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GSN

Companies & People

Middle East Energy

Saudi Arabia's Crown Prince Abdallah is preparing to revive the momentum towards energy liberalisation, whether or not Oil Minister **Ali Al-Naimi** steps down this summer. Naimi has been sceptical about the major role envisaged for international oil companies in the \$25bn Gas Initiatives Project. Delays to this have held up associated projects.

Analysis of these developments is published in **Cross-border Information's Middle East Energy** monthly, copies of which will be sent to GSN subscribers with this issue.

Also in **MEE**, the first commercial financing for a world scale gas-to-liquids (GTL) venture in **Qatar** has attracted bank support. With their large gas reserves, **Iran, Saudi Arabia** and **Abu Dhabi** could also explore GTL as they chase the holy grail of adding value to their natural resources.

Meanwhile in the Caspian, the **USA** has relaxed its diplomatic pressure to build politically motivated pipelines. Business imperatives are fuelling the development of new export pipeline routes, particularly through **Russia** and **Turkey**. In this more commercial environment, **Afghanistan** and its neighbours seem less attractive.

Across The Region

Al-Qaeda kingpin Khaled Sheikh Mohammed may be under arrest, but the *jihād* continues, and intelligence sources suggest that suicide bombings and other assaults on Western and ruling family targets could follow in coming weeks. GSN examines the current extent of the security threat and finds that expatriates are indeed the weakest link.

POLITICS AND SECURITY, PAGE 7

Keypoint defence has been put in place in Saudi Arabia, following intelligence successes that uncovered sabotage plans within Saudi Aramco.

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"Old Europe's" opposition to the war in Iraq has made an unlikely hero of French President Jacques Chirac, although a US-led war with Iraq will probably happen anyway. After Saddam, the international state order could be profoundly changed. France could be a very influential player, but it will need a new working relationship with the USA.

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The USA and UK have lodged more protests about sales of potential dual use goods to Iraq from France than any other country. GSN has seen documents listing the contracts.

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New UN data on French and German contracts for Iraq, on hold and approved. GSN lists some of the major contracts.

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There is still a significant pro-Iraq lobby in France, although it has lost influence in recent years.

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A major purge in the US National Security Council has allowed the hawkish, pro-Israeli Elliott Abrams to recast the NSC's regional team in his image.

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Kuwaitis are gossiping about shifts in the ruling Al-Sabah pecking order ahead of a succession race.

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Constitutional change inched forward with a secret ballot for a new Federal National Council speaker, but overshadowing the election of Dubai businessman Saeed Al-Ghandi was the failure of UAE rulers to appoint women FNC members.

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New questions about Oman Air. PAGE 13

The IFC has signed a guarantee for Saudi Arabia's first corporate bond. PAGE 18

GSN's Analysis

The war has not yet started, but the question must be asked: after Iraq, is Iran to be the next target for disarmament and regime change imposed by Washington? With conservative hardliners winning political victories in both capitals, huge efforts will be needed to stop Iran becoming a next big crisis, especially as proxy wars could break out again in the Middle East.

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A near future clash between the USA and Iran is not inevitable, but Tehran's status within the US Administration as top state sponsor of terrorism and its candid espousal of nuclear development will take some managing. GSN examines the potential flashpoints in an important and complex relationship.

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Concerns over regional and domestic crises have persuaded GSN to downgrade Iran's political Risk Grade to D. Its payments Risk looks better though.

RISK MANAGEMENT REPORT, PAGE 17

Bahrain's politics are volatile by GCC standards, but financiers continue to absorb risk. GSN keeps its C+ political Risk Grade and could even upgrade its payments risk grade in coming months.

RISK MANAGEMENT REPORT, PAGE 16

Kuwaitis are preparing for régime change in Iraq and the chance to begin rebuilding normal ties with their northern neighbour. Planners have been dusting off proposals for a reinvigorated northern Gulf region, and discussed the prospects with GSN.

CENTREPIECE, PAGE 10

Iran is looking for foreign investment to help it leap into the cellular phone big league from being the region's laggard. A new GSM tender is in the works.

BUSINESS TRENDS, PAGE 12

Oman's gas-based industrial projects will provide lucrative advisory work for international banks this year.

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Two of Saudi Arabia's big banks suffered steep declines in profits due to falling interest rates, tough global conditions and increased loan loss provisions.

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GSN looks at Saudi influence in Lebanon, where Prince Alwaleed and Rafiq Hariri continue to slug it out.

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Ten years ago Russia was exploring new arms markets.

PERSPECTIVE, PAGE 20

The war has not yet started, but the question must be asked: after Iraq, is Iran to be the next target for a disarmament offensive and potential regime change, imposed from Washington?

There have been few positive developments in US/Iranian relations since President George W. Bush's January 2002 "Axis of Evil" speech – an outcome that can be traced to both sides' determined pursuit of their own geo-strategic interests, as much as any number of missed diplomatic opportunities. Even discounting the scarcity of cool heads in Tehran and Washington, it is hardly surprising that relations are tense: they encapsulate a hegemonic struggle between regional and global powers.

For the Bush Administration, Tehran represents a threat in terms of the fundamental prohibitions laid down by the USA after the 11 September 2001 attacks: that nations would be considered a threat if they sponsored "terrorism" or developed ballistic missiles and weapons of mass destruction (WMD).

Control over sub-state factions has been a key strategic lever for Iran. It will cause friction with an increasingly pro-Israeli – and imminently pro-Iraqi – USA. The coming war with Iraq could see the USA's close ally Israel moving not against President Saddam Hussein, but against Hizbollah in southern Lebanon, while smiting Hamas and other Islamist groups in the Palestinian areas. All the signs are that Washington will support this, even though Israeli Prime Minister Ariel Sharon's move will further antagonise Arab and Iranian opinion.

Meanwhile, Iran – like the similarly self-reliant Israel – has made it clear that it views some degree of international isolation as a necessary cost in its pursuit of a WMD deterrent force. Given the US resolve to tackle WMD, this should place Iran directly in the way of the US's neo-conservative policy juggernaut.

These are dangerous times. The WMD debate could well upset the best laid plans of those who could potentially

bridge differences between Tehran and Washington, such as UK Prime Minister Tony Blair, whose policy of constructive engagement now seems holed below the waterline (*GSN 702/2*).

Iran needs support where it can find it to help reduce tensions, including from new friends in Saudi Arabia and the UAE – whose President Sheikh Zayed Bin Sultan Al-Nahayan has once again shown his ageless leadership qualities in leading the inter-Arab debate over Iraq towards into controversial waters over the question of Saddam's possible exile; these waters must be navigated by over-cautious Arab politicians.

Numerous factors make it difficult for Tehran and Washington to accurately gauge each other's intentions. Escalating wars of words feed the predispositions of skeptical conservatives on either side; mutual suspicion remains the overriding sentiment. This kind of distortion is particularly harmful over the divisive issue of whether Iran is decreasing or increasing its support of terrorist groups. The latest, 2001 edition of the US State Department's *Patterns of Global Terrorism* continues to identify Iran as the top state sponsor of terrorism. This status was not a reflection of firm data linking Iran to 9/11 or other Al-Qaeda activities; it is rather a long-standing reflection of its support for Lebanese Hizbollah, its dalliance with other regional Hizbollah and Shiite groups, its security services' part in murdering dissidents overseas, and its liaisons with Palestinian rejectionist groups.

In the conflicts to come, Iranian support of proxies in Iraq and Lebanon (as in Afghanistan) is likely to cause a further hardening of US attitudes. That Israel's special forces, who have spent a lot of time in the banana groves of southern Lebanon, have never captured a single Iranian liaison officer, or a single image of missiles now alleged to be threatening regional peace could be immaterial. With conservative hardliners winning recent political victories in both capitals, huge efforts will be needed to stop Iran becoming a next big crisis.

Perspective: Ten Years Ago

When it comes to arms and armaments, if you have the demand we have the supply, the Republic of Russia is saying to the world at large and the countries of the Gulf region in particular. With the latest technology, no political strings attached, rock-bottom prices, quick delivery and no quantitative restrictions, Russia and other cash-strapped republics of the former Soviet Union are making a determined push into the lucrative Gulf arms market, fuelling an already accelerating arms race between Iran and Arab countries.

During the Cold War, except for Iraq the Gulf region was almost exclusively the preserve of the USA and European arms manufacturers. But there are signs that this is rapidly changing, with the Russians hawking

warplanes, missiles, warships, and arms at extremely low prices and with attractive political and financial arrangements. The terms are tempting to Gulf Arab customers.

In recent years the Russians have lost major arms clients in the Middle East. United Nations' embargoes have closed Iraq and Libya to the arms dealers from Moscow. Syria, another of Russia's key Arab customers, has switched to China and North Korea for its arms. However, the ending of the Cold War has effectively lifted the political constraints that once curtailed Eastern bloc arms sales to the politically Western-oriented Gulf states.

GSN, Vol. 18, No. 456, 8 March 1993

Chirac Of Iraq Revives France As A Middle East Power, At Least Until The Bombs Drop

Russia's threat to veto any *United Nations Security Council* approval of military action against Iraq – hinted at by Foreign Minister **Igor Ivanov** in London this week and made explicit when he crossed the Channel to meet his French and German counterparts – piled fresh pressure on UK Prime Minister **Tony Blair**, but could serve as a confirmation by the USA that its war on Iraq must start without a second resolution. For France, on the other hand, it was a signal that the diplomatic tide was turning in its favour.

“Old Europe’s” opposition to the war, now also apparently joined by **China**, has gathered huge momentum in recent weeks (*GSN 704/2; 702/3*). It has made an unlikely hero of French President Jacques Chirac – a seasoned populist politician who only last April faced a humiliating run-off in presidential elections against *National Front (FN)* leader **Jean-Marie Le Pen**.

If France is joined by other Permanent Security Council (P5) members and doesn't blink before Chirac has to wield a veto on the UN's endorsement of **Saddam Hussein's** early enforced removal, Paris may have secured a major diplomatic victory. The popular extent of this perception in the Arab world was measured by Chirac's 2-4 March visit to **Algeria**, where Algerians came out en masse to fête an unlikely superstar.

If the second resolution is dropped – which seems likely, heaping more domestic problems still on the UK's Blair – Paris will have outflanked Washington without taking the ultimate step in diplomatic confrontation as a P5 country and wielding its 'no vote'.

However, as Secretary of State **Colin Powell** so eloquently suggested in his 5 March speech, war with Iraq to tackle weapons of mass destruction and effect regime change will happen anyway.

With the Anglo-Saxons and their allies apparently rent apart from “Old Europe”, the ex-communists, the *League of Arab States* and swathes of public opinion, the diplomatic fallout will be huge, even if the French veto stays in Foreign Minister **Dominique de Villepin's** pocket. There is no disguising the depth of the rift with Washington, and the bitterness with which France is regarded in President **George W Bush's** Administration.

Many American commentators – and not a few on the pro-US right in the UK as well – dismissively regard Chirac's actions on Iraq as self-important posturing, designed to bolster France's international clout, especially in the Arab world, and to protect its economic interests in Iraq, where *TotalFinaElf (TFE)* is in line to develop some of the most important oil deposits.

Chirac has gained hugely, riding high in the polls at home while holding some unaccustomed moral high ground. He is undoubtedly keen to defend France's status as a major power and protect its economic ties. But it may be naïve to suggest he has pursued his high-risk support for continued inspections mainly for reasons of national self-interest. Should the USA intervene to overthrow Saddam, TFE could be deprived

of the oil prospects for which it has been lined up.

The goodwill France's policy has engendered in the Arab world will be helpful for its economic interests, and particularly the sales prospects of major arms manufacturers such as *Dassault, Thales* and *GIAT*. But this factor should not be exaggerated: years of close supply relationships and assiduous diplomacy did not prevent France from losing out to the USA when it came to the UAE's last major warplanes purchase (*GSN 696/6*). Nor did it shield *GIAT* from being forced to honour rashly generous terms on its contract to supply *Leclerc* tanks (*GSN 689/1*). Should the French shift ground they could rapidly lose any goodwill bonus earned through hard bargaining over Iraq.

AFTER REGIME CHANGE

If and (as we have long suspected) when the USA carries through a policy of regime change in Iraq, the international state order, as well as countries' bilateral and international relations, will have been profoundly changed. In this changed environment, the USA and France could find themselves fighting out a number of new battles of which Iraq was the precursor.

In this difficult environment, France could be an influential player – even in Iraq, if the USA seeks to wind down its military commitment and hand over stabilisation to the UN, as well as to over-stretched allies like the UK, **Spain** and **Australia**. France has wide experience of peace-keeping operations.

However, if the USA lives up to its talk of a full-scale enduring occupation in partnership only with like-minded states – as Powell, sounding very much a neo-conservative hawk in regretful dove's clothing, implied on 5 March – the French role would probably be marginal, or non-existent.

In dealing with the Iraq issue, the French – like the rest of Europe and the Arab world – have been struggling to come to terms with a US Administration that has adopted a radically new approach to international affairs and does not feel itself bound by the more consensual multilateral approach that characterised White House foreign policy under Presidents **Bill Clinton**, **George HW Bush** senior and even **Ronald Reagan**.

Governments have reacted in varying ways to George W Bush's growing determination to remove Saddam Hussein from power with or without UN support. Even Blair, Bush's closest ally (whose own political philosophy accepts the necessity of regime change in extreme cases), is uneasy at the US determination to pursue their objective by direct action, come what may. Among the P5, only France and now, apparently, Russia seemed determined to take on the Anglo-Saxon world-view.

Many close observers of French policy have assumed that, when it came to the crunch, Chirac would finally “come round” to the idea of supporting military intervention and even contribute a small but symbolically important contingent of troops. In the

Kosovo crisis, the French President infuriated the Americans by repeatedly asking tough questions about the wisdom or legitimacy of particular actions. But he eventually endorsed action in full, and France was the second largest provider of aircraft – after the USA – for the controversial coalition bombing campaign that drove the Serb forces out of Kosovo.

France has been one of the main providers of aircraft for coalition operations in Afghanistan, in strong support of US policy – but unlike Iraq, there was big consensus over the need to strike at the *Taliban* and *Al-Qaeda*.

THE ARGUMENT FOR INSPECTIONS

While a French about-turn on the use of force against Iraq cannot be ruled out altogether, it looks equally possible – indeed quite likely – that Chirac will continue to oppose force. This should not be a surprise. Last autumn, as UN Resolution 1441 mandating the return of weapons inspectors was being finalised, policy-makers in Paris made it crystal clear that inspections had to be credible. A cosmetic exercise would be pointless.

The French believe the UN must be able to show international opinion, particularly in the Arab world and Europe, they are acting in a legitimate manner, fully in accordance with the law. From the outset they have argued that inspections would have to last for a substantial period – eight months was cited by one source – if the process was to be accepted as demonstrably fair and thorough.

Saddam Hussein clearly has the means to hide some weaponry, or chemical and biological substances from even the most painstaking controls – as US National Security Adviser *Condoleezza Rice* has pointed out. But Paris believes this does not remove the need to carry out a careful and lengthy inspection procedure before the court of world public opinion.

The protection of the authority of the UN is a fundamental goal of French policy. But the way this is interpreted is radically different from Washington's approach. The Bush Administration argues that the UN will be rendered "irrelevant" if it is not seen to act to enforce the demands it has made of Saddam Hussein – implicitly, by use of military force.

However, French officials insist that before enforcement takes place, the UN's moral authority and fairness must be demonstrated in the eyes of international and Arab opinion. The UN, they believe, has to set out a clear demand of Iraq, take a reasonable view of how quickly and how far Baghdad is complying over a reasonable period of time – and only then decide what to do. If it is then clear that Iraq has not complied, Saddam Hussein should take the full consequences.

PRESSURES ON CHIRAC

Rarely does an international crisis put so many key national leaders under such acute pressure – and Chirac is no exception, for all that he is surfing on a wave of massive popular support for his stand.

After five years, constrained by cohabitation with *Lionel Jospin's Socialist Party (PS)* government, he has been politically liberated by the crushing victory of his supporters in the *Union for the Presidential Majority (UMP)* in last summer's parliamentary election. Chirac has taken full control of French foreign policy, ably assisted by his flamboyant and media savvy Foreign Minister *de Villepin*, a career diplomat with poetic aspirations who served as secretary-general of the presidency during Chirac's first term.

Public opinion in France is even more strongly opposed to war than it is in most other European countries. Chirac can count on the backing of not only his own supporters but also the left-wing opposition.

This situation imposes its own constraints on his room for manoeuvre. The President has not effectively prepared the ground for any possible shift in favour of using force. Chirac publicly told the French armed forces to be ready for any eventuality – and there seems little doubt that in private the generals have ensured that key units such as the desert-trained Foreign Legion troops based in *Djibouti* have kept themselves up to the mark for combat.

But the official line is that France has made no special preparations for participation in military action. There have been no ostentatious public deployments of extra units to the Gulf, although Paris has longstanding exercise arrangements, notably in *Qatar*, that would probably permit this. The number of troops in Doha for the last round of training was tiny.

In recent days, attention in Paris political circles has focused on whether France should use its Security Council veto. The UMP's centre-right core, grouped around party leader *Alain Juppé* – one of Chirac's closest confidants – and prominent Paris deputy *Pierre Lellouche*, has made little secret of its concern.

It fears that a French veto of any second UN resolution authorising the use of force would deal a further devastating blow to the already much battered bilateral relationship with Washington.

Chirac himself, firmly defensive of his presidential prerogative over foreign policy, is determined that he, as head of state will take the decision. Parliament will not. But he is personally keen to avoid gratuitously angering the USA, if the diplomatic goal of further prolonging the inspections can be achieved – perhaps through the *Canadian* proposal for a continuation of inspections to the end of March.

The USA's difficulties in securing the right to enter northern Iraq from *Turkey* are helpful in prolonging the period before military action can take place.

UNSAVOURY ALLIES

In trying to avoid deploying the veto, Chirac is helped by the balance of opinion within French politics. Supporters of using the veto and overtly defying the USA include not just most of the left, but also the leaders of the right-wing nationalist tradition in French politics.

Among those pressing for outright defiance of the USA in the Security Council are the ultra-conservative *Phillippe de Villiers* of the *Movement for France (MF)* and *Jean-Marie Le Pen's* anti-immigrant FN – an old supporter of Iraqi interests. The FN leader's wife, *Jany Le Pen*, heads an organisation called *SOS Enfants Iraq*; his potential heir, daughter *Martine Le Pen*, is seen as very sympathetic to Baghdad.

These are not players with whom Chirac wants to be associated in public perceptions.

Pro-veto voices also include some firmly right-wing UMP members, such as *Yvelines* deputy *Jacques Myard*, whose good English makes him a favourite pet Gaullist for UK television interviewers.

Another pro-veto UMP deputy is *Thierry Mariani*, who last year earned a furious public rebuke from Chirac's government for accepting an Iraqi invitation to visit the country and see the damage allegedly caused by Western bombing and sanctions. This minor episode – which attracted little notice outside France – points up

the fact that Chirac wants to be seen, above all, as pro-UN rather than pro-Baghdad.

There is also pressure from within the UMP for Chirac to distance himself from Germany's more overtly anti-war stance. For Paris, war is a "last resort", but it is still a possible option.

In securing room to steer a middle course and avoid deploying the veto against an early pro-war resolution, Chirac may be able to present himself as the voice of mainstream moderation, rejecting the knee-jerk "anti-Americanism" of both the old left and the old hard right.

One notable voice – the highly popular **Bernard Kouchner**, a founder of *Médecins Sans Frontières*, a former health minister in the PS government and former international "viceroy" of liberated Kosovo – has spoken out in favour of Saddam's enforced departure. Should Chirac move right over to support the use of force, he will have little political cover, although he could probably count on majority support within the UMP mainstream. Kouchner's approval would be invaluable in helping him to make a dauntingly difficult public case.

THE IRAQ LOBBY

There is still a significant pro-Iraq lobby in France, represented by sympathetic politicians drawn from all traditions and business groups, such as *Franco-Arab Chamber of Commerce* president **Serge Boidevaix's Franco-Iraqi Economic Co-operation Association (Afice)**. **Serge Mathieu** of the *Franco-Iraqi Interparliamentary Group* is among the many to talk up business links.

But the lobby had lost influence well before the present crisis made it likely that the Hussein regime might be removed by force, thus rendering the economic self-interest case irrelevant.

Key players such as former PS minister **Jean-Pierre Chevènement** are no longer active. Gone are the days when Jacques Chirac, in the mid-1970s the late **Georges Pompidou's** young prime minister, courted Iraq's new ruler Saddam Hussein in Baghdad, as France sought to position itself as a major player in the emerging oil producer. However, France remains a major exporter under the Oil-for-food (OFP) programme (see page 13).

State Sponsor Of Terrorism Tag Weighs Heavy On Iran

Fears of a looming conflict in US/Iranian relations hinge on the challenge that Washington sees in the Islamic Republic's continued sponsorship of "terrorism", especially through *Hiszbollah* and *Palestinian* rejectionist groups, and its potential development of ballistic missiles and weapons of mass destruction (WMD) (see page 2).

The coming war with Iraq could see the USA's close ally Israel moving not against Saddam Hussein, but against Hizbollah in southern Lebanon, and Hamas and other Islamist groups in the Palestinian areas. All the signs are that Washington will support this, even though Israeli Prime Minister **Ariel Sharon's** move will further antagonize Arab and Iranian opinion.

In Washington, Iran continues to be identified as the top state sponsor of terrorism, while neo-conservative rhetoric focusing on the failure of President **Mohammad Khatami** and reformist allies to effect change has taken hold, making confrontation, rather than constructive engagement, the key to policy.

This top state sponsor status is not a reflection of firm data linking Iran to 9/11 or other *Al-Qaeda* activities. It is reflects Iran's support for Lebanese Hizbollah and its dalliance with other regional Hizbollah and Shiite groups, its security services' part in murdering dissidents overseas, and its liaisons with Palestinian rejectionist groups – as it was in the 1980s.

Such perceptions were backed up by the Karine A arms shipment, intercepted in January 2002, while a growing case has been made that Iran served as a transit point for *Al-Qaeda* operatives before, during and after the beginning of the war against terror.

This is not saying much, however. It is equally clear that the Iranian government was not fully complicit in this transit or other serious post-9/11 incidents like Karine A. Enquiries were launched at both the Majlis and Supreme National Security Council levels to ascertain the role of government officials in both cases. Although long, Iran's borders are anything but porous these days, with sophisticated anti-smuggling efforts

under way. This hinted at some degree of official complicity in allowing *Al-Qaeda* refugees in.

With the Khatami executive focused on preventing further fiascos, Iran's borders have been considerably tightened – backed by the UK and other European governments. Since 9/11, over 50 major *Al-Qaeda* suspects have effectively been handed over to the USA, via **Pakistan** and **Saudi Arabia**, while key figures such as **Abu Musab Zarqawi**, Kurdish Islamist **Mullah Krekar** and Afghan Islamist **Gulbuddin Hekmatyr** have been denied safe haven.

Yet none of this will relieve Iran of its stigma as a state sponsor of terror while the Bush Administration is in office. Iranian support of proxies in Iraq or Lebanon is likely to cause another hardening of US attitudes.

According to *Department of Defense (DoD)* officials canvassed by *GSN*, the *US National Security Council (NSC)* expects the Shiite *Supreme Council for Islamic Revolution in Iraq (SCIRI)* to fill power vacuums in Iraq. The paramilitary *Badr Corps*, commanded by *Islamic Revolution Guard Corps (IRGC)* Colonel **Hosni Merza Khalil**, is expected to secure a number of border areas in the north and south, linking up with SCIRI cells within Iraq currently under the control of IRGC intelligence liaison **Hassan Abdullah**.

Co-existence with US forces is likely to be tense but broadly amicable, with SCIRI forces playing a role in preventing *Ansar Al-Islam* and other Islamist militants from seeping back into Iran.

THE HIZBOLLAH FACTOR

Iran's historic ties with the Lebanese Hizbollah are likely to be the main sticking point. US neo-conservatives such as **Yossef Bodansky**, the US Congress's Director of the Task Force on Terrorism and Unconventional Warfare, are keen to view Iranian support for the Shiite constituency in Lebanon as an element of broader Iranian policy to create a "Shiite and Allawite belt" from Iran, through Syria and Lebanon to the Mediterranean in the face of growing encirclement.

At its least malign, Iranian involvement in Lebanon is perceived to involve training of Palestinian groups – an impression largely forged because these groups have adopted Hizbollah tactics and *modus operandi*. Neo-cons from the *Jewish Institute for National Security Affairs (JINSA)*, the *Centre for Security Policy* and the *Defense Policy Board (DPB)* have cultivated the belief that Iran is pressing Hizbollah to expand from its Lebanese role to a “regional role”. Most experts argue that this analysis does not hold water.

Under the Bush Administration estimations of Iranian involvement in Lebanon have rolled back to Reagan-era dimensions. Under Bill Clinton, it became accepted wisdom that aside from a few IRGC intelligence officers, the Iranian military presence in the Bekaa Valley had all but disappeared. Influential neo-cons such as DPB chairman **Richard Pearle** now receive a favourable hearing at the Office of the Secretary of Defence (OSD) and NSC, claiming that Iran and Syria have supplied 40km Fajr 3, 72km Fajr 5 and 210km Zelzal surface-to-surface missiles to Hizbollah, complete with IRGC crews.

That Israel's special forces have never captured a single Iranian liaison officer or a single image of these missiles is put down to their installation in underground cave systems. Neo-cons such as Bodansky and the *American Enterprise Institute's* Michael Ledeen are widely believed to source directly from Israeli military intelligence – Washington's fastest growing rumour mill.

THE NUCLEAR THREAT

If Iran's connection to trans-national terrorism, or its horizontal proliferation of missile systems to these groups, is hard to prove, Tehran's determination to build a nuclear deterrent force is becoming evident.

On 10 February, *Iran Atomic Energy Agency* head **Gholamreza Aqazadeh** announced that advances in uranium mining, milling and reprocessing would allow the Islamic Republic to operate a complete fuel cycle in the future, obviating the need for outside assistance. Although *International Atomic Energy Agency* head **Mohammed El Baradei** recently visited Iran, he failed to secure Iranian agreement to the Strengthened Safeguards System, which permit surprise inspections.

These events are likely to bring the full weight of US pressure to bear on Russia after the conclusion of an Iraq conflict, and Moscow will find it difficult to downplay the proliferation risk from providing nuclear assistance to Iran as it cannot claim to have long-term turnkey control over Iran's nuclear fuel requirements or hands-on control of spent fuel reprocessing.

The Bush Administration's NSC team is unlikely to stand by while Iran develops a “closed system” nuclear fuel cycle. The US National Strategy for Combating WMD, released in December 2002, was penned by a team packed with notably pro-Israeli, anti-Iranian hawks: Under-secretary of Defence Douglas Feith, Under-secretary for Arms Control John Bolton, Senior NSC Director for Counter-Proliferation Robert Joseph and Principal Deputy Under-secretary of Defence Stephen Cambone.

Its controversial premise, flying in the face of the spirit of the Non-Proliferation Treaty, is that rogue regimes should not be allowed to own WMD in any circumstances or whilst a window for preventative diplomatic or military counter-proliferation remains open. As US Department of State spokesman **Richard Boucher** noted before Baradei's underwhelming visit to

Iran, “we'll be interested in what he finds out.

There are a lot of things we don't fully know. It's the unknown that we fear in Iran.” Washington's neo-con community has exploited this lack of accurate intelligence on Iranian decision-making, capabilities and intentions for some time.

The State Department remains the government department in which Iranian intentions are afforded the benefit of the doubt. As Deputy Secretary of State **Richard Armitage** stated: “The Axis of Evil was a valid comment, but I would say there's one dramatic difference between Iran and the other two axes of evil, and that would be democracy – you approach a democracy differently. I wouldn't think they were next at all.”

The evidence instead suggests that following an Iraq scenario, the Bush Administration – an administration that never wanted to be judged on its foreign policy – will be loath to enter into another, potentially messier conflict in a nation where the prospect of internally driven regime change still glimmered. As a result, the ships of US and Iranian policy need not be on collision course as long as weary, if not cooler, heads prevail – but it could be a close run thing, especially as proxies start to fight it out in southern Lebanon.

US POLICY: Abrams Wields Neo-Con Knife At NEC

The *National Security Council's* Near East and South-West Asia section recently underwent a major purge, allowing section head **Elliott Abrams** to recast the team in his image. Abrams, described by State Department people as “a neo-con[servative] at birth”, is considered to be “an American *Likudnik*”, who is against the concept of land-for-peace and in lockstep with the policies of Israeli Premier **Ariel Sharon**. Abrams was an assistant secretary of state for human rights in the **Reagan** era, best known for his indictment in 1991 for presenting false testimony to Congress over the **Iran-Contra** scandal in 1987. Although found guilty, Abrams avoided a jail sentence and was awarded a pardon by outgoing President **George HW Bush** on Christmas night 1992.

Abrams' victims were the three NSC staffers most closely aligned with an even-handed treatment of the Israel-Palestine issue. **Ben Miller** and **Flynt Everett** were on loan from the *Central Intelligence Agency (CIA)* and were known to favour a road map and land-for-peace approach to Israel-Palestine issues. Senior director for Middle East affairs Everett, who was appointed the same day as Abrams – and thus without his approval – was reported to be “on long-term leave”. **Hillary Mann**, on loan from the State Department, was the third staffer “rotated” out.

US-Iranian relations can be expected to face severe challenges if Abrams fills the vacancies with like-minded individuals. Abrams advises National Security Advisor **Condoleezza Rice** – a **Russia** specialist – on the region. Iran's relationship with Hizbollah is likely to come under extremely uncharitable scrutiny.

Even more than most powerful men. Abrams has a chorus of detractors, many of whom focus on his lack of any Middle East experience. According to *Arab-American Institute (AAI)* Director **James Zogby**, Abrams' appointment sends “a very dangerous message to the Arab world”, strengthening the hold that conservatives maintain “on all the major instruments of decision-making except for the State Department”. Reflecting the *Centre for Strategic and International Study (CSIS)*'s bias towards less conservative State Department thinking, **Anthony Cordesman** described Abrams as “remarkably under-qualified for the job”.

Western Expatriates Are The Weakest Link

A *Al-Qaeda's* Kuwaiti operations commander **Khaled Sheikh Mohammed** may be in **Afghanistan** following the war on terror's biggest arrest to date, but the *jihād* continues, and intelligence sources suggest that suicide bombings and other assaults against Western and ruling family targets could follow in coming weeks.

The fatal shooting of **British Aerospace (BAE)** employee **Richard Dent** in Riyadh is the latest tragic indicator of the growing physical risk of operating in the Gulf – a risk that is clearly beginning to fray the nerves of the community.

In part, this is because contractors recognise that they are the weakest link in the array of protective measures being put in place by Western firms and their **GCC** hosts. While keypoint defence of infrastructure is rapidly tightening, the high-profile Western contractor in transit remains an undefended and inviting target to militant extremists – as was the case when two contractors were killed in Kuwait (*GSN 703/6; 702/16*).

To compound their fears, the **British** expatriate community in **Saudi Arabia** remains unconvinced that the government has recognised the scale of the problem or presented an honest account of cases currently treated as bootlegging murders.

There is considerable scepticism at Interior Minister **Prince Nayef Bin Abdelaziz's** view that a string of expatriate killings in 2000-02 were linked to turf wars over alcohol. Even though the UK authorities have been sympathetic to Riyadh's view, potential death sentences threaten another major diplomatic spat, as *GSN* has long argued.

Osama Bin Laden's most recent communiqué, issued in mid-February, unequivocally made the point that there could be no middle ground and no sanctuary in the conflict between militant Islam and the West, including the House of Saud.

Sources within the **US Defense Intelligence Agency (DIA)** told *GSN* that Bin Laden's message had been pre-empted at a 7 February meeting in London, where *Al-Qaeda* emissaries arriving from **Pakistan** told local sympathisers that militant groups within Saudi Arabia and other **GCC** states were planning to carry out "grassroots" attacks on royal and Western interests.

According to this version of events, the emissaries said the House of Saud was considered in the same way as other "infidel" regimes and forewarned of "a comprehensive change in the style of the *jihād*" to include "martyrs" – commonly held to mean suicide bombings.

In combination with President **Saddam Hussein's** call for Kuwaitis and other citizens of the

Gulf to resist the Western armed build-up, Bin Laden's message has raised the hackles of corporate and national security chiefs.

IRAQI 'SPIES', ISLAMIST 'TERRORISTS'

In Kuwait, preparations are being made to counter military moves by **Iraq**, or low-intensity threats originating from "Iraqi intelligence or *Al-Qaeda* sympathisers" in the words of Interior Minister **Sheikh Mohammed Khalid Al-Sabah**.

Two alleged Iraqi spies have been uncovered, including a government employee who allegedly planned to assassinate government figures and destroy power and other critical infrastructure.

On 24 February, three Kuwaiti Islamists were arrested after **Kuwaiti Security Service (KSS)** surveillance uncovered preparations to attack US troops travelling on Kuwaiti highways.

Planned attacks on US and Western forces have reportedly been foiled in **Bahrain** and **Morocco**.

In Bahrain, an alleged five-man terrorist cell was arrested on 16 February during a heavy-handed raid by Interior Ministry special forces that drew widespread complaints from Manama's Sunni community, who are unused to seeing such tactics used outside the Shiite ghettos. Like the Kuwaiti suspects, at least one detainee was a known Islamist veteran of **Afghanistan**. The group – composed of members of Bahrain's Sunni elite – was reportedly preparing to attack personnel from the US Fifth Fleet (*GSN 704/7*).

In Morocco, three Saudi citizens were sentenced to ten years imprisonment after allegedly preparing to launch suicide attacks against Western shipping in the Strait of Gibraltar, using tactics similar to those employed against the *USS Cole* in November 2000.

The GCC has responded quickly to protect

Saudi Defence Following Intelligence Coups

Keypoint defence has been put in place in Saudi Arabia, following intelligence successes in summer 2002 that uncovered sabotage plans by Islamist sympathisers within **Saudi Aramco**. This tied in with calls from *Al-Qaeda's* leading strategic thinker, **Ayman Al-Zawahiri**, for economic targeting and the subsequent attack on the oil tanker *Limburg* after it sailed from Saudi Arabia. Gas-oil separation plants, particularly those at Abaqaiq and Shaybah, are considered to be particularly threatened nodes. Oil Minister **Ali Al-Naimi** and Aramco Vice President **Abdallah Saif** have focused efforts of preparing gas-oil separation shut-down procedures. The last major damage to Aramco infrastructure occurred in 1973, when facilities in Lebanon were destroyed by armed militants.

Meanwhile, a blanket of 60,000 military and police personnel were thrown over the Hadj, with Interior Minister **Prince Nayef Bin Abdelaziz** promising to bring an "iron fist" down on miscreants.

military and infrastructure targets (GSN 704/3; 702/6). In Kuwait, the government first sealed off the US military deployment area north-east of the Kuwait-Iraq highway, forbidding the traditional pastimes of hunting, grazing, and camping in adjacent areas of desert. Checkpoints identify Kuwaiti citizens travelling on northern highways.

The northern oilfields at Ratqa and Kuwait's oil terminals are under military keypoint protection, with the aim of maintaining production throughout any period of military operations or civil instability (GSN 704/13).

While states have put up their defences, the expatriate community is relatively unprotected. The groups uncovered in Bahrain and Morocco are believed to have planned the killings of unprotected Western tourists and employees in urban areas, in transit, or on public transport.

This threat became reality with the killing of Richard Dent in Riyadh, which had been foreshadowed by other unsuccessful attempts.

Last June, a BAE employee was targeted unsuccessfully by a sniper near the military base at Tabuk. In late January, an Australian BAE employee was the targeted of a failed gun attack at the Khamis Mushayt base in south-western Saudi Arabia. Most clearly mirroring Dent's murder at a Riyadh traffic intersection, a BAE employee survived a gun attack on 6 February when stationary at a set of traffic lights in the capital.

The man arrested for Dent's murder was a Yemeni-born naturalised Saudi who had recently returned from Pakistan; perhaps coincidentally, the man was related to **Qaed Sinan Al-Harithi**, the senior Al-Qaeda operative killed by a **Central Intelligence Agency** Predator drone in Yemen last November in an incident that redefined the approach of the 'war on terror' (GSN 698/5).

Growing British Expatriate Anger In Saudi Arabia

BAE employee **Richard Dent**'s murder in Riyadh provoked further anger in the expatriate community, fanned by the perception that Islamist terrorism had gone largely unchecked due to the royal family's unwillingness to admit the problem existed. This frustration was evident when an initially restrained but increasingly outraged expatriate cornered Saudi Arabia's new Ambassador to the UK, former intelligence chief **Prince Turki Bin Faisal**, on a **BBC** radio talk show. **Peter Howard-Leith** said he had witnessed the death of his neighbour **Simon John Veness** last June, when a car-bomb killed the **Al-Bank Al-Saudi Al-Fransi** employee.

Noting that he had then been interrogated by the police in connection with the death, Howard-Leith accused the government of throwing a "smokescreen" around the issue of Islamic fundamentalism, endangering the expatriate community in the process. The assault momentarily stunned the usually insouciant Prince Turki, who found it hard to maintain his argument that Dent's case was the first incidence of Islamic militancy against Western expatriates, and that previous attacks had been "purely confined to the British". Dent was the fifth expatriate murdered since 2000, with a number of near-misses to add to this total. Reports suggest that increasing numbers of expatriate workers are sending their families home as a result of the twin threats of terrorism and war.

Saudi spokesmen confirmed the suspect was believed to have ties to Al-Qaeda.

Dent's murder provoked further anger in the British expatriate community (see box). But the Saudi reaction to such incidents has been limited.

The influential **Council of Muslim Scholars** issued a *fatwa* in February 2002 forbidding citizens from designating Westerners as 'infidels' and justifying violent attacks on them, mirroring the Kuwaiti reiteration of a similar 1997 *fatwa* issued in that country. Otherwise, signals from the Saudi government – such as plans to fingerprint expatriates – have only increased the community's isolation.

Critics say that Saudi initiatives remain primarily focused on improving the Kingdom's image with Westerners outside the country.

With more incidents expected, expatriate communities will become increasingly resentful if they are left as the weakest link in the GCC and Western security system in the Gulf.

KUWAIT: Succession Speculation

There is much gossip in Kuwait about potential promotions in the pecking order within the ruling **Al-Sabah** family ahead of a succession race in the next few years. After the ruling triumvirate of ailing Emir **Sheikh Jaber Al-Ahmed Al-Sabah**, Crown Prince and Prime Minister **Sheikh Saad Al-Ahmed Al-Sabah** and First Deputy Premier and Foreign Minister **Sheikh Sabah Al-Ahmed Al-Sabah**, a number of younger contenders come into play in an intensely complex situation.

Names being mentioned around the *dirwaniya* (in no particular order) include **Sheikh Mohammed Sabah Al-Salem**, the son of a former emir, Deputy Foreign Minister and Acting Finance Minister. He is open to reform ideas and is internationally well-connected; he also has a wide circle of genuine personal friends through whom he can explore new ideas and keep in touch with the wider national mood (GSN 704/8).

But as an academic and former diplomat who has spent much of his career abroad, **Sheikh Mohammed** may find it relatively hard to connect with important tribal interests. One political insider commented that "he is not a fighter", and may be too gentle to battle for the succession.

Sheikh Ahmed Al-Fahd, holder of a number of portfolios including Oil and Information, is another bright moderniser and relative liberal. He is tough as well and has built strong parliamentary links (he was influential in deterring MPs from voting out now departed Finance Minister **Youssef Al-Ibrahim** in a confidence vote last summer). He also benefits from being the son of **Sheikh Fahd**, who heroically died fighting the **Iraqis** at the Dasman palace gates in 1990.

Ahmed Al-Fahd has been careful to maintain strong links with conservative traditionalists and with sporting associations (an important means of establishing a public profile among the young).

Other potential Al-Sabah contenders include Interior Minister **Sheikh Mohamed Khalid Al-Hamad Al-Mubarak** and Defence Minister **Sheikh Jaber Mubarak Al-Hamad Al-Mubarak**. These two cousins are not from the Al-Ahmed and Al-Salem branches that have traditionally monopolised the succession. But they are qualified, as direct descendants of Mubarak the Great.

Mohammed Khalid has close ties to the Al-Salems. His wife is the daughter of **Sheikh Salem Al-Ali**, head of the *National Guard* and an influential senior “family fixer” who could have a big say in succession discussions.

Sheikh Salem Al-Ali is the most senior Al-Salem. This branch’s succession prospects were weakened when Sheikh Salem Al-Sabah lost the Defence portfolio in a reshuffle – although he chairs the National Committee on Prisoners of War in Iraq, which keeps him in the public eye.

Outside the government, **Sheikh Nasser Al-Sabah** – son of the deputy premier – is another fast-rising player for a later date (see page 8).

In the complex Kuwaiti situation, the succession has frequently passed to a less prominent individual, with little public profile. The retiring Emir Sheikh Jaber is typical of this.

Cautions a senior Kuwaiti: “We should not be surprised by any surprises”.

UAE: FNC Reform Brings New Speaker, No Women

Constitutional change has inched forward with a secret ballot to elect the new Speaker of the Federal National Council, the UAE’s nominated national assembly. But election of **Dubai** businessman **Saeed Mohammed Saeed Al-Ghandi** – in succession to the scion of another Dubai business dynasty, **Mohammed Bin Khalifa Bin Sultan Al-Habtoor** – is overshadowed by the failure of Emirates’ rulers to appoint women FNC members, despite loud hints to the contrary.

It remains to be seen whether Ghandi will have more success than Habtoor in pushing forward the case for modernisation. Habtoor had spoken out occasionally about the need for democratic change, while being careful to set no timetable. But his statements had no apparent public effect on the evolution of thinking among the UAE’s rulers. His advocacy of media freedom was more in tune with a government which has noticeably, though not fully, relaxed constraints on the press.

Should **Saudi Arabia’s Crown Prince Abdallah Bin Abdelaziz** eventually move the Kingdom towards a form of limited pluralism, as signalled in recent weeks, the UAE will stand out as the only state in the Arabian peninsula that still relies on exclusively nominated consultative institutions.

The FNC’s prospects for becoming an elected body at any early point had been discounted by insiders for some time due to the conservatism of some of the seven Emirs who constitute the Rulers’

Council. It was felt that UAE President and **Abu Dhabi Ruler Sheikh Zayed Bin Sultan Al-Nahayan** would be reluctant to contemplate any major change that could not command consensus.

But the failure to nominate any women FNC members has caused genuine surprise. Sheikh Zayed’s powerful wife **Sheikha Fatima Bint Mubarak** had indicated that women were soon to be appointed (*GSN 699/20*).

It is still possible women could be nominated separately to join the FNC – which has only 40 members – so that current members do not have to be displaced to make way for them. There is plenty of room in the Council’s spacious and well-appointed Abu Dhabi meeting chamber – and there would be a precedent for this. Five women were appointed to **Sharjah’s** Consultative Council, but only after the male members had already been selected and started work.

The failure to appoint women reflects opposition from more conservative emirs, especially in smaller emirates with only a few seats at their disposal. But it may also mean that Sheikh Zayed and Crown Prince **Sheikh Khalifa Bin Zayed Al-Nahayan** line up with the conservatives.

All Eyes On Iraq

Preoccupation with the Iraq crisis provides an alibi for inaction on the domestic front, with all eyes in the **UAE** focused on **Sheikh Zayed’s** appeal to **Saddam Hussein** to go into exile, to spare Iraqis from war. This proposal won the support of **Kuwait, Bahrain, Saudi Arabia**, and a not unfriendly reception from **Qatar**. But it failed to gain the endorsement of most governments at the early March Arab summit in **Sharm El-Sheikh, Egypt**.

The initiative cleverly shifted the onus for action back onto Saddam. But it also provoked a fair degree of criticism from those who felt no that Arab government should call on another to quit in this way. A Gulf/other Arab split is emerging, with the UAE anxiously trying to talk up the occasional words of support that Sheikh Zayed’s call elicited.

In domestic political terms the preoccupation with Iraq and general public satisfaction with the government and services means there is little immediate pressure to advance political reform. But with women accounting for three-quarters of all university graduates and assuming an increasingly important role in government and business, this issue remains harder for the rulers to avoid.

THE NEW SPEAKER

FNC Speaker Saeed Al-Ghandi, elected with 22 of the 40 FNC members’ votes for a two-year term, has been a Council member since 1993, serving on the committee for finance, economics and industry. His family business group has interests in vehicles, industrial plant, building materials, consumer goods, freighting and real estate. Ghandi is also Vice Chairman of **Dubai Commercial Bank** and one of Dubai’s most successfully prize-winning racehorse owners.

Kuwaiti Planners Look To Reinvigorated Post-Saddam Northern Gulf

Kuwaitis in government and civil society are already preparing for life after régime change in Iraq and the chance to begin rebuilding normal ties with their northern neighbour. Emergency precautions for a retaliatory attack by Baghdad, and for handling overspill impacts from the war inside Iraq, now dominate the public agenda (*GSN 704/3*).

But more long-term opportunities are also focusing some minds: Kuwaiti planners have for years been quietly working on proposals for a reinvigorated northern Gulf region.

While direct bilateral co-operation with **Iran** is a priority for Kuwait, regardless of whether Saddam Hussein's régime survives or not, it is obvious that the normalisation of relations with Iraq would open up much broader regional co-operation.

Forward thinking for this new era has been entrusted to an independent think-tank, the *Kuwait Centre for Strategic Studies (KCSS)*, which has been attempting to analyse a potential new role for the country over the long term.

The KCSS was initially commissioned by **Sheikh Nasser Sabah Al-Ahmed Al-Sabah**, Adviser to Crown Prince and Prime Minister **Sheikh Saad Al-Ahmed Al-Sabah**. Nasser is a political liberal and son of First Deputy Premier and Foreign Minister **Sheikh Sabah Al-Ahmed Al-Sabah**.

The *Bridge 21, Crossing to a New Century* document was completed in 1999, and that same year the government commissioned a report on how the strategy could be put into practical effect.

As the possibility of régime change in Baghdad grows closer, opening up the prospect that Kuwait might once more feel able to co-operate with Iraq, these documents are now being looked at afresh, as a practical route-map forward. The government has asked the KCSS to fine-tune the proposals and bring them right up to date.

Sheikh Nasser has discussed the proposals with **Iran** and **Saudi Arabia**. He has also sounded out opinion in the **USA** and **China**. The Chinese have been particularly enthusiastic, seeing the northern Gulf as a gateway to a "new Silk Road" – a revived land corridor for trade between the west of the People's Republic and the Middle East and Europe.

KCSS Director Dr **Sami Al-Faraj** told *GSN* that the underlying goal was to create a new security in the northern Gulf through economic interdependence, so that the states in the region have a powerful stake in maintaining peace and stability – and much to lose, in economic terms, if

stability is lost. "Kuwait is in a triangle of danger or development," Faraj said. "Since 1997 we have been thinking about how to entice Iraq into a zone of peace."

Kuwait does not have the size or military clout to impose stability through its power. What it can offer is finance, management and a base for services. In this parallels might be drawn with early post-Second World War Europe, where the creation of the *European Community's* precursor, the *European Coal and Steel Community*, was designed to make the **French** and **German** economies so inter-dependent that the two countries would not be able to fight each other.

Faraj also looks back to the model offered by Kuwait's history: Kuwait Bay is one of the best natural anchorages in the Gulf; the city's origins lie

Kuwait's Civil Society: Much Ado About An Ad

Kuwaiti civil society groups are exploring ways to restore a measure of goodwill and common understanding to relations with a post-war **Iraq**. Women's groups have begun to prepare to help with welfare work neighbouring southern centres over the border, such as Basra. One of the most novel, and controversial, public overtures was an advertisement taken out in the London-based Arabic daily *Al-Sharq Al-Awsat* last autumn by a group of prominent Kuwaiti liberals, including the MP **Ahmed Al-Rubai** and bankers' association general secretary **Youssef Al-Jassim**. Developed by a 130-strong steering committee over last summer, the initiative had the private support of influential non-royal government figures. But it took months for the group to find an Arab publication willing to carry the ad, which expressed sympathy for the Iraqi people and stated that the safety and sovereignty of the Iraqi people should be respected and that they should be able to choose the democratic regime of their choice.

Al-Sharq Al-Awsat initially rejected a request to publish the ad – at normal page-space rates. The Kuwaitis then contacted *Al-Hayat* and *Al-Ahram*, which also said 'no'. Then they approached a string of other Arab newspapers. One **Jordanian** publication even accused the would-be advertisers of taking an aggressive stance towards another country. A **Lebanese** paper said it would run the ad for \$100,000 – but then pulled out. At that stage the Kuwaitis decided to go public. Newspaper members of the group started to write about the affair, asking where was the free press in the Arab world. This attracted the attention of senior editors at *Al-Sharq Al-Awsat* – who had been unaware of the earlier rejection by their salesmen and now got in touch with Rubai.

Eventually the ad ran in the early autumn in a new format, carrying more than 100 signatures from leading Kuwaitis – explaining how the liberals had wanted to make an overture to the Iraqi public. Since the publication, there has been a lot of feedback, including from members of the Iraqi opposition. The Arab media has now covered the story extensively, even printing the list of signatures.

in its role as a gateway port where camel trains that had travelled down through Mesopotamia could connect with sea-borne trade. Failaka Island, off the Kuwaiti coast, was a logistics station for **Alexander the Great**, while in mainland Sabiya, just west of Bubiyan island, archeologists have found the remains of a 5,000-year old seafaring and shipbuilding society that was culturally quite independent from the Mesopotamian civilisations.

History provides an inspiration for today's "blue sky thinking" about the way forward, but the plans drafted so far are practical, based around the natural economic factors that can be mobilised to nudge the northern Gulf states into partnership.

The major population centres of southern Iraq, western Iran, Kuwait and northern Saudi Arabia represent a large regional market. They would be linked by a web of infrastructure connections – roads, railways, pipelines.

SAUDI, IRANIAN CONNECTIONS

One proposed road would run from Kuwait through southern Iraq and into south-western Iran – through the 1980s' first Gulf War battle zone.

Saudi Arabia will be closely involved. The Kingdom's railway network – currently just the Riyadh-Gulf coastline, but with plans for a major expansion (*GSN 695/14*) – would be connected, through Kuwait, to the networks in Iraq and Iran. The Islamic Republic has embarked on its own massive programme of railway upgrades.

Direct infrastructure links between Kuwait and Iran, who share a common maritime border in the Gulf, are already being established. Work on a water export pipeline is well advanced, and a direct fibre optic connection – linking in to the more than 150km of fibre-optic networks in Kuwait – will follow.

The web of infrastructure is seen as offering Iraq a route to national security through peace and development. After the impending war, pointed out Faraj, confidence will have to be rebuilt through shared projects and ideas.

The rapprochement between Saudi Arabia and Iran offers a model. Iran has, for example, turned to the experienced management at **Saudi Arabian Basic Industries Corporation (Sabic)** for advice on the development of its potentially rival petrochemicals industry (*GSN 695/13*). Saudi companies have been developing independent power projects (IPPs) in Iran.

MARITIME CHANNELS

One of the factors fuelling Saddam Hussein's aggressive assaults on Iran and Kuwait was concern about the security of Iraq's access to the sea through the Shatt Al-Arab waterway and the narrow channel leading to Mina Qasr, Iraq's only other deep-water port. Kuwait's Bubiyan and Warba islands overlook this channel.

Kuwait wants to get Iraq to understand that instead of protecting its sea access by occupying

The Islands Dispute

Seeing its own northern Gulf co-operation plans as a model, **Kuwait** is privately trying to persuade the **UAE** and **Iran** to set aside the issue of sovereignty over the disputed islands of the Lower Gulf and develop them as a common economic and free zone. Emirati complaints over the Iranian presence on the Tunbs Islands and Abu Musa has provided Tehran with an excuse to take a tough line and station Silkworm missiles on Abu Musa. But at the same time, the UAE has developed a close business relationship with the Iranians in other areas. The Kuwaitis feel that it would be more sensible to leave arguments over sovereignty to another time and focus on building security through economic partnership, giving both countries a stake in a peaceful role for the islands.

Bubiyan, as it did in the 1990 invasion, it can secure this by joining in a network of infrastructure and investments that give all four participants a stake in maintaining co-operation and open trade. A new container port, serving the entire regional market, would be built on Bubiyan.

Post-Saddam Iraq may be ruled by a regime that is hardly any less nationalistic and suspicious of the outside world than the Husseins, but the Kuwaitis point out that if a strong Riyadh-Kuwait-Tehran axis of co-operation is established, Iraq will have to come to terms with it – and joining in will seem a much more attractive option than fruitless confrontation.

HOLIDAYS IN THE SUN

Once the tanks have rolled on, one sector that could offer considerable scope for regional growth and co-operation is tourism, particularly catering for the Islamic market.

New infrastructure links would facilitate movements of pilgrims from Iran and Iraq to Mecca and Medina, while Shia from Iran, Saudi Arabia's Eastern Province and **Bahrain** would have easy access to the shrines of Karbala and Najaf.

Even Kuwait has hopes of attracting Muslim visitors, particularly in family groups, attracted by its scientific and cultural facilities, lively Arabic theatre and artistic activities. The absence of publicly available alcohol is said to be a draw for many parents of teenage children.

Being much smaller than its Northern Gulf partners in population and size of economy, Kuwait will clearly not be the leading industrial production centre in the new regional market. But it is placed to act as a major transport gateway and centre of technology and services.

With its vast financial reserves and strong locally-owned banking sector, the country would also play a major role in facilitating the supply of credit and capital for projects in the other countries, especially post-war Iraq. It has an established culture of democratic accountability and a strong legal system – important bases for international investment.

Observers might be tempted to make comparisons with the development of **Dubai** as a centre of shipping, trade, tourism and finance. But

the Kuwaiti plan is fundamentally different. Dubai has a much smaller indigenous population and has based its development on mobilising massive inflows of labour and expertise.

Kuwait has a fast-growing national population of about 700,000, and a developing unemployment problem. The new proposals would aim to maximise the use of local capital

and labour, creating a climate in which locals are encouraged to set up businesses to service the new markets, moving away from the traditional franchise rent-seeking mentality and reviving Kuwait's past role as a centre of fresh ideas and original thinking.

This would be a natural reflection of Kuwait's lively political culture. But the realisation of these ambitious proposals will require an

evolution towards more adventurous and less protectionist attitudes in government and Parliament.

Kuwait's free trade zone – conceived long before Dubai's Jebel Ali – has been decades in the making. New plans for the Northern Gulf on the ambitious scale now being finalised cannot risk falling victim to such procrastination; otherwise the new opportunities will be lost.

Business Trends

Iranians Think Big With GSM Roll-out

Teheran is looking to tap foreign investment to help it make the leap from being the region's cellular phone laggard into the big league. The government unveiled ambitious plans in early 2003 to bring in private operators to roll out 5m new cellular lines through a second GSM licence, and ramp up capacity at the sole existing GSM operator, **Telecommunications Company of Iran (TCI)**, through the use of build-operate-transfer (BOT) contracts.

TCI has just 1.2m subscribers from a total 65m population, a 3% penetration rate that compares unfavourably with a global average of 15%. Now, reformists are pushing for private investment to spearhead a massive capacity expansion programme designed to boost the number of cellular phone lines to 10m within three years.

BNP Paribas was awarded the advisory mandate on the second GSM licence in late January. The bank will prepare for a licence sale to a private operator by H2 2003, possibly as early as July. The Posts, Telegraphs and Telecommunications (PTT) Ministry aims to set up a regulatory body for the cellular sector before the second GSM licence award is made, which will co-operate with the Ministry in issuing licences. The PTT expects to begin talks with potential operators for one or more licences during this period.

Reforms also call for the PTT itself to be restructured, changing its name to the Ministry of Information, Communication and

Technology and removing operator TCI from its control.

The Ministry would concentrate on policy, strategy and regulatory issues, leaving operations to TCI.

ISPs UNDER PRESSURE

The wider push for liberalising Iranian telecoms has so far bequeathed only a handful of private internet service providers (ISPs). But even these are under pressure from conservatives, who have charged ISPs with "stealing" revenues from the PTT, mainly through the provision of hugely popular Internet telephony services which allow Iranians to make cheaper foreign calls, bypassing the state monopoly's infrastructure.

Unlike mobile and fixed-line expansion plans, the Internet has got caught up in the Islamic Republic's ongoing conservative-liberal crossfire.

The powerful **Supreme Council for Cultural Revolution** is turning the screws on "illegal" websites,

forming a commission in January to draft a list of anti-Islamic sites. It also warned that all ISPs would be taken over by the state, with TCI lobbying the Majlis (Parliament) to regulate Internet cafés and private ISPs. TCI has also issued new regulations banning under-18s from using the Internet – they are among the heaviest Internet users in the Islamic Republic.

The crackdown sits uneasily with the PTT's stated ambition to boost internet user levels from 2m to 15m within the next three years, but the conservatives' focus on the internet is unlikely to deflect reformists from pressing ahead with GSM expansion. Alongside the new 5m lines anticipated through the second GSM licence, TCI is due to tender for a further 2m lines during the first half of 2003 on a BOT basis.

GSM BIDDERS LINE UP

The consultant on the estimated \$400m-500m programme, the UK's **Aircor International**, is advising

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*.

consortia in the formulation of licence applications. It expects the winners to be announced in Q2 03, depending on the speed at which regulatory reform progresses.

The nine prequalified groups are a mix of international and local companies, with only local firms with at least 51% private shareholdings able to participate.

There is understood to be a heavy Arab presence among the bidders, with heavyweight operators such as Egypt's *Orascom Telecom*, Kuwait's *Wataniya Telecom*, Saudi *Oger* and *Libancell* in the running. Some groups are understood to be entirely investor interested, others include investors combining with service suppliers.

A significant proportion of the lines will be prepaid. Aircom said ongoing discussions would decide whether the entire rollout will be prepaid. The private-led expansion will be augmented by TCI's ongoing enlargement of its 1.2m GSM subscription base.

Tehran's other telecoms reform targets include boosting the number of fixed line subscriptions from 12m to 20m within three years.

The introduction of prepaid services will clearly broaden the appeal of cellular phones, which until now has been the preserve of the country's wealthiest citizens. Under the current system, new subscribers have to stump up a signing-on fee of around \$600 before waiting up to a year before their phone becomes operational.

OMAN: Future Unclear For OAS

Confusion surrounds the government's intentions for Oman Aviation Services (OAS), which owns flag carrier *Oman Air*.

An Economy Ministry official was quoted by *Reuters* on 1 March as saying the government would offload its 34% stake in the company in a bid to return it to profitability after two years of losses.

But OAS board Chairman **Hamad Bin Hashim Al-Dhahab** subsequently denied the report; the company had started to "reap the fruits of its strategies", he said, despite tough competition from other airlines in the region (*GSN* 697/18; 694/18).

Business Booms For French Firms In Iraq

The great debate over disarmament in Iraq has produced new leaks of **UN** documents showing the extent of French, **German** and other business linked to the Oil-for-food (OFF) programme. As with earlier leaks, extensively reported by *Gulf States Newsletter*, the new data, obtained by the London *Sunday Times* and subsequently seen by *GSM*, show the **USA** and the **UK** as the only states actively opposing sales (termed 'on hold'). The new data also show that France is now the biggest exporter against whom complaints of potential dual use are lodged.

A *Sunday Times* report said that "French companies have signed contracts with Iraq worth more than £150m [\$240m] that are suspected of being linked to its military operations." These included orders for mobile laboratories, chemical and communications equipment. Documents seen by *GSM*, from which selected bigger-priced items are listed on pages 14-15, show a large number of French firms including giants **Alcatel Cit**, **Renault Vehicules Industriels**, **Siemens'** French and German subsidiaries and the **Alstom Group** with contracts placed on hold by the USA and UK.

These documents show that French contracts worth some \$126m were blocked or abandoned after US and/or UK intervention. Another \$118m-worth got through after French lobbying overcame Anglo-Saxon lobbying. A few companies are the European arms of US-based multinationals. Several had Middle East connections.

Chemicals and specialised laboratory equipment is listed as having "significant direct application" to Iraq's alleged weapons of mass destruction programme. New attention is being paid to refrigerated trucks, which have featured large in recent US claims about mobile storage facilities and laboratories. Pesticide sales are a particular cause for concern. Even when contracts for these items have been approved, US and British officials have continued to question whether they are dual use goods.

The UK questioned a \$244,300 order for **Maxon Radiocommunication France** to supply radios to the Mayor of Baghdad. UK experts said these could be "sophisticated military communications equipment" and concluded that "if so, it would be contrary to the relevant resolutions to authorise its export to Iraq." Clarifications were sought from the supplier.

France has maintained a trade promotion office in Iraq and business has grown regularly since the introduction of the Oil-for-food (OFF) programme began to revive large scale Iraqi import flows. Two-way trade rose from €685m in 1997 to €1.8bn in 2000, before slipping back to €1.6bn in 2001 (when French oil purchases fell by 31%). But French exports jumped by 65% in 2001; capital equipment and vehicles were the main export items.

TFE has been allocated the Majnoon and Bin Umar oil concessions, projected at 600,000 b/d and 400,000 b/d respectively. These are two of the three most important new potential developments in the Iraqi energy sector.

TFE's prospects for retaining these are unclear. A new Iraqi administration, under pressure to award rights to US majors, might not want to let the French company keep them. But the new government would also want to reassure international investors generally and it might therefore find itself under heavy pressure to respect international legal norms concerning the rights of foreign investors.

It seems quite possible that TFE itself would seek to defuse the issue by inviting some US partners to join it in what would anyway be capital-intensive major projects. It is also quite possible that, as market forces take over in Iraq – presumably a US goal – that French firms would join consortia with US and other international partners, as they do elsewhere around the world. This view has been promoted by TFE Chairman **Thierry Desmarest**, in his soundings of US companies and officialdom.

Continued from page 20

Most informed comment in Beirut dismisses Alwaleed's political ambitions as score-settling between billionaires, although there is recognition that the keys to the Lebanese premiership lie in Saudi Arabia. According to a columnist on the Beirut daily *An-Nahar*, Hariri's image as Riyadh's man in Lebanon does not negate the fact that since 1996 he has been the dominant political *zaim* in Beirut, as well as head of a big parliamentary bloc. Whereas Hariri pushed through an open door when he took power back in 1992, Alwaleed will not find a power vacuum to fill so conveniently.

French/German Exports Contracts In Iraq

Phase	Contract Number Or Date	Exporter	Goods	Amount	Status	Hold By
Contracts for France						
X						
III	77/98/22	Renault V.I	Jetting vehicles	\$522,887.32	Approved	
IX	4980	Climate Control Corporation France	Compressor	\$357,263.00	On Hold	UK
IX		Subtil Crepieux	Medical equipment parts	\$13,991,086.18	Approved	
IX		Levant Overseas Developments Ltd.	Pesticide	\$3,686,226.48	Approved	
IX	09-Q-633	Renault V.I	Spare parts for truck	\$16,066,676.31	Approved	
IX	09-Q-632	Renault V.I	Fire fighting equipment, spare parts	\$1,746,830.99	Approved	
V		Siemens S.A.S. - Division Energie	Control, measurement & protection system with SPA	\$24,372,885.59	On Hold	USA
V	50476	Alcatel Cit	Telecoms equipment	\$12,791,318.47	On Hold	USA
V	50477	Alcatel Cit	Telecoms equipment	\$17,406,039.30	On Hold	USA
VI	601505	Boranex S.A.	Radio/radio equipment	\$2,190,193.51	On Hold	USA
VI	5/2/1M/2992	CIS-Paris	Pumps, compressors & rotary machines	\$3,100,000.00	On Hold	USA
VI	601487	Cofrapex	TV station equipment	\$3,731,275.00	On Hold	USA
VI	5/2/39/3335	Fisher-Rosemount S.A.	Valve/parts	\$1,316,355.58	On Hold	USA
VI	666	Gea Ergle Spirale & Soramat S.A.	Cooling towers/parts	\$370,000.00	On Hold	UK; USA
VI	81	Group Egis/ Doech Consult	Water treatment plant equipment	\$811,545.94	On Hold	UK; USA
VI		Karl Storz Endoscopie France S.A.	Medical equipment	\$2,494,100.00	On Hold	USA
VI	he/6/53	Levant Overseas Developments Ltd.	Sprayers/Parts	\$3,340,000.00	On Hold	USA
VI	VET (MOU) 110/99	Nutris Co. S.A.	Veterinary instrument	\$15,850.00	On Hold	USA
VI	(M.O.U) 115-A/2000	Nutris Co. S.A.	Artificial insemination requirements	\$17,748,598.00	On Hold	USA
VI	601085	Renault V.I.	Transportation trucks/parts	\$3,017,500.00	On Hold	USA
VI	601176	Schneider Electric S.A.	Electrical spare parts	\$39,690,222.65	On Hold	USA
VI	601700	Siemens S.A.S.	Electrical spare parts	\$10,262,045.75	On Hold	USA
VII	(M.O.U) 07-05-00205	Sopimex S.A.	Computers/accessories	\$2,790,000.00	On Hold	UK; USA
VII	601708	Thomson Broadcast Systems	Educational TV station supply	\$1,810,996.43	On Hold	UK; USA
VII	142-5/2/16/3714	Alistom T&D S.A.	Switch gear spare parts	\$229,503.95	On Hold	USA
VII	6062-5/2/24/62 S	Arras Maxei S.A.	Switch yard equipment	\$6,971,770.80	On Hold	UK; USA
VII	298	Bibby Sterilin France	Mobile laboratory	\$1,524,313.95	On Hold	UK; USA
VII	299	Bibby Sterilin France	Boats	\$4,037,028.41	On Hold	USA
VII	300	Bibby Sterilin France	Boats	\$6,843,762.80	On Hold	USA
VII	166	Biomerieux	Medical equipment	\$6,822,015.70	On Hold	UK; USA
VII	M/3/53/99/116	Boranex S.A.	Power line carrier, accessories; spare parts	\$492,390.00	On Hold	USA
VII	110-5/2/30/3287	CIS-Paris	Boiler tubes	\$20,315.25	On Hold	USA
VII	112-5/2/39/106	CIS-Paris	Valves	\$22,192.40	On Hold	USA
VII	111-5/2/39/2882	CIS-Paris	Pumps, compressors & rotary machines	\$10,809.63	On Hold	USA
VII	199-5/2/39/3415	CIS-Paris	Control protection & measuring system	\$2,200,000.00	On Hold	USA
VII	80/2000M0Uphase7	Comecom	Boats; accessories; equipment	\$672,000.00	On Hold	UK; USA
VII	4/7/00	Corobor Systems	Switching systems	\$49,325.00	On Hold	USA
VII	M(MOU)314/2000	David Brown Transmissions France	Gear boxes	\$19,884.10	On Hold	UK; USA
VII	1603	Euromark Ventures Sarl.	Spare parts for air dryer	\$164,500.00	On Hold	UK; USA
VII	M/3/7/2000/157	Euromark Ventures Sarl.	Computers	\$222,849.92	On Hold	USA
VII	26-Oct-99	Euromark Ventures Sarl.	Spare parts	\$839,040.00	On Hold	USA
VII	97/2000	Facis	Compressor for refrigerators & dep freezers	\$1,296,000.00	On Hold	USA
VII	M(MOU)284/2000	Irrifrance Industrie	Centre pivot irrigation system	\$3,593,638.18	On Hold	USA
VII		Karl Storz Endoscopie France S.A.	Medical appliances; medical equipment	\$145,444.00	On Hold	USA
VII	45-5/2/2/3528	KSB S.A.	Pumps & spare parts; pump accessories	\$50,705.00	On Hold	USA
VII	145-5/2/40/3860	KSB S.A.	Pumps, compressors & rotary machines	\$76,922.80	On Hold	USA
VII	340	Laboratoires Renaudin	Medicine	\$2,563,447.00	On Hold	USA
VII	24-Jun-99	Levant Overseas Development Ltd.	Sprayers/parts	\$2,687,500.00	On Hold	USA

Phase	Contract Number Or Date	Exporter	Goods	Amount	Status	Hold By
VII	47	Levant Overseas Developments Ltd.	Medical equipment	\$153,386.00	On Hold	UK; USA
VII	VET (M.O.U.) /146/2000	Levant Overseas Developments Ltd.	Veterinary chemicals	\$1,476,903.00	On Hold	USA
VII	2158-5/2/20/3167	Nutris Co. S.A.	Switch yard equipment & accessories	\$874,895.00	On Hold	USA
VII	5/2/39/2848	Trouvay & Cauvin	Water treatment equipment	\$554,062.15	On Hold	USA
VIII	123-5/2/39/116	Trouvay & Cauvin	Turbine system equipment	\$25,174,821.96	Approved	
VIII		Dow Agrosiences	Pesticide	\$2,192,149.54		
VIII		Karl Storz Endoscopie France S.A.	Medical equipment & appliances	\$1,132,070.97		
VIII		Karl Storz Endoscopie France S.A.	Medical equipment & appliances	\$2,851,077.02		
VIII		Karl Storz Endoscopie France S.A.	Medical equipment & appliances	\$1,350,449.03		
VIII		Karl Storz Endoscopie France S.A.	Medical equipment & appliances	\$4,798,265.41		
VIII		Levant Overseas Developments Ltd.	Pesticide	\$2,087,304.45	Approved	
VIII	GAMCO/RENAULT/RECOVERY/40	Renault VI	Recovery trucks	\$20,599,139.14	Approved	
VIII	GAMCO/RENAULT/TRACTOR/37/	Renault VI	Truck tractors	\$4,887,525.42	Approved	
VIII	GAMCO/RENAULT/CARGO 16 T/	Renault VI	Truck	\$9,090,708.33	Approved	
VIII	GAMCO/RENAULT/CARGO5T/38/	Renault VI	Lorry/parts	\$6,904,288.38	Approved	
VIII	GR/IK/23 09 00/02	Renault VI	Fuel tanker truck/parts	\$6,538,843.87	Approved	
VIII	GAMCO/RENAULT/CARGO 10T/4	Renault VI	Lorry/parts	\$3,298,393.51	Approved	
X		Alcatel CIT	Telecoms equipment	\$13,060,838.16	Approved	
X		Bureau d'Etudes d'Assistance Engineering	Centrifugal pumps	\$4,807,713.56	Approved	
X		GIS-Paris	Turbine systeme equipment & spares	\$5,183,340.63	Approved	
X		Envirotech Pumpsystems	Spare parts	\$3,722,876.22	Approved	
X		Envirotech Pumpsystems	Spare parts	\$1,780,495.10	Approved	
X		Envirotech Pumpsystems	Spare parts	\$4,846,958.15	Approved	
X		Envirotech Pumpsystems	Spare parts for pumps	\$10,146,608.19	Approved	
X		Hexacorp	Water chillers	\$1,759,482.54	Approved	
X		Laboratoires Leurquin	Mediolanum medicine	\$2,625,324.00	Approved	
X		Levant Overseas Developments Ltd.	Insecticide	\$3,351,000.00	Approved	
X		Levant Overseas Developments Ltd.	Pesticide	\$2,208,000.00	Approved	
X		Liebherr France S.A.	Excavators & spare parts	\$2,854,577.46	Approved	
X		Pompes - Salmson	Pumps & spare parts	\$5,749,955.79	Approved	
X		Renault VI.	Spare parts for Renault trucks	\$15,897,523.00	Approved	
X		Rohm and Hass France S.A.	Resins	\$4,279,032.29	Approved	
X		Roland Arroreurs/Sprinklers	Centre pivot irrigation system	\$2,676,300.09	Approved	
XI		AGCO S.A.	Harvester	\$7,530,397.24	Approved	
XI		AGCO S.A.	Tractor/spare parts	\$5,151,734.15	Approved	
XI		Hexacorp	Compressor	\$7,356,661.27	Approved	
XI		Levant Overseas Developments Ltd.	Pesticide	\$4,842,833.77	Approved	
XI		Liebherr France	Spares for hydraulic excavator	\$2,849,008.12	Approved	
III		Nutris Co. S.A.	Diagnostic kits	\$46,752.66	On Hold	USA
V	501199	Siemens AG	Cable	\$5,605,115.07	On Hold	USA
V	50713	Siemens Ag/Kwu	Turbine & gen. equipment	\$8,351,926.98	On Hold	USA
VI		Karl Storz GmbH & Co. KG	Medical instruments	\$11,105,000.00	On Hold	USA
VI	2-Jul-99	NBC Industrieanlagen GmbH	Spare parts for Wallia grain silo	\$6,300,000.00	On Hold	USA
VI	909	Siemens A.G., Medical	Medical equipment	\$4,554,883.20	On Hold	USA
VII	510	Siemens A.G., Medical	Spare parts	\$4,732,087.00	On Hold	USA
VIII		Karl Storz GmbH & Co. KG	Medical equipment & appliances	\$19,404,332.13	Approved	
VIII		Siemens	Aktiengesellschaft turbine	\$4,021,795.79	Approved	
VIII		Siemens A.G., Medical	Medical equipment	\$29,816,267.62	Approved	
VIII		Siemens Aktiengesellschaft	Power station	\$7,399,532.05	Approved	

GSN Risk Grade – C+/2: Tough times as underground groups emerge but financiers stay loyal

Political And Social Development

Overview: King Hamad Bin Isa Al-Khalifa would ideally like a peaceful solution to the Iraq crisis but despite a strong vein of feeling against the US military presence and the arrest of five Al-Qaeda suspects, the US use of Baharaini bases is not in question. Close dialogue is being kept with GCC states, notably Saudi Arabia, whose leaders are routinely consulted. A new era of democracy began in December with the inauguration of a two-tier parliament, but areas of conflict remain with the Shiite and liberal opposition.

Parliament: The new National Assembly is dominated by representatives of the Sunni minority population; opposition groups including the Shiite Al-Wefaq boycotted the elections in protest at sharing legislative functions with an appointed Shura Council. The two chambers have locked horns over a recent \$500m bond issue. The Shura Council approved the plans after the elected chamber rejected them. The bill will go back to the lower house and if rejected again a full sitting of both houses of parliament will be called; two thirds support from both houses will be required in a major test case.

Security: Five Sunni Bahraini nationals were arrested in mid-February on suspicion of planning a terror attack. King Hamad says it is an isolated incident but investigations continue. The US Navy's 5th Fleet base was probably a target. In the run-up to war, Western states including the USA, UK and Canada have issued tougher travel warnings, and an Arab League summit was moved to Egypt; increased security concerns were cited for this, although King Hamad insisted it was "just an administrative issue". US Patriot missile systems have been installed to boost defences.

Special relationship: King Hamad remains a close ally of the USA. Home to the US Fifth Fleet, Bahrain will allow the USA to use its bases in the event of a war with Iraq regardless of whether war comes through the UN or a US-led coalition of the willing. King Hamad's public support for the USA is tempered by domestic sensibilities, reflected in boycotts of US products and anti-US demonstrations over Palestine and Iraq. There is a very strong vein of anti-war and anti-American feeling. Around 4,000-5,000 protestors marched in late February, with some burning the US flag and chanting "death to America".

Economic Outlook

Overview: Bahrain continues to develop its capabilities as a regional financial centre, although some local investment banks have been hit by the global downturn; a \$1bn financial district in Manama's old harbour area and an International Islamic Financial Market are planned. Bahrain pumps around 40,000 b/d from its own oil fields and 140,000 b/d from a shared offshore field with Saudi Arabia. Unemployment remains a real concern. Official figures showed a rate of 5.6% at end-2001 but Shura Council members report it is more like 25% among Bahraini nationals. New Year riots were attributed to dissatisfaction among sections of the youth population. The government plans to overhaul the work permits system by 2005. Permits will only cover a maximum six-month period, although exceptions will be made in sectors where there are skills shortages.

Finance: A debut \$500m sovereign eurobond was launched in January. The bond was lowered to a five-year tenor from ten years but despite the fears of war in Iraq 49% of investors came from outside the region. S&P provided an initial A- rating. Fitch has raised the country's long-term foreign currency rating to A- from BBB. An \$80m three-year Islamic leasing bond issue was oversubscribed by more than three times in February. BMA plans to issue Islamic bonds worth \$670m in 2003 to develop the market; a \$250m issue is expected in May.

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

Liberalisation: Bahrain expects to attract around \$700m FDI through privatisation sales in 2003. Bids for a second GSM licence closed 5 March. A Telecommunications Regulatory Authority is being created to oversee sector liberalisation while a new telecom law is expected 2004. Electricity and transport sell-offs are likely, including management of Mina Salman and Khalifa Bin Salman ports, and studies for the privatisation of the postal services are set to begin.

Bahrain: Key Projects

HIDD POWER AND DESALINATION PLANT EXPANSION: France's Alstom has a \$300m contract to install 700MW; a consultant for the 60m g/d desal capacity is expected to be awarded by late March; Black & Veatch is the low bidder.

ALUMINIUM BAHRAIN: Fifth potline for completion June 2005; Bechtel started construction mid-February. Five tranche \$1.05bn commercial bank facility secured; further \$500m is being sought. Alstom and Hyundai group shortlisted for 850MW power unit. USA's Alcoa is mulling a sixth potline to raise output to 1m t/yr.

BAHRAIN FINANCIAL HARBOUR (BFH): \$1bn project planned in 202,272 square metre plot. First phase construction started December 2002. Completion expected October 2005

FORMULA-1 MOTOR RACING TRACK: Scheduled to open in 2004, with long-term F-1 deal secured. Construction has already started but the government's \$150m funding plan has been caught up in parliamentary tussle. It is expected to pass.

BANGAS LPG: Debottlenecking and 20m-30m ft³/d expansion to existing 280m ft³/d processing plant. Bidding for FEED contract. EPC tender expected early 2004 for 2006 completion.

GSN Risk Grades

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

Bahrain: Economic Indicators

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

^p Preliminary. ^e Estimate. GDP – Gross domestic product. CPI – Consumer price inflation.

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

GSN Risk Grade – D/3: Regional war beckons, hardliners make gains. Political risk downgrade

Political And Social Development

Overview: End February municipal elections resulted in big wins for conservatives but on a very low turnout. The result underlines growing voter disenchantment with the political system and the importance of the progress of two reformist bills through parliament. High unemployment and sluggish reforms will continue to fuel popular unrest, and frustration with political infighting. Revolutionary Guards and Basij militia have been primed to deal with trouble.

Municipal elections: Conservatives won and reformists lost heavily in the elections, only the second for the municipal districts since the 1979 revolution. Turnout, however, was low – 39% on average and only 10% in Tehran – with many voters staying away in protest at the system's ineffectiveness and the slow pace of reform, pointing to a withering away of President Mohammad Khatami's support base. The prospect of conservative-dominated municipal councils may lead to more popular unrest if, as some analysts predict, conservatives use their win to tighten up social restrictions.

Two key bills: At the centre of the reformist/conservative struggle is the passage of two Khatami-supported bills; these would give the President greater power to rein-in the reactionary judiciary and Guardian Council. Both are still locked in the parliamentary system and conservatives have yet to indicate willingness to make real concessions. Khatami has threatened to resign if they are rejected. He may try to force the issues to be settled by referendum; parliament is taking steps to revise the referendum by-law.

External factors: Iran does not support war on Iraq but would love to see the back of the Iraqi regime. Foreign Minister Kamal Kharrazi has proposed that Iraqi regime change should be conducted through a UN-supervised referendum of the Iraqi people. Iran has closed its land border with Iraq. US sanctions remain in place (expiring in 2006) and as a member of US President George W Bush's "Axis of Evil", relations may deteriorate further (see box below). Relations with the EU are strengthening; talks are under way on a new free trade agreement and the promotion of energy co-operation. Commercial and defence relations have flourished with Russia, but tensions remain over the Caspian.

Economic Outlook

Overview: Despite the absence of US trade (due to sanctions) Iran is attracting increasing flows of investment, particularly from Europe – the EU has held free trade agreement talks – and successfully returned to the international capital markets. Serious structural problems remain, however, including state domination, a weak banking system and over-reliance on oil. Unemployment is officially 16%; bureaucracy and corruption must be further addressed. The government is forecasting 6.1% GDP growth for 2003.

Borrowing: Bond issues have helped to reassert credibility among Western investors. Two Eurobonds of €375m and €625m were issued in 2002. Further issues have been mooted for 2003/04; the budget envisages borrowing up to \$2.3bn in 2003 for development projects. The debt/GDP ratio is 7.7%. A good repayments record has stimulated investor interest.

Financing: Bankers report substantial structured trade finance activity in the hydrocarbons, petrochemicals, power and mining sectors, with National Iranian Oil Company (NIOC) and National Petrochemicals Company (NPC) regarded as the soundest corporate risks. Export credit volumes are growing, although there is concern that complex trade and project finance structures may face domestic opposition. The gas and petrochemicals industries are growth areas for export credit. The UK's ECGD, France's Coface, Netherlands' NCM, Italy's Sace and ECAs from Austria, Germany and Spain have all backed energy sector projects.

Budget: Parliament has approved a \$121bn budget based on an \$18-19/barrel oil price for the 2003/04 Iranian year (beginning 21 March). This is \$14bn higher than President Khatami's draft due to the inclusion of real market prices rather than state subsidised prices for energy products.

Liberalisation: The two-tier exchange rate was scrapped March 2002 and import licensing procedures have been streamlined, although restrictive elements remain. Privatisation progress has been slow. Urgent reforms are required to the labour and commercial laws, and to regulate securities. A revised Law for the Attraction and Protection of Foreign Investment (Lapfi) passed last May. The government has proposed lifting ceilings on oil sector buy-back contracts.

IRAN NEXT FOR THE USA? US rhetoric is hotting up over Iran's nuclear energy programme, which plans to increase nuclear generation capacity to 6,000MW by 2022. The USA says the programme is a cover for obtaining technology to develop nuclear weapons and is particularly concerned at the construction of uranium processing and enrichment facilities. Iran denies this. The International Atomic Energy Agency has made site inspections; it welcomed signs of greater transparency but said more could be done.

Iran: Key Data and Forecasts*

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

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

^p Preliminary. ^f Forecast.

Sources: IMF, Washington; Bank Markazi, Tehran.

Iran: Key Projects

SOUTH PARS GASFIELD: Initial 12 phases; TotalFinaElf-led phases two and three in initial production stage. Work also under way on phases one to ten. Revised bids called for phases 11-12 mid-January.

LNG: Four projects under discussion. Contracts for TotalFinaElf and Shell-led projects expected during H1 2003. BP's Iran LNG project slower.

BUSHEHR NUCLEAR PLANT: Work behind schedule on controversial 1,000MW plant built by Russia; completion expected early 2004.

INDEPENDENT POWER PROJECTS: State company Tavanir has launched prequalification for the sale of the 350MW Khoy gas/steam plant in Azerbaijan province. A shortlist of bidders is expected in April with bids due mid-2003. Tavanir is also tendering six 500MW projects, led by Zanzan one and two, followed by Khorram Abad one and two, and plants in Mashad and Kashan. Germany's Dillinger Stahl, Italy's Enelpower, Korea Electric Power Corp. and Japan's Nichiman are among prequalifiers.

IRAN-KUWAIT GAS PIPELINE: Conclusion of a 25-year 15m m³/d gas export agreement expected H1 03; subsea pipeline construction would take 30 months. One of several major Kuwaiti/Iranian schemes

TELECOMS: Award of second GSM licence expected H2 2003, to be preceded by the creation of an independent regulatory authority. BNP Paribas advising on the GSM licence, while the International Telecommunications Union is helping the government to study regulatory options (see page 12).

OMAN: International Banks Line Up Project Mandates

The Sultanate's expanding slate of gas-based industrial projects is set to provide lucrative advisory work for international banks this year.

The government has given new momentum to Oman's economic diversification, with a planned aluminium smelter, polypropylene plant and independent water and power project (IWPP) in the rapidly expanding Sohar industrial zone, where a privately backed fertiliser plant is also likely to see progress.

Banks are lining up to bid for advisory mandates. *Citibank* looks set to add the advisory mandate on the 500,000 t/yr Sohar aluminium smelter to its two advisory awards on the *Oman LNG* project, in a run-off with *HSBC*. The mandate will cover the smelter and could be extended to include a prospective captive power plant. The project is a joint venture comprising *Oman Oil Company (OOC)*, *Abu Dhabi Water and Electricity Company (Adwea)* and Canada's *Alcan*.

OOC is also promoting a petrochemicals venture at Sohar; shortlisted *ANZ Investment Bank*, *Arab Banking Corporation (ABC)*, *BNP Paribas* and *Gulf International Bank (GIB)* are bidding to advise on an estimated \$140m debt finance package. Other project partners are *South Korea's LG International* and *ABB Lummus Global (Netherlands)* in a scheme to produce 340,000 t/yr of polypropylene, adjacent to the planned 75,000 b/d Sohar refinery, whose financial advisor *Bank of America* is drawing up a list of banks to participate in its estimated \$1bn debt package.

Banks are awaiting the award of the advisory team on the 500MW, 30m g/d Sohar IWPP. Three banks – *Société Générale*, *ABN Amro* and *HSBC* – are lining up in the bid groups that include legal and technical advisors. Muscat is pressing for a June deadline for the advisory team to draft requests for proposals. Unlike other Omani power schemes this will not be executed as a private project.

The private sector-backed ammonia and urea plant under preparation by *Engro Chemical Pakistan* should appoint a financial

advisor in H1 03. *ANZ*, *ABC*, *Apicorp* and *GIB* are shortlisted.

Financial institutions have been scrambling over themselves to secure lucrative corporate finance income in the Sultanate over the past year. The intense competition is a reflection that Muscat is at last expediting its industrial diversification programme, following years of hesitation and delay.

There is also increasing optimism that a turnaround in local banks' fortunes beckons after years of tight liquidity and bad loans.

National Bank of Oman announced in early March a 97% reduction in net 2002 losses, having previously been heavily exposed to the collapse of *Ali Redha Trading Group*. Operating income grew 23% to RO32.6m (\$83.6m).

SAUDI ARABIA: Small Fish Outshine Sluggish Big Guns

Falling interest rates, tough global economic conditions and increased loan loss provisions precipitated steep declines in profits at two of the Kingdom's largest banks last year.

Saudi American Bank (Samba)'s net income was down 17% to SR1.86bn (\$495m) in 2002. *Al-Rajhi Banking and Investment Corporation* saw profits decline again, down 8% to SR1.41bn.

The big players' disappointing performance contrasted sharply with the six small and medium-sized banks, which recorded net income growth of between 13% and 20% following improved loan demand growth. The unlisted *National Commercial Bank* continued its revival with a 25% rise in profits, while *Riyad Bank* – another big player – showed a more modest 4.8% rise in net income.

Samba blamed lower interest rates and the impact of net credit costs totalling SR101m (against net recoveries of SR103m in 2001) for its dismal performance.

Al-Rajhi, still reeling from its exposure to the *Enron* collapse in 2001, blamed difficult trading conditions for its losses. Overall Saudi bank income growth was a paltry 1.2%, despite the smaller banks' sterling performances.

Excluding *Samba* and *Al-Rajhi*, listed Saudi bank profit growth was a more robust 14.2% in 2002.

According to a review of banks' performance by NCB Chief Economist *Said Al-Shaikh*, last year's growth came on the back of a 5.3% rise in net commission income to SR10.3bn, largely due to a 47.4% drop in commission expenses.

A decline in commission expenses significantly outpaced the increase in commission income, indicating that the repricing of loans was moving at a much slower rate than the decline in interest rates.

A 14.5% across-the-board increase in banking services income contributed to the improved profits of the smaller and medium sized players. Excluding *Al-Rajhi*, loan/deposit ratios rose by an impressive 6% to 58%.

Saudi Investment Bank (SAIB) led the way with a 25.1% growth in profits last year, although *Bank Al-Saudi Al-Fransi* showed the largest total profits of SR1bn – a rise of 20% on 2001. Small- and medium-sized banks continue to improve their income diversification by increasing banking services' share of income.

Saudi British Bank (SBB) reported a 23.7% increase in service income and the Kingdom's minnow, *Bank Al-Jazira*, recorded an 18.6% rise in service income. *SBB* showed a sharp decline in loan loss provisioning in 2002 of 37.4%.

Saudi banks face a challenging year ahead, with anticipated capital markets and insurance legislation removing their monopoly on investment banking and insurance.

Also in prospect is increased competition from non-Saudi banks. The *Saudi Arabian Monetary Authority* granted licences to three *GCC* banks last year.

IFC Kick-starts Saudi Corporate Bond Market

The *World Bank's* International Finance Corporation has signed a riyal-denominated partial credit guarantee worth up to \$6.7m for the Kingdom's first corporate bond issue, for *Orix Leasing Company*.

The IFC sees the \$15m equivalent three-year bullet repayment bond as a start in the development of a local corporate bond market.

Saudi Investment Bank is issue advisor, market maker and guarantor of the bond.

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Sniping By Saudi Princes Inveigles Lebanon's Warring Billionaires

RIYADH/BEIRUT—Saudi Arabia's grip on the Lebanese public imagination grows ever tighter. Riyadh's \$700m lifeline to cash-strapped Beirut, extended in November at the Paris II meeting of donors convened by France's President Jacques Chirac, has opened up new channels of influence for the Kingdom in a country where it has traditionally exerted a strong behind-the-scenes presence. The Saudis' increased bargaining power vis-à-vis the Lebanese is already yielding impressive diplomatic dividends. Beirut signalled in early March that its top brass would not attend the *Organisation of Islamic Conference's* meetings in Qatar, in deference to the Saudis' continued pique at Doha.

Beirut's obeisance to Saudi sensitivities may be considered a price worth paying, given the Kingdom's apparent unending willingness to bail it out of its self-inflicted financial quandary. Less welcome for the Lebanese-born, Saudi-made Prime Minister-tycoon Rafiq Hariri is the growing interest in Lebanon being shown by influential Saudis with axes to grind. Hariri has maintained a relative diplomatic silence over the looming political ambitions of the other Saudi-Lebanese billionaire, Prince Alwaleed Bin Talal. His stoicism could be tested this year, if Alwaleed makes real his intimations towards staking a claim for the Lebanese premiership (*GSN 699/9*).

As if deflecting Alwaleed's pointed barbs at his handling of Lebanon's debt-ridden economy wasn't enough, Hariri is finding other members of the Saudi royal family lining up to take potshots at his leadership. One Al-Saud with an steadily increasing public profile, Prince Sultan Bin Turki Bin Abdelaziz – whose father was Ibn Saud's eldest recorded son, making him a nephew of King Fahd – broke with usual Saudi diplomatic niceties to label Hariri a "thief", for allegedly pocketing previous loans granted by the Saudis instead of spending them, as intended, on Lebanese public projects.

According to a statement received by the *UPI* news agency in

January, Sultan Bin Turki charged Hariri with using a \$500m Saudi loan to buy a *Boeing 777* worth \$250m. "The royal family disburses some SR10m in charity to the Saudis while it grants hundreds of millions of dollars to the servant thief to buy fancy private planes," the statement said. "Such techniques are not those of a statesman but of a contractor and entrepreneur who follows his innate greed."

Prince Sultan has also been vocal on the subject of Arab intervention in Iraq, while his business interests have attracted considerable attention in Pakistan, where he has tried to buy assets including *Habib Bank* and make major investments. He is chairman of at least two bodies, *International Islamic Development Trust* and *International Infrastructure Development Company*.

Hariri's political reputation in Lebanon was forged largely as a result of his close ties to the House of Saud; he acted as special emissary for Saudi Ambassador to Washington Prince Bandar Bin Sultan Bin Abdelaziz during the early 1980s Lebanese civil war. He may surmise that the missiles landing from Riyadh have more to do with rivalries inside the Saudi elite than from any of his own alleged transgressions. Hariri's close ties to Crown Prince Abdallah Bin Abdelaziz provide a useful cover for the real target of some Sudairi princes' ire – the Al-Faisal camp inside the royal family (*GSN 702/20*).

Prince Sultan Bin Turki's new-found support for Hariri's bitter foe Prince Alwaleed has more than whiff of opportunism. In 1999 Sultan lambasted Alwaleed for making noises towards internal political reform in the Kingdom. The billionaire investor's comments he said "were in the interests of the West and parties opposing Saudi policies".

The Lebanese Premier would be advised to keep his head down in the enveloping intra-Saud crossfire if he is to consolidate his position as Lebanon's man in Saudi Arabia.

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