**.

Media coups are a reflection of the raised profile of the ‘Young Shah’, the son of the late **Mohammed Reza Pahlavi**, deposed Shah of Iran.

Reza Pahlavi’s growing popularity is traceable to a combination of savvy public relations, orchestrated through his Falls Church, Virginia-based ‘*Secretariat*’; the increasing disillusionment felt by Iran’s youth towards the reformist government of President **Mohammed Khatami**; and strengthening ties with supportive Washington neo-conservatives.

The first two factors look set to strengthen his political appeal, but given Iran’s political traditions the latter association should make him ‘unelectable’. It says much about the prevailing political atmosphere that Reza Pahlavi could excite much interest.

The niche that Reza Pahlavi is carving out for himself is not that of an Iranian version of **Afghanistan’s King Zahir Shah**. US government policy, as espoused by spokesman **Zalmay Khalilzad**, now focuses on supporting grassroots, youth-led political change in Iran as opposed to reformist politicians and other figureheads.

Director of *Central Intelligence* **George Tenet** backed this statement at an 11 February Senate Select Committee on Intelligence hearing, noting: “We are currently unable to identify a leader, organisation, or issue capable of uniting the widespread desire for change into a coherent political movement that could change the regime.”

Both Reza Pahlavi and the **Bush** Administration recognise that Iranian memories of the 1953 coup and reign of the Shah make overt US support politically untenable, and evidence of decreasing ‘Bonapartism’ in Iran’s politics suggests that Iranians are turning away from the desire for a strong leader and towards more pluralistic democracy.

Instead, Pahlavi has exploited the synergy of his freedom of speech outside Iran with satellite and internet media broadcasts into the Islamic Republic to become the only recognisable Iranian politician able to freely present his ideas on secular democracy to the Iranian audience.

With many of Iran’s youthful population losing

faith in the ability of the theocratic system to reform, secular models of democracy are becoming more attractive. Pahlavi has adopted a model of non-violent resistance and political collapse, followed by referendum on the nature of government in Iran, constructing an uncontroversial – if not bland – position capable of attracting broad support.

Pahlavi’s royal lineage confers a delicate balance of positive and negative associations. It has guaranteed him a central role in the strongly royalist and nationalist diaspora, but threatened his standing with those who remember the brutal, pro-American police state administered by his father – described as “Cold War excesses” by the ‘Young Shah’s’ current associates.

A Secretariat insider told *GSN* that Pahlavi’s stress on freedom and democracy was an important differentiator between father and son.

Post 9/11 PR

Pahlavi’s rejuvenation began five years ago, but has accelerated since 9/11 and the January 2002 State of the Union address, which dubbed Iran a member of the ‘Axis of Evil’. Determined public relations (PR) efforts kick-started the process, exploiting the needs of the satellite television stations of the Iranian diaspora in southern California and elsewhere in the USA.

The Secretariat entered into mutually beneficial arrangements with leading Farsi satellite channels, including the four key politically-focused stations – *Pars TV*, *Azadi TV*, *National Iranian Television (NITV)* and *Channel 1 TV*. Such broadcasters, notably the cash-strapped *NITV*, were able to maintain their paying customer bases in the USA – predominantly loyalists to the old Shah – and attract new audiences in Iran with footage of the ‘Young Shah’.

In return, the Secretariat has been able to negotiate discounted airtime rates and increase Pahlavi’s exposure. Due to these channels’ 24-hour schedules and the syndication of supplied broadcasts, footage of Pahlavi is shown with considerable regularity.

In partnership with PR firm *Tactical Sales Professionals*, Pahlavi has begun participating in web conferences and Q&A sessions.

The Secretariat has increased its mainstream media profile inside the USA. In December, a letter from Pahlavi to President George W Bush was printed as a paid double-page spread in the *Washington Post*, expressing appreciation for the

Administration's encouragement of reform in Iran but criticising new travel restrictions on the diaspora and Iranians attempting to visit them.

The letter was well-received, according to **Patrick Clawson**, research director at the well-connected *Washington Institute for Near East Policy*; it succeeded in displaying Pahlavi's loyalty to both his constituency in the diaspora and the process of political change in Iran.

In January, Pahlavi released a new book, *The Winds of Change*, which laid out his strategy for non-violent resistance and underlined his commitment to whichever system of government the Iranian people favoured in a referendum – both themes that will resonate well inside Iran.

Although opposed to military action against Iran or violent change, Pahlavi's commitment to democratic process has endeared him to the Bush Administration. According to Clawson, "he is viewed as a figure that the administration listens to". He is admired for his "demeanour of constitutional monarchy".

WITH FRIENDS LIKE THESE

Pahlavi's following in neo-conservative and pro-Israel circles is a mixed blessing for his long-term prospects. It yields greater access to the media and the Administration, but also drawing Pahlavi on to dangerous ideological ground.

Pahlavi's childhood friend, Georgetown professor and Caspian lobbyist **Rob Sobhani**, is an arch-Republican, derided in some Iranian-American circles for dropping his Iranian forename, Sohrab. While unsuccessfully contesting the 2000 Congressional election in Maryland, Sobhani denied that the **Palestinian** cause had any resonance with Iranians.

Professor **Michael Rubin** of Israel's *Bar Ilan University* is another Pahlavi supporter, believing that the "young Shah" would provide focus in an Iran primed for political and social revolution.

In a recent article, Rubin breathlessly wrote: "[Pahlavi] is a story of reinvention, the tale of a prince who lost his title, fortune, and the love of his people, and in the process came to appreciate the virtues of democracy. He has bucked the crude monarchism of many of his supporters and serves up frank criticism of his father's regime. In fact, with Khatami's support eroding, Pahlavi's moment may soon arrive. He's rallying the fractious diaspora opposition and supersaturating Iran with posters and video messages calling for insurgency. Once exiled as the successor to a discredited throne, he has become Iran's most unlikely, and most important, spokesman for democracy."

Another close supporter is **Michael Ledeen**, an archetypal neo-conservative, who has pressed for the war against **Iraq** to be followed by a war against Iran, as part of the 'total war' against state sponsors of terrorism (see box).

Ledeen: Advocate Of 'Imperial Iran'

Michael Ledeen, current holder of the *American Enterprise Institute's* Freedom Chair, is another fan of the **Pahlavi** dynasty – a long-term apologist for the regime of Shah **Mohammed Reza Pahlavi** who blamed the **Carter** Administration for the Peacock Throne's collapse in one of his early books. According to Ledeen, "in the context of the Middle East, Imperial Iran was a remarkably decent place". Unsurprisingly, he is a convinced advocate of early military action and regime change in Iran.

Ledeen is a major member of the *Jewish Institute for National Security Affairs*. His links with **Israel** run deep, having served as the go-between linking **Reagan**-era National Security Advisor **Robert McFarlane** and the Israeli government, facilitating the transfer of Israeli arms to Iran during the Iran-Contra affair.

Some of Pahlavi's least auspicious moments – such as suggesting an Iranian role immediately after 9/11 – are likely to have been prompted by these associations. This prompted some damning comparisons with **Masoud Rajavi**, the Iranian politician and later *Mojaheddin-e Khalq Organisation (MKO)* leader accused of plotting to cede **Khuzestan** to **Saddam Hussein** in return for the presidency of Iran in 1981.

Unconvinced that the three-man Secretariat could have organised his increasing access to *Fox News*, *ABC*, *CNN*, and *NBC*, many observers uncharitably credit Pahlavi's raised profile to two key neo-conservative influences – alleged support from the *American Israel Public Affairs Committee (AIPAC)* and PR guru **Eleana Benador**, head of *Benador Associates*.

Along with Ledeen, Benador's clients include Defence Policy Board and *American Enterprise Institute (AEI)* head **Richard Perle**, the "hawk's hawk" **Charles Krauthammer** and "Saddam's Bomb maker" **Khidir Hamza**.

VIEW FROM THE SECRETARIAT

Media co-ordinator **Kamran Beigi** downplayed such links, stating that Pahlavi had "zero connection" to Benador, or to the neo-conservatives that support him.

This relationship may well be one-sided, but Pahlavi's association with the neo-conservative camp is growing, and clearly irks some of his supporters. Though stressing that AEI's backing was "welcome" – and "we don't want to alienate them" – Beigi stressed the Secretariat's wish that neo-conservatives would stress the moral commitment to democratisation over the mechanism of war or revolution in Iran.

Reza Pahlavi has worked hard to cultivate the middle ground. He may now be drawn into the slipstream of Bush's Iran policy that will unfold once Iraq has been "transformed". This may be the road to power – but the route is far from sure and, for now, Reza Pahlavi remains a footnote to history, rather than a history-maker.

www.gulfstatesnews.com

Twin Threat Of Osama And Saddam Sends Regional Energy Giants Scrambling For Cover

The US/UK alliance's insistent push for military action has had a galvanising effect on Gulf oil producers, who are under strong pressure to reassure world markets over the stability of oil supplies in the eventuality of war against Iraq.

Saudi Arabia and Kuwait, the two Gulf energy heavyweights standing directly in Iraq's sights, have spent the 'phony war' days of February battening down the hatches, securing oil installations and shutting off production at exposed wells along their northern borders.

For Saudi Arabia, it is the more worrying threat posed by *Al-Qaeda* to its already heavily guarded oil installations that has prompted its latest bout of anxiety.

That threat is no mere hype. Last summer, Saudi officials arrested *Al-Qaeda* sympathisers who were said to be plotting to blow up the Ras Tanura oil terminal and refinery and the pipelines that serve it. This was supported by US intelligence picked up in the mopping-up operation in Afghanistan, which identified Saudi oil interests as key targets for sabotage.

SAUDI STRATEGIC STORAGE

Ras Tanura remains vulnerable to attack by sea, while oil tankers could prove relatively easy prey after the *Limburg* tanker attack in October. Some Saudi oil fields with custom-made equipment are regarded as particularly vulnerable to an assault, since these could not be repaired immediately.

The Saudi authorities chose to unveil in mid-February their third strategic storage facility, at Abha in the southern province. Designed to store millions of barrels of oil and petroleum products and meet the Kingdom's requirements for months ahead, its commissioning appears particularly timely in the light of the looming *Al-Qaeda* threat.

The *Saudi Aramco*-operated facility, one of five such planned units, is linked to the distribution centre in Jizan via a 245km-long pipeline, part of which passes through 10km-long tunnels. During

emergency situations, the project is also intended to meet the needs of the armed forces and major civilian sectors such as agriculture, industry and transport.

KUWAIT PREPARED FOR THE WORST

Kuwaiti authorities have outdone their Saudi counterparts in preparing for the worst (see page 3; *GSN 701/13*).

Kuwait Oil Company (KOC) has begun shutting in wells at the Ratqa and Abdali fields on the northern border, besides moving drilling equipment out of the area and evacuating staff. This accounts for only 25,000 b/d of the northern region's estimated 400,000 b/d production capacity.

Industry sources claim up to six drilling and maintenance rigs may have been removed to southern fields in the past month. The entire northern third of Kuwait has been closed off to civilians.

Meanwhile, state security officials have relieved KOC staff of their duties at checkpoints in the southern Burgan field. US helicopters carry out frequent security sweeps of oil fields and KOC is also considering stationing a

consignment of US Patriot missiles at the giant Burgan field.

These security measures, allied to wider US initiatives such as the aerial monitoring of Iraqi troop movements, are doing little to quell market fears over Gulf energy risk.

The double-whammy threat conjured up separately by **Saddam Hussein** and **Osama Bin Laden** is proving increasingly costly for Gulf economies reliant on uninterrupted hydrocarbons exports.

Shipping insurance premiums have skyrocketed, forcing some Kuwaiti traders to shift their import and export transit routes to land links via Saudi Arabia. Large-scale energy projects outside the immediate fray are also feeling the heat of heightened war risk.

RASGAS DOWNGRADE

Moody's Investors Service on 10 February confirmed its downgrade on Qatar's *Ras Laffan LNG Company (RasGas)* debt rating to Baa3 from Baa2, citing the more limited terrorism and sabotage coverage of the company's recently renewed insurance policies.

Moody's said the \$100m-worth of insurance cover on property damage

S&P Holds Firm On Gulf Project Ratings

Standard & Poor's has ruled out taking any ratings actions on Gulf projects in response to heightened war risk. Analyst **Rachel Goult** told *GSN* that S&P's project ratings in the Gulf already accounted for increased political tension in the region. "We do not feel that those pressures have increased specifically on the projects themselves and therefore are not taking any action linked to the current tension in the Middle East."

With *Moody's Investors Service* announcing downgrades, ratings agencies' inability to sing from the same hymn sheet underlines the general lack of hard fact about the exact nature of the threat faced by the region's showpiece energy developments.

According to new S&P research on the consequences of a war in Iraq, obtained by *GSN*, any downgrades of sovereign ratings

would stem from factors specific to decisions by the governments themselves. It says the most likely scenario was a war being "short and decisive". Under this scenario, war's impact on oil and other commodity prices would be shortlived and risk aversion by cross-border investors would not rise materially.

But there is a downside. "Although the most likely outcome of a war in Iraq would be a speedy victory, much worse scenarios could unfold," the 11 February-dated report suggests. "Collateral war damage could extend beyond Iraq, with extensive damage to oil and port facilities in the Gulf states."

Ratings agencies do not distinguish between war risk – chiefly posed by retaliatory action from **Saddam Hussein's** regime – and terrorism risk, associated with the activities of *Al-Qaeda* cells. In the resultant fog, quantifying the risks faced by rival Gulf projects is a thankless task.

and business interruption on RasGas' onshore operations might not cover its estimated maximum loss – largely a consequence of tight liquidity in the terrorism insurance market since the 9/11 attacks. Previously, terrorism cover tended to be included as an 'all-in' deal with the general insurance policy.

This post-Twin Towers disaggregation is adding a costly extra expense for sponsors of Gulf energy projects, with market availability on policies above \$100m severely circumscribed.

The Moody's downgrade will affect future project finance deals expected this year, including one for RasGas, with pricing likely to suffer.

"Banks are now much more sensitive over the issue of terrorism cover. It's been debated at length at *Oman LNG [OLNG]* even though that project is a stonker," said a

project financier active in major Gulf deals. "It's just this one aspect at RasGas that is being focused on."

OLNG STILL A BLUE CHIP

Moody's has reaffirmed OLNG's AAA debt rating, noting that it was not an increased threat faced by RasGas in comparison to that faced by the Omani company that prompted its decision to downgrade, rather that OLNG's rating was supported by its comprehensive insurance policy rolled over on 15 January.

OLNG has the luxury of tapping into the resources of its key shareholder *Royal Dutch/Shell*. Rachel Goult, a senior Gulf corporate ratings analyst at ratings agency *Standard & Poor's*, told *GSN* that OLNG's use of an insurance company owned by *Shell* proved critical to its ability to source sufficient terrorism cover in

tight market conditions.

With the outlook so unclear, bankers with long experience in the region will most likely continue to act on hunches.

"The market for sabotage and terrorism cover is not the most liquid, but you'd expect Oman to be relatively unscathed in any conflict," said the project financier.

By the same token, those furthest away from the action could be equally at risk as Gulf States. As an S&P report on the Gulf crisis commented: "Sovereigns reliant on global growth to improve domestic living standards or to maintain fiscal debt trajectories and, particularly, countries reliant upon commercial external debt may be far from the conflict but have their creditworthiness hurt more than those nations directly in the fray."

Kuwaiti Planners See Reform In Months, Not Years

Economic policy planners and senior parliamentarians in Kuwait told *GSN* they were confident of implementing crucial regulatory reforms within months, despite the Iraq crisis and the resignation of Finance Minister **Youssef Al-Ibrahim**, an architect of the modernisation strategy.

These technical measures do not require the approval of Kuwait's often fractious National Assembly and could have a big impact, opening up key services sectors to increased competition and new investment.

However, parliamentary deputies' reluctance to court unpopularity in the run-up to this summer's elections will delay other key reforms that need the legislature's agreement. These will not now get the go-ahead before the second half of 2003 or early 2004 – provided Parliament agrees.

The new four-year plan, the privatisation bill, a programme of subsidy cuts and service fee increases, and a new sales tax, will all have to wait until the new Parliament's first year, when deputies feel less pressured by public opinion, the Assembly's Finance Committee Chairman **Abdelwahab Al-Haroon** told *GSN*.

Haroon, a liberal, is a committed advocate of change. But the cause of

economic reform cannot count on a reliable parliamentary majority; support for individual measures has to be secured vote by vote, through hard-fought debate and negotiation.

Modernisers see the sales tax – which will be introduced at a minimal rate – as an important step in weaning the Kuwaiti public off the widespread misconception that public funds are unlimited and there is no need to control spending.

But getting the tax plan through Parliament and then implementing it will require political skill and guts. Most Islamists, **Ahmed Saadoun's** populist bloc and most tribal MPs are opposed to subsidy cuts, higher fees and the introduction of taxation.

Ibrahim quit in exasperation at the political obstructions he was encountering on issues such as this.

With such high-profile measures postponed, government economic strategists see the technical regulatory changes permitted under existing legislation as the best way to maintain the momentum for change during the months of wartime and pre-election political stalemate. These will be the basis of increased competition and, they hope, better services and employment creation in the future.

Emir **Sheikh Jaber Al-Ahmed Al-Jaber Al-Sabah** is empowered to

press ahead by emiri decree with the devolution of government authority over public service utilities to new independent and transparent regulators, who will supervise liberalised markets. Transport, telecommunications and power are the priorities (*see box*).

SUBAIH'S VIEW

Looking beyond the election, progress on economic reforms will not be plain sailing – as Ibrahim's departure showed. **Adel Al-Subaih** – the respected independent Islamist who held a string of social and economic cabinet portfolios, including oil, before quitting for the relative peace of a private sector business job last year – believes progress is possible, but progress will depend on the government's capacity to show leadership.

"The private sector is well ahead of the government – and the government is a little bit ahead of the Parliament," Subaih told *GSN*. The Kuwaiti public sees privatisation simply as the selling off of national assets, he observed – and MPs tend to follow this public mood, rather than explaining how privatisation could be used to help develop the quality of utility provision.

Subaih argued that the government needed to develop a vision for economic development and reform and then go out and win

over opinion in parliament through active political campaigning. "The government – I was part of it at one time – would go to parliament without preparing our position properly, without our lobbying, without presenting our position in the national media."

Votes can be won, Subaih believes. The Assembly has 50 elected seats, plus up to 16 ministers who sit as of right. So to win a vote, the government only needs to win over about one-third of the elected MPs; opponents of reform cannot block change unless they can muster 30-32 votes.

Subaih noted that as health minister he prepared a much-needed health insurance scheme. This was not popular, but he prepared detailed arguments, lobbied MPs and appealed to public opinion directly through the media; eventually, he persuaded Parliament to pass the necessary legislation.

A QUESTION OF EMPLOYMENT

Official strategists believe that it will be possible to mobilise sufficient parliamentary support for key changes because of the need to stimulate private sector employment for Kuwaitis, particularly young men.

Some 94% of Kuwaiti workers have public sector jobs and the government still tends to placate political pressure from populist and tribal MPs by creating further public sector posts. But this cannot continue if Kuwait is to avoid sliding into Saudi-style persistent deficits

and payment pressures in state departments and agencies.

The concentration of locals in public sector positions leaves the private sector massively dependent on foreign workers, maintaining the population imbalance.

These issues have already been implicitly recognised through the introduction of two key measures introduced last year – a *Manpower Law*, which introduced new penalty and quota rules to nudge private sector employers into taking on more locals, and a new system of unemployment benefits.

Between 10,000 and 15,000 Kuwaitis have registered to claim the benefit. A proportion of these are married women who want to work, but are not under immediate pressure to get a full-time post; others are well-qualified men and women seeking a job suited to their skills and taking their time until the right opportunity comes up. The government's big worry is the pool of 7,000-8,000 high school drop-outs who have applied for benefit; many of these lack appropriate skills or motivation. They will come under pressure eventually, because benefit recipients must be able to show they are seriously looking for work.

There are some 3,000 attractive private sector job vacancies that Kuwaitis could take up, but these require particular skills.

Planners recognise that much more detailed research is needed on the employment market's structure. But they believe that while

"Kuwaitisation" of existing posts has a big role to play, the real key to long-term stimulation of employment is the diversification of private sector business.

They see scope for Kuwait first to become a more lively and competitive domestic market where companies can prove themselves and develop expertise before exploring new opportunities abroad.

MOBILE EXPANSION

The mobile phone sector is seen as a model. In rivalling each other, *Mobile Telecommunications Company (MTC)* and *Wataniya Telecom* developed competitively-priced and efficient services within Kuwait and are now looking abroad.

Wataniya and MTC have been buying up assets from overstretched Egyptian company *Orascom Telecom Holdings (OTH)*. MTC paid \$423.9m for OTH's 91.6% equity interest in *Jordan Mobile Telephone Services Company (Fastlink)*. In Tunisia, Wataniya bought a 50% stake in *Orascom Telecom Tunisie (OTT)*.

Some observers might draw parallels with Dubai, but Kuwait reform planners see their strategy as fundamentally different.

Kuwait has a national population of 900,000 and an emerging problem of local unemployment. Like Saudi Arabia, but on a smaller scale, it needs jobs for its native population.

Unlike Dubai, it has plenty of oil and huge accumulated capital assets. It is not under pressure to attract massive inflows of foreign investment and labour to succeed.

The aim, therefore, is to create a liberalised and more dynamic economy, but one that is largely financed and staffed by Kuwaitis.

UAE: RAK British University Plan

A site has been chosen for the planned *Ras Al-Khaimah British University*. It will be located near the Bin Majed Resort Hotel in RAK's Al-Jazeera Al-Hamrah district.

The location was chosen especially because of its access for students from the other Northern Emirates, who will be targeted along with students from Ras Al-Khaimah itself and other GCC countries.

The university plan was announced by RAK's Crown Prince and Deputy Ruler *Sheikh Khalid Bin Saqr Al-Qasimi* in January. More studies are now expected.

Kuwait's Regulation Agenda

According to planners canvassed by *GSN*, the upcoming reform agenda is as follows:

- **TRANSPORT** – Competition has already been introduced in bus services, and new changes will come first in the government's schedule; four months ago the government promised to come up with a new regulatory system 'within four months'.

- **TELECOMS** – Regulatory change will come next to this sector. Kuwait already has two successful mobile phone companies, *MTC* and *Wataniya*, and the authorities are now inviting bids from consultants to design the new regulatory structure.

- **POWER** – The introduction of radical change in the power sector will take longer. This is not due to regulatory problems but because the necessary infrastructure has not yet been built. Some small

privatisations could happen soon, and plans for a first build-operate-transfer (BOT) concession can also be made. But the major change and potential cost saving will only come with the introduction of gas-fired generation, which should be 40% cheaper than fuel oil. This will inject a powerful new competitive pricing edge into what should, by that stage, already have become a liberalised power market.

Progress in securing gas supplies depends on *Kuwait Petroleum Company's* purchase negotiations with *Iran* and *Qatar* – and on securing *Saudi Arabia's* approval for the import pipeline from Qatar's North Field, which will have to pass through its waters. An early green light from Riyadh is not yet assured (*GSN 703/15*). Once all the project details are settled, it will take six years to design and build the scheme.

- **FINANCIAL REGULATION** – A new structure is needed for Islamic banks (*see below*).

GSN Risk Grade – B+/2: War jitters but oil output, real estate plays should weather storms

Political And Social Development

Overview: Although the authorities would privately be happy to see a Saddam-free Iraq – provided a unitary, Arab-led state remained – most in the UAE would prefer inaction to war. The UAE is expected to be at the forefront of any post-Saddam Iraq debate, stressing humanitarian issues and promoting its virtues as a business base. The Emirates are regarded as an oasis of stability but Dubai has had trouble losing its darker reputation.

Crime: The UAE has worked hard since the 11 September 2001 attacks to combat terrorist financing and remain attractive to investors, with some considerable success. However, the main commercial hub Dubai – and to a lesser extent smaller emirates like Sharjah and Ajman – continue to attract an underworld of radical Islamist cells, Gulf smugglers and Indian mafia dons. The 'revenge' killing in January of hotelier Sharad Shetty, an associate of the infamous Darwood Ibrahim, highlighted the problem. Dubai has undertaken a big crackdown, with the arrest of 110 suspected members of Ibrahim's D-Company; but how many will face charges is uncertain. The Indian press complains these men enjoy a degree of local protection.

Social forces: Official concern is growing at the size of the expatriate population. Emiratisation programmes are in place to boost the entry of UAE nationals into the private sector, while a four-month amnesty for illegal immigrants is under way (ending in April). There has been no major anti-American protest at the prospects of war with Iraq. Women were not, as expected, appointed to the 40-member Federal National Council. Despite promising noises from UAE President Sheikh Zayed Bin Sultan Al-Nahayan's influential wife Sheikhha Fatima Bint Mubarak, several Emirs delayed the move.

External factors: A GCC Peninsula Shield force is being sent to help defend Kuwait in the event of war; UAE is contributing Apache helicopters. The UAE will quietly back a UN-led war but wants to see more time for weapons inspections – as urged by Abu Dhabi's close ally, France – and will continue to lobby the USA behind the scenes about the urgency of tackling the Palestinian situation. Sheikh Zayed has ratified the UAE's border agreement with Oman and implementation is expected soon. Diplomatic tension with Iran over disputed islands has not impacted on a growing commercial relationship.

Economic Outlook

Overview: The UAE can pump 2.138m b/d under revised OPEC quotas introduced on 1 February – a 131,000 b/d increase. With Saudi Arabia, the UAE is considered the only OPEC member with sufficient spare capacity should output levels be affected during a war with Iraq. Real growth rates were around 2.5% in 2002. Real GDP growth for 2003 has been forecast at 2.8-3.1%. The IMF has cited increasing non-oil revenues as the principal driver for real economic growth. Big ticket projects are pressing ahead despite regional instability, many underwritten by Abu Dhabi's huge oil wealth. Unemployment remains low with expatriates taking most jobs. Inflation is around 1.5%.

Finance: A sustained period of high oil prices has boosted public coffers. The very discrete Abu Dhabi Investment Authority (Adia) is a global scale investor. Abu Dhabi accounts for the majority of the UAE's oil revenue earnings and underwrites Dubai and the other emirates during periods of stress. The Dubai government's planned Dh1.5bn (\$408m) five-year bond issue to finance the IMF/World Bank Annual Meetings in September has been delayed and is now expected February/March. Foreign banks operate in an over-banked financial sector. UAE banks earned net profits of Dh5.795bn in 2002, 18.25% up on 2001; the combined capitalisation of the Abu Dhabi and Dubai bourses was Dh119bn at end-2002.

Privatisation: The programme has been limited, beyond IWPPs promoted by Abu Dhabi. Telecoms company Etisalat is traded on the stock exchange, but is still majority state-owned. The Zado oil firm may be part privatised, as might Abu Dhabi's electricity transmission system.

Investment: The UAE is a WTO member. Foreign investors can hold 100% of companies in the free zones and 49% elsewhere. The Ministry of Economy and Commerce has drafted a foreign direct investment law that would allow investors to transfer income from the sale of projects in the UAE. An offset programme is run by the powerful UAE Offsets Group; all foreign defence contractors must invest in it. The GCC Customs Union became effective on 1 January; standard duty on goods and commodities entering the UAE from outside the GCC has been increased to 5% from 4%.

UAE: Key Projects

POWER PROJECTS: Abu Dhabi's \$1.6bn 1,500MW Shuweihat S1 power and desalination project to start 2004 (US' CMS Energy and UK's International Power have a 20-year O&M deal); \$1.5bn Al-Taweelah A1 power and water plant (TotalFinaElf and Tractebel developing); Umm Al-Nar IWPP near Abu Dhabi City (private developer will take 40%, award expected April); Dubai-based 700MW Jebel Ali L power and 70m gallons per day desal plant (meetings with bidders concluded, awards expected March following final report by consultant Lahmeyer International; due onstream 2005); phase two work on Fujairah's Qidfa power/desal project expected 2003.

DOLPHIN ENERGY: \$3.5bn project to send Qatari gas to the UAE is progressing. Partners are Occidental (which replaced Enron), TotalFinaElf and UAE Offsets Group. Omani gas from Q4 03 will be used to supply a Fujairah power plant until Qatari gas project comes onstream in 2006.

AJMAN INTEGRATED WASTEWATER PROJECT: \$140m project financing recently closed for the \$450m project, including a \$77.5m 14-year club loan.

DUBAL: Dubai Aluminium Company funding Kestrel expansion project with \$200m term loan from Citibank and \$150m loan from Standard Chartered Bank. Works include a fifth potline and additional power.

GCC GRID: Electricité de France was awarded a consultancy contract for phase II work (UAE-Oman link) in January. Completion of link expected 2005/06.

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.

UAE: Selected Economic Indicators

	1998	1999	2000	2001	2002f
GDP growth (%)	-6.2	10.1	20.4	-4.0	3.5
GDP per capita (\$)	16,991	17,668	20,300	19,945	19,600
Population (million)	2.78	2.94	3.25	3.39	3.50
Exports/re-exports (\$ bn)	30.4	35.1	43.3	38.5	40.0
Imports (\$ bn)	28.9	30.8	32.0	33.5	35.4
Trade balance (\$ bn)	1.5	4.3	11.3	5.0	4.6
Oil production (million bpd)	2.3	2.1	2.3	2.1	2.2
Crude oil exports	34.6	45.4	70.1	56.0	56.0

f = Forecast.

Source: Central Bank of UAE, Local authorities, Ministry of Planning.

GSN Risk Grade — D/3: Saleh struggles to contain internal divisions, poor investment outlook

Political and Social development

Overview: The domestic political situation remains turbulent in the run-up to planned April parliamentary elections – highlighted by the killing of Yemeni Socialist Party Deputy Secretary Jarallah Omar. Power is concentrated firmly in the hands of President Ali Abdallah Saleh, while Prime Minister Abdelqader Abdelrahman Bagammal fronts the reform programme and ensures southern interests are represented. The government must be careful how it presents its co-operation with the USA. Al-Qaeda cells and other radical Islamists have found sympathy in tribal groups.

Government: The political arena remains turbulent ahead of parliamentary elections. The Jarallah Omar shooting came at a conference of the Islamist party Al-Islah – not the secularist Omar's natural allies, but a potential ally as Yemeni politicians realign in the wake of the latest regional crisis. The authorities blamed the shooting on radical Islamists linked to Al-Qaeda but there is some scepticism among public opinion, with some accusing elements of Saleh's General Peoples' Congress (GPC). Omar's presence at Al-Islah's conference along with a number of other leftist and nationalist figures suggested a short-term opposition realignment ahead of the elections – but the ruling GPC is unlikely to be threatened.

Security: Concerns persist including tribal violence and general lawlessness. Three US nationals working at the Baptist Hospital in Jableh were killed in December, prompting another visit from US Federal Bureau of Investigation anti-terrorism agents. The USA has provided significant funds and expertise for security issues; in November, a US CIA predator drone killed alleged Al-Qaeda commander Qaed Sinan Al-Harithi. Co-operation with the USA is passionately disliked by many.

External factors: Saleh's readiness to act against "terrorism" has earned Western support, despite the late 2002 North Korean Scud missile shipment incident. Relations with Saudi Arabia have improved and Yemen has joined some secondary Gulf Co-operation Council consultation groups as a prelude to full membership. Saleh wants a political solution to the Israel/Palestine situation and has spoken against war with Iraq and the dangers of regime change. Saddam Hussein is an old ally.

Economic Outlook

Overview: Despite problems of political instability and poverty, Yemen has a creditable payments record, a low debt service ratio and has used its oil revenues carefully. Terrorism is impacting on the economy, with tighter money transfer systems reducing remittances from Yemenis abroad by up to a half, a reduction in container traffic through Aden Port and the delay of key industrial and tourism projects. World Bank estimates suggest that 42% of the population is living under the poverty line. Unemployment is estimated at over 25% and a downward trend for oil output is not good news.

Development: A *Poverty Reduction Strategy Paper* for 2003-05 underlines the need for structural and governance reforms. Reforms to the civil service, judiciary and tax system and customs are planned. YR293.6bn has been allocated for development and service projects in 2003, of which YR106.9bn is expected to come from foreign sources. The IMF, World Bank and other donors pledged \$2.3bn over three years in October. Yemen's General Investment Authority approved 382 investment projects totalling YR104.6bn in 2002. Rural programmes are crucial to reducing widespread deprivation. The fragile state of water resources is a serious constraint.

Budget: Parliament approved the 2003 budget in January. Based on a \$21/bbl oil price, it envisages a YR64.1bn deficit, with spending of YR668.4bn and revenues of YR604.3bn (YR207.4bn oil export revenues). The government anticipates real GDP growth of 3.2% for 2003. Yemen's latest IMF Article IV assessment pressed for budget reform, reduced energy subsidies, a clearer public spending focus, poverty reduction and efforts to cut the non-oil deficit.

Oil: The government remains bullish about oil output (forecast at 448,000 b/d for 2002) despite a World Bank study's claim that output is set to decline to 198,000 b/d output forecast for 2008. Oil exploration has increased since production sharing agreement terms were made more favourable. The clarification of Yemen's border with Saudi Arabia has opened potentially attractive exploration zones along the fringes of the Rub Al-Khali (Empty Quarter). The government says 130 offshore oil wells are planned for drilling in 2003 with total output targeted at 555,000 b/d.

THE LIMBURG EFFECT: The cost of the Limburg environmental clean-up was estimated at \$31m, but its wider impact was greater still. The government estimates a \$15m a month loss due to the attack's affect on shipping, and is reportedly ready to offer shipping companies guarantees of up to \$150m against acts of terrorism in Yemeni waters. Canada's Nexen has increased security at its Mina Al-Dhaba oil terminal.

Yemen: Selected Economic Indicators

	1999	2000	2001e	2002p
Real GDP growth (%)	3.7	5.1	3.3	4.1
Real non-oil GDP	2.9	4.7	4.0	5.0
Consumer price inflation (%)	8.0	10.9	11.9	15.8
Yemeni crude price (\$/b)	18.7	28.2	23.0	23.1
Public revenue and grants*	29.8	41.7	38.5	36.2
Public expenditure*	30.0	33.2	35.7	35.7
Public finance balance*	-0.2	8.5	2.8	0.4
Current account*	2.8	14.1	6.8	4.0
External public debt*	—	54	56	54
Reserves (months of imports)*	6.0	12.3	14.8	15.1

e = estimate p = projection*percentage of GDP

Sources: IMF, Yemeni authorities

Yemen: Key Projects

ADEN PORT: Managed by 49% shareholder Port of Singapore Authority, Aden's \$580m container terminal and transshipment hub competes against Oman's Salalah and the UAE's Khor Fakkan and Fujairah ports as a regional gateway for East Africa and the Gulf, avoiding the Straits of Hormuz. Container throughput reached 380,000teu in 2001. The World Bank is backing a three-phase \$96m development programme to develop business and infrastructure in Aden, Hodeidah and Mukalla.

HYDROCARBONS: Established operators include Nexen and TransGlobe Energy Corporation (both Canada), Occidental and Hunt Oil (USA). UK-based Capital Oil & Gas signed E&P agreements for blocks 37 and 39 in January. TotalFinaElf has a long-planned LNG project, but risk mitigation questions persist, even if markets are found. The government plans a \$280m Hadramaut refinery.

POWER: Delma is to develop a \$300m 400MW gas/diesel independent power plant near Marib. A feedstock announcement is awaited. A \$400m IPP between Aden and Mukalla is under study. Contract awards are also awaited for projects including the 60MW Sanaa South and 60MW Aden al-Arish power plants.

SANAA INTERNATIONAL AIRPORT: Turkey's Eko Construction & Trade Company and local Hawk International are undertaking a \$7m runway extension and other work. A new terminal building is expected.

BAHRAIN: Bond Splits Assembly

Bahrain's appointed Upper House rubber-stamped the government's \$500m spending plan as expected on 17 February, precipitating a likely special sitting of both chambers of Parliament to obtain final approval after the lower House of Deputies' narrow rejection of the spending plan on 4 February.

This held up the \$500m bond programme signed with *BNP Paribas*, *Salomon Brothers International* and *Salomon Smith Barney* (*GSN 703/1*) – and the government will need the support of two-thirds of both chambers if it is to get the three-pronged spending plan passed unscathed.

According to *GSN's* soundings, it is likely to get its way. However, the House of Deputies' action has laid down a marker for future relations between legislature and executive.

The lower house's unexpected display of teeth indicates legislators are intent on playing a key role in shaping macro policy, which is unlikely to be well received by Manama's established economic policy-making institutions. MPs' main gripe was that they were not informed well in advance of the decision to approach the market with a \$500m Eurobond. Many had wanted to raise funds from the burgeoning Islamic market.

They were also unimpressed by the lack of detail on the spending programme, which is to finance *Aluminium Bahrain (Alba)*'s plant expansion and the *Bahrain Petroleum Company (Bapco)* refinery upgrade, as well as the building of a tourist resort at Bandar Al-Seef and the much-vaunted Formula 1 race track.

Sources in Manama said MPs also questioned why the \$150m-200m Formula 1 race track was included in the spending programme when the government had already signed the deal and track construction was under way. According to a member of the Shia opposition *Al-Wefaq National Islamic Society*, Parliament was wasting its time "debating issues that are beyond their control".

The government was expected to conduct an intensive lobbying of House of Deputies members to

ensure the programme's safe passage. The Sunni Islamist-dominated chamber may be persuaded to back the plan with government promises to use Islamic instruments for future financings.

The five-year Eurobond received a strong reception on its 24 January launch, with pricing at the lower end of government bond yields. The spread of investors confounded expectations that Gulf subscribers would snap up most of the paper – some 49% of the investors came from outside the region.

UAE: Dubai's Emaar Reports Profits Surge

Bellweather of the new Dubai economy, Emaar Properties has announced a big increase in its revenues – up 63% to Dh.1.334bn in 2002, with profits 51% higher at Dh517m – and plans for a foreign listing, probably on the *London Stock Exchange (LSE)*. Emaar is proposing a 10% dividend, equivalent to Dh1 per share.

An LSE listing would mark Emaar's emergence as an international player, but is also a recognition by Chairman *Mohammed Ali Alabbar* – a key ally of Dubai's Crown Prince *Sheikh Mohammed Bin Rashid Al-Makhtoum*, whose family retains a big holding – that the *Dubai Financial Market (DFM)* cannot meet major local corporates' needs.

Alabbar told brokers the LSE option was now open, especially as Emaar was following implemented International Accounting Standards and Practices. He also suggested that Emaar might sell a 6% stake – acquired in last year's buy-back programme – to GCC investors.

Alabbar said earnings per share reached Dh2.03 in 2002, compared to Dh1.29 in 2001. He forecast 25% growth in net profits for 2003.

The results suggest the Emaar magic is working, especially in the UK market where the Dubai product is well established. Investors in Alabbar's most audacious development yet, The Palm, include England soccer captain *David Beckham*, his wife *Victoria 'Posh Spice'* and British TV personalities such as *Grant Bovey* and *Anthea Turner*. These investors must pay a minimum 30% downpayment but may then borrow from Emaar's *Amlak Finance* mortgage subsidiary or (like Bovey) from other Dubai banks.

Kuwait's Islamic Banks Wait On Regulatory Structures

Central Bank of Kuwait Governor *Sheikh Salem Abdelaziz Al-Sabah* will approve licences for Islamic finance institutions – and four or five are likely to secure approval in the first stage – but the authorities have still to design a regulatory structure before this can go ahead.

In this process they are anxious to maintain the standing of Kuwait's financial sector as one that is well capitalised and carefully managed – the disastrous Souk Al-Manakh secondary market collapse of the early 1980s taught an enduring lesson. Officials believe the new Islamic system must have clear and transparent rules governed by regulators with real authority.

This fits with the international drive for improved regulation. In one indication of the mood, controls on hotels cashing travellers cheques have already been tightened.

Gulf Currency Box

	\$	£	€	¥ (x 100)
Bahrain	0.3770	0.6013	0.4050	0.3175
Iran	7981.0	12,728.9	8672.4	6721.13
Iraq	0.3110	0.4960	0.3341	0.2619
Jordan	0.7095	1.1316	0.7621	0.5975
Kuwait	0.2998	0.4781	0.3220	0.2524
Oman	0.3851	0.6141	0.4136	0.3243
Qatar	3.6410	5.8071	3.9108	3.0662
Saudi Arabia	3.7501	5.9811	4.0280	3.1581
Syria	46.000	73.3654	49.4086	38.7385
UAE	3.6729	5.8579	3.9451	3.0931
Yemen	177.890	283.717	191.072	149.808

Source: *Financial Times*.

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USA Avoids Confrontation Over Qatar's Closet Islamists

DOHA/WASHINGTON—Mindful of the need to maintain good working relations during the Gulf troop build-up, the USA has leapt to Qatar's defence following *The New York Times* report linking a member of the ruling Al-Thani family with the operations of senior *Al-Qaeda* operative **Abu Musab Al-Zarqawi**, the alleged toxins expert and leading terrorist organiser cited by the **Bush** Administration as providing a link between **Iraq** and *Al-Qaeda* (*GSN 702/3*).

Quoting "intelligence officials", the *NYT* alleged that **Abdul Karim Al-Thani** – a low-profile member of the ruling family who does not hold public office – provided Zarqawi with Qatari passports, more than \$1m via a special bank account, and a safe house for use on trips between **Afghanistan** and Qatar. US State Department Spokesman **Richard Boucher** dismissed the allegations. "We have never seen any credible information to corroborate them". Boucher added that Qatari support in the campaign against international terrorism and terrorism financing had been "outstanding".

Gulf sources have suggested the report was simply "overblown". Abdul Karim Al-Thani is described as "very religious", and has long been a charitable supporter of militant causes. He was unaware that he may have been contributing to terrorist operations, friends in Doha said.

The pattern of allegation and rebuttal fits the Islamist financing debate since 11 September 2001. **Saudi** charitable funders who have been accused by the USA of financing groups linked to *Al-Qaeda* have usually denied the charge claiming ignorance of the eventual end-user; these charges will be tested if and when the appeals of **Yassin Abdallah Al-Qadi** and some other leading blacklisted Saudis come to court. Qatar-based charities and donors have been much less prominent in this process, but there have been sporadic reports that hardline local Wahhabis provide backing for a range of underground groups; **Russian** intelligence has claimed that senior Chechen opponent **Zelimkhan**

Yandarbiev is in Doha (*GSN 700/5*). Saudi intelligence officials have alleged that Qatar provided a safe haven in late 2001 for the **Kuwait-born Khalid Sheikh Mohammed**, now seen as the key *Al-Qaeda* planner of the 9/11 attacks and more recent incidents (*GSN 698/3*). Conservative Qataris were also rumoured to have provided shelter to the fleeing *Taliban* consul to **Abu Dhabi** and his family.

Qatar does not have a problem with radical Islamists of the sort that has led to violent, public anti-American feelings in Kuwait and **Bahrain**. Qatar-based scholar **Youssef Al-Qaradawi** – Qatar's in-house Islamic *enfant terrible*, who is well-known to the wider Arab audience via *Al-Jazeera Satellite Channel* – recently courted controversy by being seen to condone the killing of US forces stationed in Arab countries in an interview with *Al-Quds Press Agency*. "Those defending against attempts to control Islamic countries have the intention of Jihad and bear a spirit of the defence of their homeland," he said. In carefully guarded remarks, Qaradawi steered clear of referring directly to the US presence in Qatar and stressed the difference between targeting military personnel and civilians. "The issue is not with the Americans who are peace-loving, but with their arrogant government". A majority of Arabs would agree with these views, which Western media lapped up.

Qatari officials have remained quiet, preferring to deal with such matters out of the public gaze. Although Qatari imams officially have "total freedom" of expression, the state security apparatus keeps a close watch on conservative elements and there are unofficial but recognised limits to free speech – as conservative academic **Abdelrahman Al-Nuaimi** found when he was detained without trial for three years (1998-2001) for criticising Emir **Sheikh Hamad Bin Khalifa Al-Thani's** reforms. Sheikh Hamad is not so secure he can ignore Wahhabi and conservative opinion – but if push comes to shove his security forces will move to contain any threat.

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