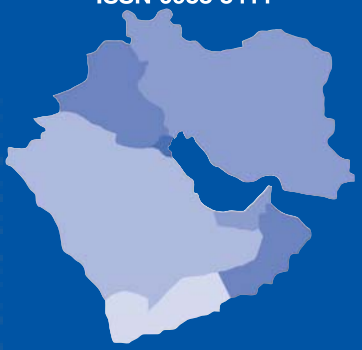
Gulf States Newsletter

Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, UAE, Yemen

4 April 2003
Volume 27, Issue No. 707
ISSN 0953 5411



GSN

Companies & People

Dubai Democracy Shock

Not content with pushing ahead with global-scale sports events to show it's business as usual and taking a lead in events to raise funds for Iraq, Dubai's driving force, **Crown Prince Sheikh Mohammed Bin Rashid Al-Makhtoum**, has ordered the establishment of democratically elected district councils within three months. *GSN*'s suggestion that "reform in the ***GCC*** could yet be the legacy of regime change in Iraq" could be confirmed even before President **Saddam Hussein** is removed – although the **UAE** itself had advised against 'regime change' course of action *(GSN 706/2)*.

The reform, revealed at a 1 April meeting of Dubai's ***Executive Council*** chaired by Sheikh Mohammed, represents a first step into democratic politics for the UAE. While Sheikh Mohammed's forceful vision has been pivotal in shaping Dubai's dramatic economic transformation in the past 20 years, his has been a top-down style of leadership and – in contrast to leaders in **Sharjah** and **Ras Al-Khaimah** – he had shown little interest in political innovation. But perhaps observers should not be surprised that a man who has put such

Continued on page 14

Across The Region

US Air Force, Centcom and Defence Intelligence Agency planners told *GSN* the military phase of Iraq's "transition" was developing at about the speed they expected. Best case and worst case scenarios have not come to pass in the war's first fortnight. The War, Page 7

Operation Iraqi Freedom has entered a decisive stage, with three US divisions fixing Iraq's principal fighting forces in the southern hemisphere of Baghdad. Centcom is relieved that Saddam Hussein allowed this decisive encounter to develop, but resistance could be fierce. Page 8

Turkey's refusal to allow the USA to launch an invasion of Iraq from the north did not stop the war, but it has shaped the pattern of the conflict. *GSN* counts the cost for Turkey and the USA. Page 5

Iran's warring domestic factions have shown a spirit of compromise absent before the US/UK assault on Iraq began. Reformers have some recovery space, but there are big battles to come. Page 9

Crown Agents has become the first UK firm to win a subcontract in the US programme to rebuild Iraq. How this squares with EU and other efforts for the UN to take a lead in Iraqi reconstruction remains to be seen. UK officials are praying for the Bush Administration to give ground to a produce genuine multilateral effort. Page 24

Oil companies are resuming offshore work in northern Iran having evacuated workers in the run-up to war. Page 14

Saudi Arabia's Ambassador to Côte d'Ivoire Mohammed Bin Ahmed Al-Rashid was found dead. Page 13

Rising domestic debt poses questions of payments risk. Finance, Page 22

Germany's KfW is leading the $600m Sohar fertiliser plant financing. The IDB Infrastructure Fund has bought its first big equity stake, in AES Oasis. Page 22

MEE Pointers on Bahrain, Kuwait, Qatar and Yemen. Middle East Energy, Page 15

Al-Jazeera is emerging as the defining media organisation of the Iraqi war, just as CNN was during Gulf War II. Its leading role was apparent well before 9/11 focused US attention. Perspective, Page 2

GSN's Analysis

Iraq's accession to oil's big league will depend on geopolitics and corporate spending, rather than its 6m b/d production potential. *GSN*'s new *Middle East Energy* section analyses the claims that Iraq can emerge as a new super-giant oil exporter that have fired IOC and neo-conservative imaginations. Middle East Energy, Page 15

The Iraq war's intense unpopularity has meant key US allies such as Saudi Arabia, Turkey and Jordan placing their domestic constituencies' requirements above those of the US military. The war will be longer and more costly for the USA as a result. Regional states are aware that for all the superpower packs the biggest punch they have some degree of autonomy of action. *GSN* looks at the basing options. Page 3

If George W. Bush wants to give the lie to accusations that the war is about oil and US power, he must accept that supreme authority over post-war Iraq should be vested in the UN and Iraqi politicians, not the White House. GSN View, Page 2

War in Iraq adds to pressures on Saudi Arabia, with official data showing 30%-plus unemployment and Jihadi groups claiming increased support. The Al-Sauds will survive, despite some uncomfortable moments, buoyed by big oil revenues and the promise of more reforms. *GSN* retains its C/2- Risk Grade. Risk Management Report, Page 21

Qatar is caught between its alliance with the USA and popular opposition to the war, but its small population remains under control. Huge gas potential helps to underwrite Doha's political adventures. *GSN* maintains Qatar's B/2+ Risk Grades. Risk Management Report, Page 20

The northern Emirate of Ras Al-Khaimah is dominated by the Al-Qasimi family, in business as well as politics. They are promising political reforms. *GSN* looks at the prospects for political change and economic prosperity in RAK. Centrepiece, Page 11

Reports of a Pentagon blacklist of companies investing in Iran should shake IOCs and others who believed the USA had dropped its sanctions threat, and underlines how bad US/Iranian relations have become. Page 14

GSN View

Can the United Nations really count for much in Iraq? US neo-conservatives would have us believe that in refusing to back their government's policy, the UN has rendered itself irrelevant. The massive military clout deployed by President George W Bush supposedly shows us that the globe's sole hyper-power now makes the rules. An assertive post-war US redistribution of Iraqi oil concessions would only reinforce this impression. *GSN* argues in its new *Middle East Energy* supplement that Iraq National Oil Company (INOC) has the means to run key elements of the recovery programme – and suggestions that a US executive, such as former Shell Oil chief executive Philip Carroll, should head up Iraq's upstream will not help win over Arab hearts and minds.

Many names are being mentioned as candidates to help run a post-Saddam Iraq – with the mainstream media just coming to terms with the US Administration's choice as head of reconstruction, retired Lieutenant General Jay Gardner *(GSN 706/6)* – but US policymakers do not even have a clear and commonly agreed plan for the governing and reconstruction of Iraq. The Pentagon is said to envisage a network of some 23 American provincial governors, with Iraqi "advisers" alongside. But the USA has neither the legitimacy in international law, nor the practical capability, to impose and operate such a system.

The White House is already finding that other parties can do some things that USA Inc. has reserved for itself. In a telling vignette, US fire-fighters commercially contracted by Washington to plug burning Rumeila field oil wells were still waiting for their imported equipment to arrive when experienced Kuwaiti teams simply drove in and started working free of charge as a goodwill gesture to Iraqis.

The UN's role could be this experience writ large. It is the UN that has personnel, local knowledge and contact points nationwide – and a catalogue of past experience in the recreation of political structures, economic activity and public services in post-conflict situations such as Kosovo and Afghanistan. Even US conservative hawks now say they would like the world body to take on much of the humanitarian burden. But whether they will accept the need for UN authority over political matters is another matter.

The Bush Administration talks about the need to create a well-governed and democratic Iraq as a pole of stability and reform in the Middle East. But such an entity cannot simply be imposed, least of all through a "jobs for the [Iraqi National Congress] INC boys" distribution of patronage to returning pro-American exiles, and the creation of an alliance that also includes some big-time Baathists who changed sides just in time. If a reconstructed Iraqi state is to be stable and contribute to the region's wider stability it must be built through demonstrably open-minded consultation and a political process that enjoys genuine popular acceptance. Pentagon puppets, installed after years in armchair exile, will have roots no deeper than those of the short-lived monarchies Britain devised for the Middle East after the First World War.

Only the UN can endow the process of political reconstruction with broad legitimacy, in the eyes of Iraqis and their Middle Eastern neighbours. Only if the transitional political authority is vested in the UN will all potential donors feel able to contribute to reconstruction. There are tight legal constraints on when the European Union – generally the largest contributor in such situations – can release funds, after the immediate humanitarian emergency is over.

The Oil-for-Food Programme already been placed under the authority of UN Secretary General Kofi Annan. He will be able to deploy its resources to much greater practical effect if Iraq is governed by a UN-sponsored transitional administration than if it is ruled by a contested neo-colonial American viceroy. If military advances on 1-3 April really do mark the start of the "battle of Baghdad" – and the massive US bombing of Republican Guards divisions really has caramelised a key element of hardcore Iraqi resistance – we face a true test of Washington's intentions. If George W. Bush wants to give the lie to accusations that this is a war about oil and American power, then he must accept that supreme authority over post-war Iraq should be placed in the United Nations and not the White House.

Perspective: One Year Ago

News that Al-Jazeera Satellite Channel is contemplating the launch of English language services is a measure of the international attention the Qatar-based satellite television station has attracted since emerging as the prime reporter of communications from Osama Bin Laden *(GSN 685/1)*. Al-Jazeera had established a big reputation in the Arab world well before 9/11. As all eyes turned to Bin Laden, the West was forced to come to terms with a media organisation that covered events from an Arab standpoint – and had achieved global impact… Among Arabic speakers it is acquiring the standing of a basic point of reference, like CNN or the BBC.

Adjusting to this reality has not been a comfortable experience for Western governments, forced to send senior figures for interview and rapidly upgrade their ability to provide Arabic-speaking press spokesmen – while at the same time complaining that the channel is Bin Laden's 'mouthpiece'…

The key to Al-Jazeera's popularity is its role as a forum for free speech in a region where governments have traditionally controlled the media and stifled news and debate that might stir popular discontent.

GSN, Vol. 26, No. 685, 1 May 2002

Geopolitics

Basing Restrictions Channel Coalition 'Like Toothpaste Through A Tube' Towards Baghdad

The **Iraqi** conflict, intensely unpopular in the region, has seen key **US** allies such as **Saudi Arabia**, **Turkey**, and **Jordan** place the requirements of their own domestic constituencies above those of the US military. The result will be a longer and more costly war for the US in terms of blood and treasure.

This has surprised the Western public who (pro- or anti-war) had been conditioned to expect a speedy victory over a collapsing ***Baathist*** regime for a US-led military campaign, backed by a mighty political sledgehammer to crack recalcitrant allies' resistance to a new conflict.

But regional states had become increasingly aware that for all that the superpower punches biggest, they had some degree of autonomy of action.

When *GSN* reviewed US basing options last September, we noted that "regional powers are finally beginning to recognise their individual and collective roles in US power projection and the leverage that goes with such roles. The perception is slowly dawning in the ring states surrounding Iraq that regional powers could stop or shape a future war between Washington and Baghdad *(GSN 693/3)*."

With Turkey, Saudi Arabia, and Jordan vetoing the insertion of major US ground forces and limiting air operations, **Kuwait** held the key that allowed the war to proceed. The concept of operations and conduct of operations was shaped by the basing conditions set by regional states.

The 'Kuwaiti aperture'

As the **German** government is keen to point out – and ***GCC*** states are keen to obfuscate – some of the most significant military contributions to *Operation Iraqi Freedom* have come from states outside the 'Coalition of the Willing'. Kuwait is the only Arab state willing to be listed as one of the 44 members of this nebulous grouping *(GSN 706/2)*.

Kuwait, plus Iraq's small coastal opening into the Gulf, provided the 'aperture' through which the USA and **UK** were forced to introduce major land forces – a far cry from the 1991 war, when the full breadth of Iraq's 488km Saudi border was available for land operations.

Yet, while coalition ground forces have been forced to deploy out of Kuwait like toothpaste squeezing from the tube, it is uncertain that the ground forces element of the concept of operations has been substantively altered by basing restrictions in Saudi Arabia and Jordan.

One US Central Command (Centcom) planner outlined the impact on ground operations for *GSN*, explaining: "the [Operations Plan] OPLAN was a modified version of the follow-on plan designed after *Desert Storm* in the spring of 1991, merged with elements of the main Centcom OPLAN, 1003V, which planned for an attack along the axis towards Baghdad from Kuwait."

The planner noted: "we always suspected that we would be unable to use Saudi Arabia, which has been increasingly unwilling to accept US ground forces since [*Operation*] *Vigilant Warrior* in 1994, when Iraq deployed strong forces to the south."

Explaining that Iraq's strategic geography was "a wheel, with Baghdad as the hub", the planner argued that the ground element of the current plan would only have differed by including up to two new "spokes in the wheel" – an advance by 4th Infantry Division from Turkey, and perhaps an advance by the US 101st Air Assault Division from the Saudi border directly to the Karbala or Falluja areas, south-west and west of Baghdad.

The planner noted that in the optimal version of the OPLAN's many variants, Centcom aimed to operate one line of communication (LOC) to each of the main divisions in Iraq: the 4th US Infantry via Turkey; the 101st US Air Assault via Saudi Arabia; the 3rd US Infantry via the line of the Euphrates to Kuwait; the 1st US Marine Expeditionary Force (MEF) via Kut to Kuwait; the 1st UK Armoured Division from Basra to Kuwait.

Consequences of Saudi reluctance

The loss of Saudi Arabian land forces basing has resulted in heavier logistical strain on the 101st Air Assault and some difficulties in running its LOC parallel and to the west of the 3rd Infantry Division LOC. The Centcom planner noted that "we were always heading towards Baghdad, and always had to take Basra, for humanitarian reasons, so the loss of Saudi bases hasn't affected operations – the big loss there was caused by the Turkish failure."

Centcom officers canvassed by *GSN* are less sanguine about the loss of Saudi ports.

Kuwait's two main ports for consumer goods – Mina Shuwaikh and Mina Shuaiba – represent a considerable chokepoint for US logistics and reinforcements. With Umm Qasr assigned to high-priority humanitarian supplies, Centcom is anxiously pondering the mid-April arrival of the 4th Infantry Division.

Saudi ports would considerably ease the burden. Shuwaikh has 21 deepwater berths, but Saudi

Arabia's port complex at Dammam boasts 39 deepwater berths, including six specifically designed to accommodate the roll-on, roll-off ferries used to transport the armoured vehicles of 4th Infantry Division and other units.

In other ways, the concentration of coalition ground forces in Kuwait proved a blessing. Kuwait was possibly the only Arab country that could rhetorically justify the basing of US forces, counting as a "special case" since 1990.

Kuwait is an 'intimate US ally'

Kuwait proved to be a relatively secure location, with strong government force protection measures reducing the potential for attacks on deployed coalition personnel.

Considerable tracts of agricultural land and road infrastructure have been damaged by transiting forces; a considerable portion of the country was turned into a militarised zone; checkpoints dot key highways; the Kuwaiti security services and police forces have taken preventative actions; Kuwaiti naval forces have patrolled the entrance to the Shatt Al-Arab, protecting US forces and destroying an Iraqi dhow believed to carry saboteurs.

Kuwaiti citizens can harbour no illusions about their national stance: Kuwait made the war possible, has supported it ungrudgingly and in every possible way.

The Catch: Air Operations

The loss of Saudi airbases has not crippled the air campaign. But it has thrown the spotlight onto smaller ***Gulf Co-operation Council (GCC)*** states like Kuwait, **Qatar** and **Oman**, and has made the task of providing high sortie rates harder. The current air forces order of battle sits equidistant between the high and low-end estimates issued by *GSN*, with 550 land-based aircraft supplemented by 450 carrier-based aircraft and 29 cruise missile-capable ships and submarines.

- **Kuwait and Oman:** As was the developing trend throughout the 1990s, Kuwait and Oman have not restricted overflight or basing of combat aircraft.

- **Saudi Arabia and Turkey:** The no-fly zone forces based in Saudi Arabia and Turkey are providing quasi-combat forces, including tankers, surveillance aircraft (JSTARS, AWACS, Rivet Joint), combat search and rescue, and suppression of enemy air defences (SEAD) aircraft.

- **The UAE:** In keeping with **Sheikh Zayed Bin Sultan Al-Nahayan**'s firm stance on the war, the UAE has only permitted US reconnaissance assets to base from the Emirates.

Although neither will admit to allowing cruise missile overshoots, either Saudi Arabia via the empty areas of the Western Desert or Jordan must be allowing Tomahawks to transit their airspace. Reports that four Tomahawks had landed on Saudi territory point to overflight of the Kingdom. With air operations commanded from Prince Sultan Air Base (PSAB), informed commentators from the US ***Defense Intelligence Agency (DIA)*** told *GSN* that Saudi Arabia had effectively ceded airspace control to the USA, allowing some air-to-ground strike packages to transit its airspace.

Questions of proximity

The relatively trim forces deployed in-theatre fell far short of the bloated 2,800 aircraft force used in 1991, considered by air planners at the time to be an airspace management nightmare for no appreciable operational advantage.

The smaller, more advanced force used in *Operation Iraqi Freedom* has not been short of ramp and apron space in the GCC states – requiring 6m-10m ft^2 of space, the airfields currently being used by land-based air forces provide over 40m ft^2.

The key limitation has instead been useable bases for offensive combat aircraft (bombers) at close proximity to the Iraqi border.

Kuwait absorbed as many of these aircraft as possible – a non-optimal solution that has resulted in serious overcrowding of the airspace. This is a particularly dangerous situation when the area is under ballistic and cruise missile attack – as displayed by the downing of a returning British Tornado GR4 by a US Patriot missile.

With the majority of strike assets travelling in from US aircraft carriers, **Diego Garcia**, the UK, Oman and Qatar, the key effect of Saudi Arabia's unwillingness to base additional strikers has been to reduce the sortie rate, lower availability of on-call close air support and increase support requirements (such as tankers).

Airfields are required within a 400- to 700-mile range of Baghdad to allow more than one sortie per day to meet the requirements of close air support as forces engage in large clashes near the capital.

The emerging solution is to deploy US close air support aircraft ('mudfighters') such as the A-10 or AV-8B Harriers to newly captured Iraqi airfields in the south (Tallil), the west (H-3), and perhaps the north (Harir, Bakrajo).

This entails a higher risk of airbase attacks and imposes a considerable support burden, but provides the requisite proximity.

Did Arab States Shape The Conduct Of Operations?

The campaign has highlighted the limits of US unilateralism and host-nation leverage. Without Kuwait, *Operation Iraqi Freedom* could not have involved a credible ground forces element.

Saudi Arabia and Turkey defined the axis of advance, according to Centcom expectations in the former case, and in contrast to their expectations in the latter.

In the air war, Kuwait, Qatar and Oman have each provided essentially unlimited support to the air campaign; Turkey and Saudi Arabia are likely to have made key low-profile concessions, but their reluctance has increased the USA's difficulty in providing omnipresent air cover for its forces.

The key lesson from the opening of *Operation Iraqi Freedom* has been that, no matter how narrow the aperture, the USA displayed the capability to make a forced entry into Iraq.

With the exception of Kuwait's decisive hold on operations – marking it out as an intimate US ally – the other Arab states have only made the US mission harder, longer and more costly in terms of blood and treasure.

Unrealistic Expectations Cost Turkey, USA Dear

With the battle outside Baghdad almost concluded as *GSN* went to press on 3 April, it was clear the battle in Baghdad would involve a gradual probing to isolate defended keypoints, followed by precise air strikes in a version of the gradual approach used by the **British** in Basra. It remained uncertain that the Iraqi regime would crack immediately, especially while it retained a defended enclave to its rear – in the area bounded by Republican Guard forces at Ramadi in the west; Kirkuk, Bayji and Tikrit in the north; and the Jebal Hamrin mountain range to the north-east, anchored by an untouched Iraqi Corps near Qanaqin.

The preservation of the Jebal Hamrin haven is the most serious consequence of the USA's failure to gain Turkish basing rights and develop a northern threat using the 4th US Infantry Division.

US Centcom staff told *GSN* that Iraq's ability to hold on to this enclave was "Saddam Hussein's greatest military victory of the campaign".

As the Turkish and US administrations count the economic and military cost of their failure to reach an accommodation over the deployment of US ground forces, commentators have started to unravel the chain of events that led to the withdrawal of the original $6bn US sweetener, the 4th Infantry Division's diversion to Kuwait, and the insertion of lighter, airmobile forces in the north.

The reverse has caused deep personal affront in a **Bush** Administration packed with advocates of a closer relationship with Ankara – notably Deputy Defence Secretary **Paul Wolfowitz**.

Secretary of State **Colin Powell**'s 2 April visit to Turkey confirmed a revised deal, described below. But for all Powell's soothing words, relations will remain uneasy while Iraq remains at war.

What is clear is that instead of stopping the war, Turkey has shaped it.

The original concept of operations for *Operation Iraqi Freedom* called for the 4th Infantry Division's heavy ground elements, plus elements of other units to enter northern **Iraq**, supported by the airmobile 173rd Airborne Brigade deploying from Vicenza, **Italy**. This powerful front, including the US military's most modernised division, would have required the use of airbases such as Erzurum, Diyarbakir, and logistical hubs at Antalya, Batman, Erhac and Mus.

Operating with considerable air support and local assistance, this option would have made a very considerable contribution to the war and would have provided greater guarantees against Kurdish expansionism than the current light option. As Turkish Chief-of-staff General **Hilmi Ozkok** noted on 5 March (after the vote): "The General Staff view is the same as the government – the war would be shorter, there would be less pain and fewer people would die."

Deep state view

Marking the difference between Turkish military and civil views, Ozkok concluded: "Turkey is not capable of preventing this war on its own – ours is the choice between bad and worse."

This voice of the Turkish 'deep state' – the military and intelligence communities – has been largely absent in this crisis. Their silence has been "thunderous", and hints at the willingness of the security state to let the new government fall flat on its face in the eyes of the USA.

According to Beltway insiders, the military agreement now under way between the USA and Turkey was arranged in the aftermath of a scathing letter sent by President Bush to the Turkish government, which threatened a major rift in aid and diplomatic relations unless some form of accommodation emerged. "sense of betrayal".

The Turkish response was to issue new proposed legislation at the earliest possible date, performing bureaucratic tasks in three days that would normally require months to achieve, and reshuffling officials to minimise the presence of anti-war sentiments within the Iraq policy team.

In response to a paltry $1bn in aid, currently under consideration in US Congress, which can be levered into $8bn in loans, Turkey has agreed the following concessions.

• Use of 11 lanes in Turkish airspace for US attack and support aircraft; this is being used to fly US special operations forces, paratroopers of the 173rd Brigade, and mechanised units from European Command directly into northern Iraq.

• Ongoing air operations from Incirlik air base, ostensibly under the remit of the northern no-fly zone but increasingly operating in direct support of US and Kurdish ground forces, albeit with some Turkish prohibitions. Cruise missile shoots over

Turkey were suspended after two missiles splashed down in the villages of Birechik and Virensehir.

Chief-of-staff General Ozkok recently agreed to co-ordinate all military actions in the north with the deployed US Task Force North commander in northern Iraq, Lieutenant General **Colby Osbourne**, who now has assurances from both the Turkish and Kurdish militaries that no unilateral actions will be attempted.

Although useful for stabilising northern Iraq, dissuading Kurdish or Turkish moves, and for pinning Iraqi forces in the north – away from the battle for Baghdad – the loss of the northern front did not stop the USA from starting the high-intensity phase of the war, but may have stopped it from ending it sooner.

The loss of 4th Infantry Division, representing one of the two strongest of the four divisions committed to the war is a grave blow, with the unit effectively out of the action until around 10 April, when it will deploy out of Kuwait.

Although this crisis may not represent a "watershed" in US/Turkish relations, as many commentators suggest, it will make the status of US basing at Incirlik highly uncertain, particularly in the context of largely misplaced concern about future operations against other potential targets such as **Syria**, **Iran** or the **Lebanese *Hizbollah***.

As former US ambassador to Turkey **Mark Parris** noted: "To the extent that it meant anything at all, 'strategic partnership' meant something different to the US and Turkey on the evening of 1 March than it had in the morning."

The context

US/Turkish relations had appeared on an upwards curve until the Turkish Parliament's 1 March vote narrowly rejecting the bill allowing US forces to transit through Turkey.

By the mid-1990s the USA had made up for its lack of promised financial support after the Gulf War and investment opportunities were developing at a faster than expected pace. The USA and Turkey agreed on key issues, including energy corridors to the Caspian and Turkish ambitions to join the ***European Union***.

Turkey made important steps to contribute to reducing the US strategic and military burden, supporting peacekeeping operations in the former **Yugoslavia**, and contributing forces to operations in **Somalia**, **Bosnia**, Kosovo, **Macedonia** and particularly in **Afghanistan**.

The Turkish/**Israeli** strategic alliance – a concept driven by commissioned studies carried out by Wolfowitz and other analysts now inside the Bush Administration – contributed to US containment of Iran and Syria. By November 1999, the **Clinton** Administration had labelled Turkey a "strategic partner" – a title that only Israel could claim in the pre-'war against terror' era. Turkey received firm support from the USA in February 2001, to obtain a major ***International Monetary Fund (IMF)*** programme.

Insiders noted the relationship had changed in subtle ways, however. Former US Ambassador to Turkey **Mark Parris**, an acute observer of the region now with **Baker Donelson**, noted that the rate of privatisation and US investment in Turkey had declined in the last two years, culminating in disappointing results when US private sector participation was courted through the January 2002 launch of the Qualified Industrial Zone. Although the Baku-Çeyhan gas pipeline is due to begin operation by 2006, prospects for the profitable operation of a parallel oil pipeline are less clear.

With the US State Department having achieved its primary goal in diffusing the ability of any one regional state to dominate energy transportation, particularly Iran, the diplomats from Foggy Bottom appear to be backing off and handing the baton to industry – a problematic policy during a period of global economic downturn.

Negotiations with Washington over military aid and technology transfers, concerning airborne warning and control systems (AWACS) and advanced attack helicopters, also appear to have stalled, mirroring Israel's disappointing experience of the Turkish/Israeli military alliance.

Misconceptions and insensitivities

Against this background of accumulating small reverses in US/Turkish relations, the newly elected ***Justice and Development Party (AKP)*** faced an uphill battle to win parliamentary backing for the deployment of a massive US military presence in Turkey.

This was a sensitive matter during the Cold War and since the end of the Gulf War, let alone during a period when opinion polls showed the Turkish electorate to be 90-94% against war with Iraq.

Initial US diplomatic moves were insensitive to these factors, resulting in the first US bid asking Turkey to base an unprecedented 90,000 US troops, later reduced to the hardly less threatening figure of 62,000.

Misperceptions appear to have exacerbated this situation. According to former foreign minister **Yasir Yakis**, a participant in the recent negotiations: "We thought that the US needed the northern front. We made bargaining plans based on this. We did not consider the possibility that they would apply Plan B." He noted that Bush moved to $6bn plus a further $1bn that could be leveraged to $8bn of loans, but stated: "We'd like you to be with us. But if you decide not to be with us, we can do this ourselves."

The Turkish government appears to have miscalculated in the belief that it stood a chance of stopping the war, leading anti-war Prime Minister **Abdullah Gul** to vacillate over pressing the case for US basing rights. This contributed to the narrow failure of the 1 March vote.

Operation Iraqi Freedom: An Interim Assessment

The initial phases of *Operation Iraqi Freedom (OIF)* are under way, but many of the uncertainties associated with the operation remain unresolved.

The ***Baathist*** regime retains a number of levers and could still trigger widespread infrastructure damage or use weapons of mass destruction (WMD). Extensive street-to-street fighting may or may not be necessary in Baghdad and other conurbations. The resilience of the Baathist regime and the tenacity of local Iraqi resistance pose thorny questions on the issue of conflict termination.

This interim assessment will review the phasing of OIF, the thinking behind the phases seen so far, the success of these stages, and the unexpected features that have emerged from them.

Read his lips

The political objectives of OIF have been clearly stated, and remain tied to the themes outlined in January 2002 in President **Bush**'s State of the Union address: disarming Iraq of its WMD and ballistic missiles and deactivating the country as an alleged haven for terrorists.

Regime change and the establishment of conditions for a stable and broad-based government are an adjunct political objective now that military operations are under way.

As a starting point for this analysis, it should be pointed out that a decade of military containment of Iraq has shown that these political objectives – particularly the first two – are among the least amenable to military solution.

The overarching military objective of extending control over the country is possibly the only means by which some progress can be made towards realising OIF's political objectives, but only if control is maintained for a sufficiently long time to locate WMD, neutralise terrorist groups or regime recidivists, and establish an economically and politically viable system.

The high-intensity, war-fighting part of OIF, not yet completed, represents only the first step required to achieve the operation's political objectives – the achievement of the military objective of establishing baseline control over the country is, in itself, only an interim step.

Not so bad militarily

According to US Air Force and ***Defence Intelligence Agency (DIA)*** planners canvassed by *GSN*, the military phase of Iraq's transition is developing at about the speed and in the approximate shape that US military planners expected in their median scenarios. Optimistic scenarios have been dashed, with the regime showing greater resilience than expected, and selected regular military forces fighting with some tenacity.

Neither have pessimistic scenarios come to pass, with no WMD use yet, minimal Iraqi sabotage of the southern oil fields, with the effective suppression of Scud launches against **Israel**, and with light coalition casualties.

If anything, the US military is growing increasingly exasperated by the media's perceived appetite for a disaster, and its attempts to suggest that operations are not unfolding as expected.

...bad media-wise

This perception was reinforced by a rare and controversial statement issued by the commander of US V Corps, the pistol-packing Lieutenant General **William Wallace**, who broke ranks and told reporters that "the enemy we're fighting is different from the one we'd war-gamed against".

This conditioned the public to expect up to 100,000 more troops and the possibility of an operational pause outside Baghdad while air forces prepared the battlefield for three to four weeks.

Iraqi error

President **Saddam Hussein** can claim several propaganda coups, but on the battlefield Iraq's movement of units south of Baghdad represents a critical error, illustrative of the inability of the Iraqi dictator to remain inactive and cede the initiative – and the burden of attacking – to the opponent.

As in the Iraqi incursion into Khafji during *Desert Storm*, operational movement has only

The View From Centcom

US Central Command (Centcom) planners canvassed by *GSN*, speaking on condition of anonymity, suggested that General **William Wallace** was right to condition expectations in his "war-game" intervention, but argued that Iraqi resistance was conforming to their median scenarios. They noted that "an operational pause outside Baghdad was always part of the OPLAN [operation plan]."

When questioned on the issue of reinforcements now being called from the USA, the planners noted: "These forces were assigned to us as an option in the [Time Phased Force Deployment Directive] TPFDD, but it was not expected that they would be needed." Arriving in 35 to 50 days, these forces are conceived of as follow-on forces to assist with the occupation of Iraq, which has been re-evaluated as a force protection environment due to the recent series of attacks by irregular forces and the lukewarm reception for coalition forces entering "tribal areas".

OIF's First Five Phases

The phasing of *Operation Iraqi Freedom* is entering the fifth of its loosely defined stages. The stages provide a good framework for analysis of the conflict:

- **Pre-war preparation:** No-fly and no-drive zones allowed the **USA** and **UK** to undertake a multi-faceted military campaign to begin even before the formal commencement of hostilities. Total air supremacy was established in the airspace north of 36N and south of 33N, radar and early warning networks were degraded, extensive psychological operations were undertaken, and – in advance of the campaign – Iraqi surface-to-surface missiles, anti-shipping missiles, and artillery pieces were struck to prevent anti-access strikes on deploying coalition forces.

- **Initial probes:** Initial operational activity focused on two immediate objectives. The first was to suppress Scud missile launches against **Israel**. Low-profile heliborne special forces and air operations in the Western Desert successfully overran the H-3 and H-2 airfields and surrounding Scud launch baskets. The second aim was to allow a brief window for a regime collapse to occur. Though not a pre-planned action, the time-critical attempted decapitation strike against the ***Baathist*** leadership provided a possible precursor to such a collapse.

- **Insert ground forces and secure base of operations:** This phase involved the initial break-in to the Basra and Rumaila oilfield areas, the capture of oil infrastructure and coastal keypoints, and the creation of sufficient elbow room for the US 3rd Infantry Division to develop a threat towards the Euphrates river valley.

- **Move to contact:** This phase, currently under way, involves the three main US formations moving towards their assembly positions outside Baghdad, engaging and overcoming resistance where encountered. The 1st US Marine Expeditionary Force (MEF) is developing a threat on the Nasariyah-Kut line of communication (LOC). The 3rd US Infantry Division is developing a threat on the axis of the Euphrates river, and has met the Iraqi line at Karbala. The 101st US Air Assault Division is moving on a parallel axis to the west of the 3rd Infantry Division, and is reported to be developing a threat towards Ramadi, to the west of Baghdad.

- **The high-intensity military campaign:** The next stage of operations is likely to be the decisive phase of the high-intensity military campaign – when the three US divisions fix Iraq's principal fighting forces, the three to four Republican Guard divisions protecting the southern hemisphere of Baghdad, allowing them to be destroyed by air and artillery strikes. Centcom staff are reportedly relieved that **Saddam Hussein** allowed this decisive encounter to develop. The USA moved quickly to prevent any retrograde re-deployment of Iraq's main fighting forces within Baghdad, interdicting the radial highways along which Republican Guard units could have retreated.

With ground attack aircraft redeploying to captured airfields in Iraq, and with the majority of air assets 'chopped' from the strategic air campaign to preparation of the battlefield, the USA appears to have successfully trapped Iraq's main fighting force in a vice.

exposed the Iraqi military to intense air attack.

All the Iraqi tactical successes in OIF came without operational movement of large armoured forces. On the contrary, they involved small pockets of low-intensity or light forces fighting from static positions or moving amongst civilian communities. Saddam's inability to cede the initiative to his opponent may cost him many of his best troops for no gain.

When serious uprisings began in March 1991, the immediate precursor was a highly visible battlefield defeat in **Kuwait**. With the coming battle around Baghdad, residents of that city will witness sights they have never witnessed during over a decade of US military containment – the flash and rumble of artillery on the horizon, deserters and wounded moving through the city describing the battle. Although decisive battle is a rare incidence in modern warfare, it may take something this archaic to unseat the Baathist regime.

Unpalatable alternatives

The Baathist regime now faces a number of unpalatable alternatives, with Iraq facing significant obstacles to prosecuting an effective long-term urban warfare strategy, despite the apparent successes of the war's early days.

The four Republican Guard divisions around the capital have been deployed to force US formations into a long operational pause that could ossify into a stalemate or a negotiated settlement.

Consequently, the regime will probably avoid bringing them into Baghdad – at least while they remain more or less intact – for fear that they might undertake a coup.

Should they attempt to fall back to the outskirts of Baghdad, they could suffer heavy losses en route as a result of coalition air strikes.

Those units that make it back to Baghdad will probably lack sufficient numbers or time to establish effective defences. This job will be left mainly to units of the lightly armed Special Republican Guard (SRG) with 15,000-25,000 men and some 100 tanks, the Special Security Organization (SSO) with 5,000 men, and other paramilitaries. These organisations have a major presence in Baghdad, know the city well, and could feasibly wage a protracted urban guerrilla war against coalition forces while senior members of the regime escape into the hinterlands.

Some way from endgame

The Washington policy community is turning its face from the current battle towards the policy horizon, questioning whether decisive military victory outside Baghdad will obviate the need for street-to-street fighting in Baghdad, and asking how much the achievement of the military objective of occupying Iraq will contribute to OIF's political objectives.

The regime's savvy media strategy and the lack of suicidal actions, such as using WMD or Scuds, indicates that the Baathists do not want to give the Bush Administration any evidence that its *casus belli* were legitimate – and is not thinking in terms of a final battle. This is a chilling thought for some US policy-makers already seeking to justify a quick pull-out after the military phase ends.

Politics And Security

Iran Is United, For A Moment, To Oppose War Against A Reviled Old Enemy

War in **Iraq** has left the political and clerical elite united in public criticism and private wariness – for all that **Saddam Hussein** is hated for the 1980-88 first Gulf war – Iranian reformers are working to re-establish their own position after catastrophic defeat at the hands of conservatives in the recent local elections *(GSN 705/17)*. But faced with the risks to regional stability posed by the **US/UK** assault on Saddam Hussein's regime, Iran's warring domestic factions have exhibited a spirit of compromise that had been notably absent over the past year.

The war has given the battered reformers some much-needed recovery space by fostering an increased sense of national unity. All political camps are united in criticism of what they regard as an illegitimate Anglo-American attempt to impose regime change on Baghdad.

This sense of national consensus has been heightened by US Defence Secretary **Donald Rumsfeld**'s attacks on Iran and **Syria** for their alleged interventions in the Iraqi conflict. As *GSN* has long argued, the irresistible rise of neo-conservative thinking in Washington has acted to confirm Iranian conservatives' fears that Iran could come under renewed attack from the USA *(GSN 705/2; 704/11)*.

Even though London has given private reassurances of its intention to maintain good relations – provided the Islamic Republic stays out of the war – all camps in Tehran are well aware that some of Washington's most influential hawks plan to pile the pressure on Iran once Saddam has been "taken care of".

Ayatollah **Ali Montazeri**, the moral beacon of Iran's reformers, recently released from house arrest, has been unambiguous in his condemnation of the attack on Iraq and those who have connived in it. "The countries that have granted use of their territory or airspace like **Kuwait** and **Turkey** have committed a grave error," Montazeri said on 31 March.

The confrontational *ambiance* could easily return to Iranian politics. Indeed, it almost certainly will do so once the Iraq war is over, if not before.

But for now, both the hard-line clergy/conservative camp, and their opponents, the parliamentary supporters of President **Mohammad Khatami**, have shown themselves ready to compromise over some domestic issues, notably cutting a deal over a potentially contentious budget increase for the ***Guardians Council (GC)***.

Conservatives, their confidence bolstered by the election gains (albeit achieved on a low turnout), may have felt they could afford to show a touch of magnanimity on this secondary issue. Meanwhile chastened liberals, struggling to recover their confidence, were willing to accord a significantly increased purse for the GC.

But the manner in which the settlement has come about suggests that the reformers who dominate the Majlis (Parliament) still feel strong enough to draw the line on some issues. The fact this paid off may go some way towards restoring their hopes for future progress.

The big test is yet to come, when the Majlis seeks to secure the consent of the Islamic Republic's other key institutions to its bill increasing the President's powers.

GC BUDGET BATTLE

The GC budget wrangle has provided a modest foretaste of this more contentious impending political battle.

The GC's budget for 2002/03 was IR24bn. A hefty increase was always going to be needed for 2003/04, because the Council is responsible for organising parliamentary elections. These are next due to be held in February, towards the end of the 2003/04 financial year, which began at Norowz on 21 March.

In its budget bill for this new year, the Majlis ratified a near doubling of the allocation to ensure the GC to could meet the election costs.

This did not satisfy the Council – whose main role is to act as a constitutional watchdog, ensuring that proposed new laws and government measures are in line with the basic principles of the Islamic Republic. It sought a further budget hike of IR60bn (compared with the IR24bn offered by parliamentarians).

Despite claims that it risked accumulating an IR60bn deficit if it did not get the extra cash, the GC appeared to be using the issue to publicly assert its importance vis-à-vis the Majlis.

The Council comprises six clerics appointed by the Rahbar (Supreme Leader) – Ayatollah **Ali Khamenei** – and six jurists appointed by the head of the judiciary and approved by Parliament. This balanced membership is theoretically supposed to ensure its credibility as a neutral enforcer of constitutional principle.

But like the judiciary, it has moved towards an increasingly conservative interpretation of the Islamic Republic's basic operating principles. This has had the practical effect of blocking many reform measures put forward by Parliament. With Majlis and GC deadlocked, the issue passed up to the ***State Expediency Council (SEC)***, whose role is to arbitrate when these two institutions are in conflict.

The SEC is chaired by wily former (and future?) president **Ali Akbar Hashemi Rafsanjani**. In recent months Rafsanjani has successfully rebuilt his influence, positioning himself as a pragmatist – conservative on core issues and able to keep the clerics on side, but nevertheless a man with whom the outside world can deal.

By mid-March SEC Secretary **Mohsen Rezaei** was indicating that his body supported the case for a big hike in the Guardian Council budget, to around IR100bn. He said this assessment was shared both by the SEC's own team of financial experts and by officials from the ***State Management and Planning Organisation (SMPO)***.

So on 15 March, the SEC decided to ratify GC's own budget proposal, setting aside the decision taken by Parliament. The Majlis and President Khatami rapidly smelt a rat – and perhaps an empire-building play by Rafsanjani.

The SEC had overreached itself. On budget matters, the Constitution does not entrust it with the final power of decision. Khatami, Majlis speaker **Mehdi Karroubi** – a distinctly moderate reformer but a fiercely committed defender of parliamentary prerogatives – and Majlis Budget Commission Chairman **Majid Ansari** all walked out of the SEC meeting in protest at the move.

Karroubi was blunt: he said the government and the SMPO had already agreed the shortfall in GC funding would be met through other channels. He accused the GC and SEC of seeking to bypass Parliament's role.

The Constitution, which in so many other areas gives the judiciary or the GC and SEC the last word, vests the main budget powers clearly in the Majlis. Legislators clearly felt this was a crucial instrument of power that they must fight to retain.

Truce before a big battle

Having made their point and secure in the knowledge that, for once, the Islamic Republic's arcane rules were on their side, parliamentarians then felt they could offer the olive branch of compromise.

Damning with faint praise, Deputy Speaker **Behzad Nabavi** generously insisted that Rafsanjani could not be blamed for the SEC's "illegal" attempt to ratify the GC budget proposal as he "merely presides" over Council meetings.

On a more practical level, Parliament's arbitration committee – Nabavi, Ansari and three other MPs – met Rafsanjani and the GC on 19 March. They negotiated a settlement endorsing a government suggestion that the GC budget be more than doubled, but with the funding released gradually over the course of the year.

Having successfully defended the principle of its control over budget affairs, the Majlis did not want to waste time and goodwill haggling over the detail of the figures. It will need to harbour every possible ounce of political leverage if it is to make headway with the much more controversial bill to enhance presidential powers.

This is a crucial measure because it begins to shift a measure of constitutional clout from the nominated GC and SEC – in which clerics and conservatives have a powerful voice – to the elected President (Khatami).

That would enhance the long-term prospects for further reform progress, because it undermines these nominated bodies' ability to block reform measures proposed by the elected head of state or Parliament. Much of their constitutional power would move to a new body appointed directly by the president.

This bill would oblige all state bodies to co-operate fully with a committee the President would establish to oversee execution of the Islamic Republic's Constitution. Those arms of the state that failed to comply within two months would be subject to formal examination by this committee on charges of violating the Constitution; they could face court proceedings.

The committee's creation would allow Khatami to chose a new team of constitutional arbiters, more modern in outlook and drawing on a broader spectrum of opinion than the overwhelmingly conservative circles that influence nominations to the conservative GC and SEC. Attempts to drive forward a reform of this type date back as far as 1986, but it has never made progress.

The new reform bill is strongly supported by Khatami's parliamentary allies. But it will only become law if it can secure the assent of the very bodies – the GC and SEC – whose own present dominance will be undermined if the new structure is put into effect. Parliament's recent victory over the budget issue thus represents no more than a minor skirmish.

Chamber of Commerce elections

A victory for reformists in the 26 February election of the Iranian Chamber of Commerce, Industries and Mines (ICCIM)'s representative board showed what can still be done if voters mobilise. The vote, organised by reformist industrialists, turfed out the conservative leadership that has dominated ICCIM since 1980.

In Tehran (where only around 10% of voters turned out in municipal elections), 1,812 ICCIM members out of 8,858 eligible voters participated – sufficient for a clean-out. Twenty-five of ICCIM's

40 elected representatives were elected for the first time – including two women – suggesting further changes could follow.

Reformists need all the encouragement they can get, and Khatami and his allies cannot allow themselves false optimism. Karroubi insists the reform movement survives, but for a reality check modernisers need only look back to their recent crushing local election defeat – the result of a dismal turnout among voters fast losing hope.

A failure to secure further gains this year – and especially those of a practical everyday nature appreciated by ordinary Iranians – would leave the reformers exposed to the risk of further ballot box punishment when voters are invited to elect the next Majlis just over ten months from now.

That bellweather of Iranian politics, Rafsanjani, continues to point towards a conservative trend at the core of the Iranian state. In an early March interview with hard-line daily *Jomhuriye Eslami*, Rafsanjani compared Iran today with the turbulent period of the third Shiite Imam, Hussein – whose shrine at Kerbala, Iraq, is so in the news – commenting that "a secularist current is pushing to distance people from their beliefs … it is time to rise up and brandish sword or unleash the shield of Jihad against enemy's sword. It is not a time for compromise."

Imam Hussein died with sword in one hand and Koran in the other, with the words: "Death with dignity is better than a life of humiliation." Iranian conservatives, like Iraqi fedayeen, plan to go down fighting.

Centrepiece: Ras Al-Khaimah

Business As Usual For RAK's Al-Qasimis

Ras Al-Khaimah is not the most obvious wellspring of political reform in the **UAE**, but RAK seems to be making the running in recent initiatives.

Sheikh Saqr Bin Mohammed Al-Qasimi, born in 1920, is the UAE's longest-serving ruler, having assumed power in 1948. Initially he had hoped to establish a viable independence outside the UAE – and he only took his Emirate into the federation in 1972, a year after the other six former Trucial States had come together in a single state.

The ruling Al-Qasimi family still occupies a central role in government and business – to an even greater extent than is typical for the Lower Gulf – even while RAK's **Crown Prince Sheikh Khalid Bin Saqr Al-Qasimi** has been positioning himself as a leading advocate of political modernisation.

Sheikh Saqr has underlined the Al-Qasimi's reformist credentials by announcing the appointment of an RAK Municipality Council.

Sheikh Khalid's previous hints at his belief in the need to move towards some form of democracy, aired a couple of years ago, were politely ignored by the leaderships of the UAE's six other Emirates. Now – with Western governments and even **Saudi Arabia**'s **Crown Prince Abdallah** openly talking of the need for more participatory forms of government in the region – Sheikh Khalid has returned to the theme.

In recent public remarks to a meeting at the ***RAK Research and Follow Up Centre***, the Crown Prince said that UAE nationals would elect his Emirate's members of the Federal National Council (FNC) and women would have the right to vote. "It is the right time for the UAE government to start studies to find ways to implement this for the good of nationals," Sheikh Khalid said. "It is essential for women to take part in these elections."

The exact status of Sheikh Khalid's plans remains unclear. He appears to have the assent of his elderly father – who these days limits his role in public life mainly to social occasions and formalities, leaving his eldest son to take care of day-to-day government.

But it does not yet seem to be certain that RAK will proceed with elections next year. Like all the smaller emirates, RAK is heavily dependent on subsidies from **Abu Dhabi** and lavish public expenditure through the federal budget. The Al-Qasimis' room for manoeuvre is limited – and they could find themselves pressured to hold back by more conservative ruling families reluctant to be "put on the spot" by reformist advances in RAK.

Abu Dhabi Ruler and Federal President **Sheikh Zayed Bin Sultan Al-Nahayan** surprised many with his recent decision not to include any women in the latest round of nominations to the council, despite predictions of change from his wife **Sheikha Fatima Bint Mubarak** *(GSN 705/9)*. It remains unclear whether Sheikh Zayed and his son **Crown Prince Sheikh Khalifa** decided to hold back because other emirates were unwilling to embark on change or because they decided the time was not yet ripe.

However, back in RAK, Sheikh Khalid has now effectively set out his stall. A failure to act on such publicly announced plans would undermine his personal prestige, suggesting he had gone beyond the limits of the authority informally delegated to him by his elderly father. It would not be surprising if he faced a degree of reluctance, if not opposition, within the ruling family.

Sheikh Saqr's fourth son, **Sheikh Saud Bin Saqr Al-Qasimi** is a dynamic businessman and chairman of the Emiri Diwan (ruler's office), with a considerable voice in government affairs. He has been known to dismiss ideas of democratisation in conversation with foreign visitors.

But, lively and outward looking, with a suave command of American slang, the entrepreneurial Sheikh Saud is a man for the provocative remark – and his apparent views should perhaps be treated with caution.

Not just a backwater

Ras Al-Khaimah has no ambitions to emulate the combative political life of **Kuwait** or **Bahrain**.

Outwardly the Emirate appears to be one of the most traditional corners of the Federation. It is thought to have the UAE's lowest proportion of foreigners in the total population. In contrast to Abu Dhabi and **Dubai**, the picturesque northern landscape is characterised by farming oases and long-established small villages, clinging to the Gulf shoreline. Unlike most UAE cities, RAK still has a historic core of centuries-old mud-brick houses.

But education services are well developed, and women play an increasingly important role in employment and business life. There are female taxi drivers, providing a service for women.

With only minor oil finds, RAK is one of the poorest Emirates. Its 174,000 people make it the fourth most populous Emirate, but some 60,000 of these now live in Abu Dhabi, many working for the Federal Government. Relative to its size, the Emirate is thought to have provided quite a high proportion of senior federal officials. These "expatriates" generally return home at weekends – which is when downtown RAK is at its busiest.

Like **Sharjah**, which is also ruled by a branch of the Al-Qasimi, RAK shows evidence of conservative religious influences. Uniquely for the UAE, all RAK shops are obliged to close for prayer time. In contrast to Sharjah, RAK has not imposed a total ban on alcohol – something that would have seriously interfered with its development of a small but lively tourist trade, largely catering for visitors from the former Soviet Union.

There may be some underground Islamist opposition – that the Al-Qasimis and Federal authorities keep under control. 11 September hijacker **Marwan Yusuf Al-Shehhi** was the son of an RAK muezzin; some of his associates were rounded up in September 2001, since when little has been heard of the matter (apart from the odd claim that Shehhi was one of a handful of 9/11 hijackers who had met **Iraqi** intelligence agents).

More important for most citizens is securing a good job *(see box)*. The success of RAK's businesses is very much an Al-Qasimi family affair.

Those Entrepreneurial Al-Qasimis

The Al-Qasimis have adopted a notably entrepreneurial approach to economic development. **RAK**'s long history of engagement with the outside world finds a dynamic reflection in the modern economy. Only an hour's drive from the much larger facilities at **Sharjah** and **Dubai**, RAK's airport has still managed to attract a modest range of regular services to Gulf cities, **Egypt** and **India**, various ex-Soviet destinations and Qeshm island and Meshed in **Iran** – the latter despite the Emirate's ongoing dispute with Tehran over its occupation of Abu Musa and the Tunbs Islands.

The Airport Department, headed by **Sheikh Salem Bin Sultan Al-Qasimi**, has launched a Dh60m expansion programme and has plans for an air cargo venture. A golf course and five-star hotel, to be funded by the private sector, are envisaged. RAK's combination of dramatic scenery, largely unspoilt beaches and cultural tradition offers ready scope for further tourism promotion, particularly in Western Europe – and the upscale Al-Hamra Fort hotel complex in the south is clearly targeted at this higher spending market.

But the Al-Qasimis have sought to diversify well beyond tourism. Education has been a priority for an Emirate where the absence of hydrocarbon wealth means that most locals aspiring to the middle class emirate lifestyle have to work for it. RAK has higher colleges of technology for men and women. ***Ittihad University*** – founded in the late 1990s under the presidency of Dr **Sultan Bin Khayed Al-Qasimi** – has focused on courses of relevance for the modern economy; its open-learning centre offers in-service course in computer science, information systems and internet technology, for professionals already in employment.

National Bank of Ras Al-Khaimah (RakBank), chaired by the **Crown Prince Sheikh Khalid Bin Saqr**, has branch coverage across the **UAE**. In 2002 its profits jumped by 25% to Dh75.5m.

RAK's Free Trade Zone, set up in 2000 and now occupying three sites, has registered more than 145 companies. By late 2002, invested capital was approaching Dh210m, including a Dh40m shipyard; combined turnover of zone businesses was projected at Dh300m. India, **Iran**, **China**, **Pakistan** and **Russia** were major sources of investment. As with many other RAK activities, the FTZ's development has been helped by an eye for niche opportunities.

However, it is the industrial success story that really stands out in RAK. The ceramics business, established in 1989, is a $300m company, with eight factories, sales to 125 countries, and offshoots in **Bangladesh** and **Slovakia**. It has interests in the Al-Hamra Fort tourism venture and ***RAK Glass***. Profits in 2001 reached Dh106m and the company went public in 1998. Meanwhile ***Gulf Pharmaceutical Industries*** – which operates under the brand name ***Julphar*** – has reported a 19% rise in profits, to Dh43.3m, for 2002. Turnover in 2001 was Dh333m. Julphar has achieved remarkable success in establishing itself as a supplier of affordable generic medicines to the international market, with factories in **Ecuador** and **Germany** as well as RAK; sales in Germany rose by 240% in 2001. This has produced furious complaints from **US** pharmaceutical giants jealous of their brand names; the US government has repeatedly lobbied the Emirates authorities over the issue, but to little effect.

Sheikh Saud Bin Saqr, the Ruler's fourth son and head of the Emiri Diwan, chairs the boards of ***RAK Ceramics*** and Julphar. With other local business partners, he was also involved in developing the $32m Manar Mall retail development in Ras Al-Khaimah City.

The Crown Prince chairs ***National Bank of Ras***

Al-Khaimah (RakBank), ***RAK National Oil Company*** and the Gas Commission.

His younger brother, Sandhurst-trained **Sheikh Sultan Bin Saqr**, has chaired ***National Insurance Company*** and ***Rock Company*** (the Hajar mountains provide valuable quarries), although his main career focus has been the command of the Emirate's miniature army, the ***RAK Mobile Force***.

The Crown Prince's democratic thoughts are being aired in an entrepreneurial and outward-looking society, where traditional ruling family interests predominate.

Elections and women's political rights would be in line with evolving social trends. But they might also begin to provoke awkward questions about the extent to which Al-Qasimi family interests shape not just RAK's politics but also its economics.

Two men, the Crown Prince and Sheikh Saud, exercise enormous influence over government issues and many of the key economic interests. The existence of a wider circle of advisers, policymakers and independent business investors is much less evident than in larger emirates.

There are signs that the need to broaden the base of consultation and leadership is recognised, with the creation of the new Municipality Council, which includes individual councillors and representatives of government departments.

But the family is keeping a firm hand on the tiller: Sheikh Saud chairs the new body, although Under-secretary of the Municipality **Abdallah Ali Al-Naqbi** is from outside the family.

Getting on with the neighbours

Against this delicate home background, the RAK leadership may well seek to co-ordinate any moves towards political modernisation with the other Emirate leaderships. Two in particular have always been key partners: Sharjah, also ruled by Al-Qasimis, and Abu Dhabi, which has traditionally maintained close ties.

RAK has provided many officials for the Abu-Dhabi led Federal Government. **Sheikh Faisal Bin Sultan Al-Qasimi**, brother of Sheikh Saqr, was a close colleague of UAE President Sheikh Zayed and his son and Crown Prince Sheikh Khalifa in the UAE's early post-independence years.

Sheikh Faisal was a member of the Crown Prince's staff in 1970, before becoming under-secretary at the Defence Ministry the following year and stepping up to become chief-of-staff of the Abu Dhabi Defence Forces in 1973.

Should RAK move ahead with political reform, it might seek to co-ordinate the move with Sharjah – whose Ruler Sheikh Sultan Bin Mohammed Al-Qasimi has already established a council, which includes five women, and hinted at his interest in further political reform (this being the UAE through measures such as holding contested elections to a children's parliament, to teach school pupils about politics).

The timetable for change appears undecided. But the advocacy of elections by RAK's Sheikh Khalid is not necessarily at odds with Sheikh Zayed's recent failure to nominate women for the FNC. Council members serve two-year terms, so Sheikh Khalid's talk of elections next year might be well-timed: late in 2004, Ras Al-Khaimans could vote for their preferred names – who could then be put forward formally by Emir Sheikh Saqr as his nominees for the six RAK slots on the FNC.

Saudi Ambassador Killed In West Africa

ABIDJAN—Saudi Ambassador to **Côte d'Ivoire Mohammed Bin Ahmed Al-Rashid** was found dead in his apartment building on 28 March. Diplomats said his body was found in the building's stairwell, lying in a pool of blood. He was found on the 15th floor, two floors below his apartment. The government said he had been murdered, but the Saudi Foreign Ministry said he had died of natural causes.

The ***Saudi Press Agency*** said preliminary information from the Foreign Ministry "stated that there were no traces of aggression on the victim's body. It is likely the death was natural and caused by internal bleeding. The Ministry is still waiting for the coroner's final report to be conveyed by the authorities in Abidjan." Ivoirian Prime Minister **Seydou Diarra** visited the scene.

Rashid, who took up his post in December 2002, was the first Saudi ambassador to Abidjan. He lived in Abidjan's Plateau district, in a normally secure area close to the **US** and **French** embassies and a police station. His body was flown to Riyadh for burial, accompanied by a delegation led by Foreign Minister **Mamadou Bamba**. The Ivoirian government described Rashid's death as a "barbaric act". Diplomats said there was no suggestion of any political motive. "The government... notes that every time Ivory Coast emerges from a state of war, the enemies of our country commit hideous crimes to keep it in such a state," said a government statement.

Shadowy death squads have been operating in Abidjan since the start of a rebellion on 19 September by groups, including many northern Moslems, opposed to the government's xenophobic nationalism. West African foreigners have been driven from their homes and many have fled the country, but groups such as the **Lebanese** business community have not been touched.

IRAN: Stop-Start As IOCs Assess War Risk

Oil companies had been taking security measures even before the invasion of **Iraq** began, but with **US** troops claiming to be near Baghdad International Airport on 3 April, as *GSN* went to press, work was resuming in northern Iran.

Royal Dutch/Shell evacuated workers from the offshore Soroush and Nowruz oil fields in the northern Gulf, shutting in some 60,000 b/d of crude production from Soroush. But ***Shell Exploration***, which acts as a contractor to ***National Iranian Oil Company (NIOC)*** for the two fields, resumed output at Soroush on 1 April.

Soroush is expected to be fully operational at 100,000 b/d by end-Q4 03.

Shell oil workers also returned to Nowruz, now under development and due to be operational at around 90,000 b/d by Q4 03.

Norway's ***Norsk Hydro*** postponed drilling of a well in the Anaran field, in an area of south-western Iran close to the Iraqi border, which it took over in April 2000 with the takeover of S***aga Petroleum***. Eight of Norsk's 50 employees in Iran were working at the field.

…While Sanctions Risk Looks Worse

The President ***George W Bush*** decided to stick with the 1996 *Iran-Libya Sanctions Act (ILSA)* and executive orders sanctioning pariah states, the conventional wisdom had it that Washington would not impose these measures on European and Asian companies doing business in Iran.

The **Clinton** Administration was inclined to give waivers if requested (as it did to **France**'s ***TotalFinaElf***). Bush renewed ILSA in 2001, but before the 'war against terrorism' the signals were that it would not be enforced in a signal of 'constructive engagement' with **Iran**, **Libya** (which has worked hard to build rapprochement with the USA) and the ***European Union***.

The Iraq conflict and rising tensions with Iran and **Syria** have placed that assumption in jeopardy – at least if **Donald Rumsfeld**'s Department of Defense continues to make the running. Reports from Washington suggest the Pentagon now has a blacklist of non-US companies investing in the Iranian energy sector.

This could be used to bar 'offending' companies from bidding for Iraqi reconstruction contracts let by the USA. This would become a critical issue if a **US**-led administration takes over the running of Iraq's oil industry.

Among companies in apparent breach of ILSA are ***TotalFinaElf***, ***Royal/Dutch Shell***, **Italy**'s ***ENI***, **Norway**'s ***Statoil*** and **Malaysia**'s ***Petronas*** (all of whom have invested more than $20m/yr in the Iranian or Libyan energy sectors). Officially, their cases remain "under review" in Washington.

The Pentagon has not confirmed whether the "blacklist" exists, but several IOCs, including Statoil, confirmed they were aware of the threatened move.

The report, carried by the *Financial Times*, represents another point of conflict between Washington and Tehran.

Rumsfeld further angered Iranians with his warnings for Islamist fighters based in Iran to stay out of Iraq.

Neither would the "blacklist" ease the USA's relations with the EU, which complains that ILSA is in breach of international trade rules.

US SHAREHOLDER PRESSURES

Halliburton, the oil services company formerly headed by Vice President **Dick Cheney**, has continued to work in Iran.

Under shareholder pressure, Halliburton – like Cheney before it – has reviewed its stance on Iranian operations.

ConocoPhillips has agreed to ensure oversight of its business in Iran and Syria. This came after New York City Comptroller **William Thompson Jr.** proposed on behalf of the **New York City Police Pension Fund** and **Fire Department Pension Fund** that new controls should be introduced to meet their "concerns about corporate ties to states sponsoring terrorist activity".

The two NYC funds have more than $31m invested in ConocoPhillips, whose board on 2 April felt constrained to announce that "the company will strictly adhere to US policy against aiding countries that promote terrorism".

It was the third such commitment that Thompson (who administers five NYC pension funds) had extracted from companies with interests in Iran and Syria, following agreements with Halliburton and ***General Electric Company***, both of whom have operations in Iran.

CONTINUED FROM PAGE 1

effort into ensuring Dubai adapts to international business trends should also conclude the Emirate could no longer stand aside from the creeping advance of democratic ideas across the Gulf.

Although primarily responsible for local social and leisure services, the new elected councils will mark a significant change in a country where – in contrast to **Bahrain** or **Saudi Arabia** – a contented population has exerted little pressure for reform and the occasional advocates of democratisation have seen their views politely sidelined in council. Sheikh Mohammed ordered the local councils' creation "as part of the Dubai government's efforts to enable people to participate in the process of decision-making". The Executive Council meeting that endorsed his decision explicitly stated that the councils would be chosen through "democratic election".

Dubai's reform move injects a new theme into the traditional competitive rivalry with **Abu Dhabi** – which had hitherto been seen as the more likely pioneer of political innovation, but recently held back from making a much trailed appointment of women to the nominated Federal National Council (FNC). The Federal Government's daily news round-up bulletin did not make any mention of the Dubai election plan.

Sharjah has a nominated municipal council, including women, and Ras Al-Khaimah's **Crown Prince Sheikh Khalid Bin Saqr Al-Qasimi** recently set out plans for the residents of his emirate to elect its representatives to the FNC *(see page 11)*.

MIDDLE EAST ENERGY

POLICY, RISK AND PROJECTS IN THE GULF AND LEVANT

Is The Iraqi Pump Primed For Supergiant Status?

Iraq's possible emergence as a new super-giant oil exporter may be firing IOC and neo-conservative imaginations. But Iraq's accession to oil's big league will depend on geopolitics and corporate spending, rather than 6m b/d production potential.

The spiralling costs of the **US/UK** military adventure and the looming bill for bringing Iraq back to some semblance of its pre-1980s self have focused attention on the oil sector, the one guaranteed cash cow. Iraq's possible emergence as new super-giant oil exporter rivalling **Saudi Arabia** and **Russia** is firing the imaginations of international oil companies (IOCs), as well as some of the neo-conservative elite currently shaping Washington policy. But *GSN*'s soundings suggest that geopolitics and corporate spending, rather than a production potential of more than 6m b/d, will be the ultimate arbiters of Iraq's accession to oil's big league.

The theory runs like this: Iraq could, within a six- to eight-year lead time, hit 8m b/d production capacity from its present known recoverable reserves, estimated at 112bn barrels. This could even swell to 10m b/d, if new discoveries are made.

Furthermore, the oil is the kind of stuff that oil majors' dream of. Iraq has a world-class supply of giant undeveloped fields that are, in the words of consultant ***Wood Mackenzie***'s **Martin Purvis**: "The easiest oil that's left in the world outside of **Saudi Arabia**. It's big, it's simple and it's already discovered."

So much for the hype. But from the slew of policy papers and reports pumped out by oil policy experts in the period leading up to Gulf War III, there exists a deep vein of scepticism about Iraq's chances of realising anything like its potential. If the Pentagon's planners have been rash enough to bank on ***Iraq National Oil Company (INOC)*** cashflow to underwrite its ambitious new roadmap for the Middle East, they will soon be disabused of this notion.

Decline after the fall

The consensus view among analysts and former Iraqi officials is that oil production will decline in the early stages of a post-**Saddam** settlement, even if significant conflict-related damage to oil infrastructure is avoided. Former Iraqi oil minister **Issam Al-Chalabi** told an oil conference in February that it would take a minimum of "two years of hard and unrestricted efforts, plus around $3bn, to bring Iraq's oil capacity back it its pre-August 1990 level of 3.5m b/d".

Present production capacity is estimated at 2.6m-2.8m b/d. The Washington-based ***Council on Foreign Relations***' task force on post-conflict Iraq gauges the investment figure to get to that level even higher, at $5bn-7bn.

Long-term, Baghdad's chances of staking out such vertiginous output territory as 6m-8m b/d would depend on its exit from

MEE Pointers

YEMEN: Chinese exploration

A memorandum of understanding for exploration in Block 1, in Shabwa governorate, has been awarded to ***Jiangsu Oil Petroleum Exploration Corporation***, a division of the Chinese state ***Sinopec*** company. Jiangsu is committed to investing $10m in a two-phase exploration programme. Technical studies will follow.

QATAR: Chiyoda contract

Japan's ***Chiyoda Corporation*** on 3 April announced it had won the $200m engineering, procurement and construction contract for stage one of the 1.75bn ft³/d Al-Khaleej Gas project. Chiyoda is in joint venture with ***Mitsui & Company*** and **Italy**'s ***Snamprogetti.*** Using North Field gas, phase one is scheduled for completion by Q4 05. The developer is ***ExxonMobil Middle East Gas Marketing***.

KUWAIT: Northern fields again

Kuwaiti officials are talking up the prospects for a post-war breakthrough in the estimated $7bn Project Kuwait, to bring foreign investment into the northern oil fields. ***Kuwait Petroleum Corporation*** Chief Executive **Nader Sultan** said KPC was waiting to give IOCs details of terms so they could make their investment proposals. The problem, as ever, is that this requires National Assembly approval – which is not expected until at least after this summer's elections, and possibly not then.

BAHRAIN: Cegelec contract

France's Cegelec reported progress on its $57m contract to install instrumentation systems at the ***Bahrain Refinery Company (Bapco)*** refinery. One system is working on Bapco's hydrocracker; the other on the fluid catalytic cracking unit will be completed by end-2004. This forms parts of Bapco's $900m upgrade, which has fallen behind schedule due to "technical problems".

ISSN 1352 7924

Liberated Iraq: Out Of OPEC?

The possibility of Iraq leaving the ***OPEC*** fold is taken seriously in Washington and welcomed by some neo-cons as a handy way of neutralising the perfidious cartel's influence. According to **Amy Jaffe**, a fellow at the moderate ***Republican***-inclined ***James A. Baker III Institute for Public Policy*** at ***Rice University***, there is a school of people inside and outside the Administration that believes the best thing for the oil market and global energy strategy "would be for Iraq to decide that it wants to go its own way, privatise its oil industry and wave goodbye to OPEC." The problem with that scenario is that it is not as easy as just somebody saying so, Jaffe said. Even if Iraq's new oil authorities have the ear of neo-liberals of a unilateralist bent, reasons of history and geography suggest Iraq will resume its position among the OPEC heavyweights.

A **US**-led administration might pull Iraq out of OPEC, but such a move would lack nationalist credibility. Most of the exiled opposition would opt to stay in the cartel and stabilise prices at a level acceptable to Arab states. Since it would take much time and effort to reach an expanded quota, there is little near-term incentive for Iraq to depart the fold. Quitting the cartel is unlikely to be the first priority confronting the new regime. Presuming a transition authority is instituted in the aftermath of **Saddam Hussein**'s removal, such an administration will be wary of taking such life-changing decisions so soon without greater political legitimacy.

More likely, say informed sources, is that Iraq would continue to remain outside OPEC's quota system until it is in a position to get back on its feet. Analysts like Jaffe argue that even a neo-con dominated Washington will be sensitive to the fact that issues such as privatisation or OPEC membership can only realistically be decided by a representative Iraqi government – which according to US timetables could take two-three years.

the self-imposed constraints invoked by ***OPEC*** membership. But this would precipitate a massive increase in global oil production and a consequent slump in prices.

The question then is whether the supermajors eyeing up Iraq's assets will have the stomach to commit the capital investment needed to upgrade Iraq's oilfields – with ballpark figures of $40bn regularly bandied around – when global oil markets appear on a downward trajectory.

IRAQ'S GLASS CEILING

Probable reserves are estimated by some at more than 300bn bbls, pointing to huge medum/long-term potential. But Iraq's chances of speedily ramping up production to 6m-plus b/d are tempered by a number of factors.

The huge post-war reconstruction task means there will have to be trade-off between oil revenues and income to keep 23m Iraqis fed and clothed.

According to a ***Baker Institute*** report, even in the unlikely eventuality that no facilities were damaged, Iraq's total oil revenues would still only average around $10bn-12bn/yr. Already, one-quarter of oil revenues earned under the ***United Nations*** Oil-for-Food Programme (OFP) is purloined by creditors owed reparations under the UN's own scheme instituted after the 1991 Gulf conflict – and this does not even include oil income that the Bush Administration hopes will be devoted to the reconstruction effort.

This puts the onus squarely on IOCs to stump up the billions needed to rehabilitate frayed oil infrastructure. Few doubt their interest in bringing readily accessible fields on stream. But translating this interest into firm contracts is another matter.

As ***Deutsche Bank***'s Global Oil and Gas Research team argued in a recent post-conflict hypothesis, investing in Iraq has to stack up as a global investment opportunity. Although production-sharing contract (PSC) terms are relatively generous as they stand, these may not last the duration *(see below)*.

Most analysts expect INOC to move to tougher terms through buy-back style development production contracts (DPCs).

New terms could still prove more attractive than other regions on offer, but IOCs will still have to operate within Iraq's likely production ceilings.

This brings into play the trajectory of oil markets as a decisive factor in upstream investment decisions. If some more ambitious ***International Energy Agency (IEA)***, ***Energy Information Administration*** and OPEC forecasts are to be believed, the supply and demand balance for the next 20 years would see sufficient room for big increments of additional Iraqi oil.

But other analysts are not so sure. The sceptical ***Centre for Global Energy Studies (CGES)***, staffed by a string of senior former Iraqi officials, posits instead that the world will consume less oil in future. The CGES argues that rising Iraqi oil exports could combine with slacker OPEC production restraint, amid weak global economic growth, to herald an era of cheaper oil prices.

"Such conditions of weak demand and higher supplies would tend to make Iraq's huge incremental capacity appear almost redundant, leading to very low oil prices and a situation of over-supply, in which OPEC would find itself unable to stabilise the market or control price movement," CGES executive director **Fadhil Chalabi**, a former director of oil affairs in Baghdad, told a mid-March conference in London.

Other analysts support this thesis. According to Deutsche Bank's oil and gas team head **Adam Sieminski**, rising incremental OPEC and non-OPEC output suggests there will be a lot more oil on the market, and this must fit into a demand picture that isn't growing as fast as it has in the past. "Eventually OPEC is going to have a problem even without Iraq in the equation. If you put Iraq in, it does raise some interesting issues about oil price management," Sieminski said.

A KEY MARGINAL PLAYER

The prospect of investing billions of dollars in potentially "redundant" extra capacity is not one that would excite ***TotalFinaElf*** Chief Executive **Thierry Desmarest**, mulling $7bn commitments on the Majnoon and Nahr Umar PSC contracts inked with Baghdad during the 1990s.

These factors will obstruct the rapid revival of

Iraq: The Corporate Landscape

Field name	Interested parties
Ain Zalah/Butmah	Chauvco Resources (now defunct)
Al Ahdab	CNPC/Norinco[1]
Bai Hassan	Tatneft/Zarubezhneft[1] (drilling contract)
Gharaff	TPAO[1], Japex, Kriti, CPC
Halfaya	BHP, CNPC, Samsung/Hanol/SK/Pedco, ONGC, ENI
Kirkuk	Tatneft/Zarubezhneft[1] (drilling contract), Petrom (Khurmala Dome)
Luhais and Subba	Slavneft[2] (now TNK/Sibneft), Lundin, Machinoimport, CNPC
Majnoon	TotalFinaElf[1]
Nahr Umr	TotalFinaElf
Nasiriyah	Repsol, ENI[2]
North & South Rumaila	Russian consortia – Tatneft, Lukoil, Zarubezhneft
Ratawi	Shell[2], Nexen, Petronas, Escondido, Crescent, Fortum
Saddam	Tatneft/Zarubezhneft[1] (drilling contract)
Tuba	ONGC/Sonatrach/Reliance[1], Pertamina, Machinoimport
West Qurna	LUKoil[1]/Zarubezhneft/Machinoimport, more recently Rosneft
Amara	PetroVietnam[1]
Kifl	ETAP[2]
Noor	SPC
Rafidain	Sinochem[2]/Norinco, Pacific Resources

[1] Provisionally awarded. [2] Perceived leading contender.
Source: Wood Mackenzie; Deutsche Bank.

Iraqi production and slow down the drive to establish it as a global oil superpower. But a rehabilitated Iraq will be a key marginal player and, if favourable conditions are secured for foreign investment, could ultimately realise some of its strategic value.

Baghdad could still push its weight in the oil market. Around 30% of global production growth in 1996-2001 came from Iraqi oil exported through the OFP. "What happens in Iraq is going to have a dramatic impact on how the oil market progresses," said Jaffe.

Conspiracy theorists' charge that Washington's regime change strategy is primarily designed to challenge Saudi Arabia's position as the guarantor of US energy security may be wide of the mark. Yet Iraq's geographic position endows it with a unique strategic importance.

In 1975, Baghdad built a strategic pipeline that links the southern fields with the north, allowing oil to be pumped from south to north and *vice versa*. Iraqi crude is totally exportable through pipelines to the East Mediterranean, avoiding the Gulf and Straits of Hormuz.

This gives Iraq the advantage of great flexibility in being able to use both Gulf and East Med export terminals as the need arises.

Conjecture over Iraq's long-term potential will be pushed aside in the rush to stabilise short-term supply. Thoughts will turn to more prosaic matters, such as the management of oil revenues, where analysts believe the OFP will stay in place for some time, but there could be some important changes to the make-up of the scheme.

Washington Wants To Control OFP

US Ambassador to the ***United Nations*** **John Negroponte** has proposed altering control of the Oil-for-Food Programme (OFP) escrow account, in which the US and **UK** might displace **Iraq** in nominating vendors for the oil.

This, analysts say, could threaten the position of **French** and **Russian** vendors.

The OFP could ultimately give way to an oil trust fund, within the framework of the ***World Bank*** – similar to the Bank-supported **Chad-Cameroon** export pipeline scheme, in which state authority over revenue distribution is restricted.

But US post-war aggrandisement could extend beyond management of the OFP, if the neo-cons get their way. Early April reports that the Defense Department is drafting a plan to bar IOCs active in **Iran** from accessing Iraqi acreage, indicate a strong unilateral push for control of oil assets – never mind the sensitivities of potential Iraq players ***TotalFinaElf***, ***Repsol*** and ***Royal Dutch/Shell***.

If the State Department is unable to wrest control of foreign policy away from the Pentagon hawks, General **Tommy Franks** could soon find himself lording it over some of the world's biggest oil reserves.

Iraqi Recovery Prospects

Strategies for revival of Iraq's oil capability differ in detail, but broadly centre on three phases: the initial stage of basic reconstruction, including the maintenance reinvestment phase, bringing production up to around 3.5m b/d within an 18 month to three-year period; a second phase, in which production could hit 4-4.5m b/d, after a further three years; and a final stage in which more ambitious long-term production targets of 6m b/d plus are realised, perhaps within a ten-year timeframe.

INOC will initially call on the advice of the IOCs and grant oil services contracts to stabilise output.

Damage limitation in the southern fields appears limited in the early days of war, with the only significant sabotage taking place in the southern end of the giant Rumeila field.

Apart from fires at seven wells and two pumping stations, no other visible damage was evident. A **UK** military spokesman said repairs to the southern fields would nevertheless cost $1bn to bring them back to their 1.8m b/d capacity within three months. Northern well damage would inflate the bill substantially.

Output is likely to decline in 2003, as uneconomic and unsafe wells are re-drilled. It took **Kuwait** two years to rebuild following the 1990-91 Gulf War. ***Deutsche Bank*** argues there is room for

500,000 b/d of new growth in 2004, but substantial amounts must be spent on wellhead repairs and beefing up field management for this to be realised.

Iraq has very few producing fields, most of which will need redevelopment. The crown jewels are its slate of supergiant undeveloped fields, dangled in front of IOCs during the 1990s.

Under-investment means that quick output gains will be in existing producing fields, dominated by Kirkuk and Rumeila, with around 2m b/d combined capacity.

Huge reserves potential

Proven reserves are 112bn bbls, but this is an inaccurate reflection of the true reserve position – a legacy of poor quality seismic data and under-exploration over the past 20 years. Most exploration was carried out in the 1970s.

The Oil Ministry recently put out a conservative 186bn bbls estimate. A CGES report said that as much as 200bn bbls additional reserves were likely to be discovered. The rigorous application of new technology combined with new field exploration will quickly inflate reserve estimates.

Many existing fields have only been drilled down to the Cretacious, and according to ***Wood Mackenzie*** the potential for light crude is high. "It doesn't take too much of a leap of faith to see Iraq approaching Saudi Arabia in terms of a reserve base," said WoodMac's **Martin Purvis**.

Only 15 of Iraq's 74 discovered and evaluated oilfields have been developed and the highly prospective Western Desert has yet to be explored.

According to former oil minister **Issam Al-Chalabi**, 526 hydrocarbons structures have been discovered, delineated, mapped and classified as potential prospects, of which only 125 have been drilled. Discovered but undeveloped fields have the potential to produce 4.7m b/d more.

Northern production is dominated by Kirkuk, which accounts for 700,000 b/d of output, and Bai Hassan, pumping out 110,000 b/d. Other northern fields make much smaller contributions.

In the south – which is expected to see the bulk of future production growth – the North Rumeila field produces about 750,000 b/d; South Rumeila fields add another 500,000 b/d.

Other southern fields are Al-Zubair (240,000 b/d capacity), Missan (160,000 b/d) and West Qurna (120,000 b/d) fields, which depend on water injection systems and gas treatment facilities.

Big technical challenges

Kirkuk is also suffering water intrusion problems. However, technical challenges to boosting production are not insurmountable.

The application of simple materials and assistance could help most fields achieve substantial extra production.

Most investment will be geared towards drilling some 300 new wells. But reinvesting in the base must be accompanied by repair of the processing and export infrastructure – critical elements in a serious attempt to stabilise and expand output.

Repairing gas processing, gas oil separation plants and other facilities could take a couple of years. Oil pipeline pumping stations may require months of repairs and rebuilding.

According to the report of a working group convened by the ***Baker Institute***, repair of two pumping stations and the Zakho metering station is essential to increase exports through **Turkey** to their pre-1990 capacity of 1.7m b/d via the two parallel pipelines to Çeyhan.

The 1.3m-1.4m b/d southern export terminal of Mina Al-Bakr appears to have emerged unscathed from early conflict. Yet further repairs are needed to restore operations to the nameplate 1.6m b/d capacity. Full repair of the Turkish parallel lines and Mina al-Bakr would bring total export capacity to 2.8m b/d, the report says. The other southern port of Khor al-Amay on the Gulf coast could add 1.2m b/d of export potential if repaired.

Refining capacity must also be upgraded, to cope with increased local demand for products. Total throughput capacity of 678,000 b/d is not geared for export.

Former senior INOC official **Thamer Al-Uqaili** of ***Petroconsult Canada*** forecasts domestic consumption will revert to pre-war levels of 550,000-600,00 b/d, rising to about 800,000 b/d – 900,000 b/d in 2005. Uqaili estimates an immediate $700m investment requirement to maintain and upgrade the downstream, including $400m for the Baiji and Basra refineries.

US engineering and oil services firms have already snapped up the big reconstruction contracts. ***Halliburton***'s ***Kellogg Brown & Root (KBR)*** arm was granted the main first phase reconstruction contract within days of troops entering the Al-Faw Peninsula *(GSN 706/8)*.

Refinery Capacity – Not Geared For Export

Refinery	Location	Throughput ('000 b/d)
Baiji (North)	Baiji	150
Baiji (Salaheddin)	Baiji	140
Baiji 1 & 2	Baiji	20
Basra	Basra	170
Daura	Daura	100
Haditha	Haditha	14
Khanaqin/Al-Wand	Jambour field	11
Kirkuk	Naft Khaneh	27
Misan	Kirkuk field	10
Muftiah	Kirkuk field	5
Nasiriyah	Al-Ahmara	27
Qayarah	Nr Basra	4
Total		**678**

Source: Wood Mackenzie; Deutsche Bank.

WHO WILL MANAGE THE OIL?

INOC appears well placed to run the initial upstream reinvestment phase. It has a reputation for managerial and technical competence, with a well-trained cadre of technocrats and technicians experienced at running an oil sector through decades of war and sanctions. While under-invested, INOC still has the logistical and operating expertise to manage upstream tendering, as well as letting repairs and rehabilitation contracts.

INOC is likely to retain initial ownership of the production base, possibly through reservoir management contracts with IOCs, who may be reticent about assuming ownership of problematic assets ahead of the more lucrative greenfield opportunities anticipated further down the line.

INOC could continue development work in producing fields, with technical and service assistance from oilfield services firms.

But the new administration will face strong calls to go down the Russian route to privatisation and tempt IOCs with equity deals. The CGES' Chalabi said: "The most important initial step is to detach Iraq's oil industry from total state ownership and control, and to create an internationalised national industry through partial privatisation."

He offered a radical prescription for the sector's revival, with the creation of a new, independent oil company, with 25-40% of its shares floated on stock markets. This new, self-managed entity would be taxed and supervised by the government.

"In this way, the industry would be managed jointly by foreign companies and Iraqi nationals, some representing the Iraqi government, so that Iraq would have a majority share in decision making," said Chalabi.

Such a set-up would allow the authorities to accrue revenues through taxation and increased foreign exchange inflows. It would tie in neatly with the neo-conservative privatisation push.

According to leaks from the State Department's Future of Iraq office, INOC is regarded as prime candidate for a sell-off, along with downstream assets such as gas stations.

Liberals argue that an injection of private sector discipline would mitigate against nationalist sentiment prevalent within the state oil company. The experience of post-Gulf war **Kuwait** is instructive, with promised upstream entries by IOCs stymied by fierce political opposition. It could counteract the balkanisation of Iraq's oil sector, which might see diverse ethnic groups clamouring for ownership of the nation's hydrocarbon wealth.

Model Contracts: PSCs-V-DPCs

Analysts predict that the oil industry's initial two- to three-year transitional recovery phase would give Baghdad time to establish a framework for longer-term relationships with IOCs, renegotiating – if not reneging on – the MoUs signed during the 1990s. New deals will be designed to suit a radically different context.

Neo-liberals like ***CGES*** Executive Director **Fadhil Chalabi** argue that without offering "equity oil" to foreign investors, Iraq has little hope of finding the estimated $5bn-6bn needed to rehabilitate its oil industry. "The huge rehabilitation programme will put a strain on the government's already poor finances, while the production-sharing contract (PSC) requires the foreign investor to put money only in the field in order to reach production capacity targets."

In the mid-1990s, ***Iraq National Oil Company*** signed PSC-style agreements with companies including **France**'s Elf (now ***TotalFinaElf***), a **Russian** consortium headed by **Lukoil** and ***China National Petroleum Corporation (CNPC)***, mainly on the giant fields discovered in the 1970s but undeveloped due to wars in the 1980s and 1990s *(see table on page 17)*. Even if these contracts were honoured, reformists argue they would not be conducive to creating favourable conditions for expansion. Older PSCs were a product of their time, when Iraq was desperate to enlist foreign investment to expand its production capacity. Terms were attractive, offering a 22% internal rate of return (IRR), similar to regions where an exploration risk is involved.

Now the favoured contract model for greenfield projects is the development and production contract (DPC) – akin to **Iran**'s "buy-back" model – which offers the contractor a remuneration fee for field development, after which it reverts to state control. According to the Edinburgh-based ***Wood Mackenzie***, Iraq's putative DPC offer involves a 12-year term, 10-15% government stake, commitments to production targets, and cost recovery of up to 50% of production.

But DPCs are less attractive to IOCs. Discounted returns are poor for the contractor group, even though Iraqi contracts have been designed to yield a healthy post-tax IRR of about 20%. ***Deutsche Bank*** forecasts overall profitability to be reduced towards Iranian terms – nearer 15% than the 20-22% on offer now. These are still appealing prospects for IOCs with good long-term production profiles – and left to its own devices, analysts believe INOC will lean towards the DPC model. The two contracts signed under PSC terms in the mid-1990s were the Al-Ahdab field, awarded to CNPC, and the Lukoil consortium, which was granted the West Qurna field. The Russians' participation now appears in doubt, after Baghdad abruptly cancelled the contract in December.

Lukoil is adamant that its claim to the $3.7bn West Qurna project will stand up to international legal scrutiny. The legality of 1990s era oil deals could be challenged by the new authorities in Baghdad, whether as violations of ***UN*** sanctions or because of perceived political motivations. But international legal challenges could undermine progress on field upgrades, tying up IOCs in reams of red tape. Despite the obvious temptation to victorious forces to tear up **Saddam**'s oil deals, cooler minds may yet prevail – so long as American hawks' urge to penalise recalcitrant Russian and French companies can be contained.

The new political reality could see the incumbent list of foreign majors, including TotalFinaElf, ***ENI***, ***Royal Dutch/Shell*** and ***Repsol***, linking in partnership deals with "coalition companies". Deals signed with these groups by Saddam's regime were not rigid contracts. "The sustainability of those deals across the regime change will be a function of the relationships that those companies have and also their level of technical understanding," Deutsche Bank argued.

Despite France's new pariah status in neo-conservative Washington, TotalFinaElf appears particularly well positioned for an Iraq upstream entry. Its robust growth profile and strong balance between different regions means it is well placed to bargain with the new regime. But waiting in the wings are the "Coalition Club" contenders – including ***BP***, ***ExxonMobil***, ***ChevronTexaco***, ***ConocoPhillips*** and ***Occidental***. Appetite for Iraqi assets will depend on their political risk perceptions. Some may seek fresh deals with the new regime, but others will want to get in on the back-end of existing partnerships.

Risk Management Report — Qatar

GSN Risk Grade — B/2+: Doha squeezed between US and Arab ties, but cushioned by gas

Political And Social Development

Overview: Despite the very high profile of the US Central Command complex at As Sayliyah life goes on more or less as usual. Doha International Airport remains open and most major airlines have not altered their services. Emir Sheikh Hamad Bin Khalifa Al-Thani has pushed conciliatory rhetoric to avoid an anti-US backlash while security forces keep a close watch on potential 'problem' elements. A 45-member, two-thirds elected Parliament is expected in 2003/04 with all Qataris over 18 allowed to vote; political parties will not be allowed. A protracted war and regional instability may delay the process.

Social forces: Qatar has not fallen victim to the growing Arab anger at the war in Iraq, despite the presence of US forces. Many Qataris dislike closer military links with the USA. Those opposing the war – including conservative Daawa groups – are allowed to express their views in the press although they are aware that the state security apparatus keeps a close watch for signs that this anger is not directed at the government. Conservative academic Abdelrahman Al-Nuaimi was detained without trial for three years between 1998-2001 for criticising the Emir's reforms.

Islamist links: Reports have resurfaced in the US press about the ruling Al-Thani family's possible radical Islamist links. This time the focus is on Interior Minister, Sheikh Abdallah Bin Khalid Al-Thani. Such reports, potentially embarrassing for Sheikh Hamad, are not new and have never been substantiated. "We have never seen any credible information to corroborate them," the US State Department said about an earlier bout of media speculation.

External factors: As chair of the Gulf Co-operation Council and Organisation of Islamic Conference, Qatar expects to have a significant voice in the debate over post-Saddam Iraq. Qatar is actively trying to cement a GCC consensus on these issues, but bilateral relations with Saudi Arabia remain poor. Relations with Jordan have improved after Sheikh Hamad pardoned Jordanian national Firas Majali who was facing execution on charges of spying. The Al-Thani-sponsored Al-Jazeera Satellite Channel was then allowed to reopen its Amman office. High-level contacts are also being maintained with the permanent Security Council members.

Economic Outlook

Overview: War is not expected to hit investor decisions in the medium/long-term unless a protracted conflict leads to domestic hostility at Western interests. Moody's Investors Service's downgrade of Ras Laffan LNG Company (RasGas) underlines a degree of investor wariness. Qatar National Bank has forecast 2% GDP growth for 2003, compared to an estimated 4% in 2002; nominal GDP growth averaged 13.5% over the last five years. Strong fiscal and current account surpluses have been posted in recent years. Total debt was estimated at around $16bn at end-2002. Oil production under the OPEC quota production ceiling is 635,000 b/d.

Budget: The 2003/04 budget has a $474m deficit, 4.8% less than in 2002/03, and is based on a cautious average oil price of $17/bbl. Part of any surplus will be directed to the Oil Stabilisation Fund. The budget envisages $5.9bn revenue and $6.4bn spending. The government has set aside $1.69bn for major projects, compared to $1.2bn in 2002/03. The government is understood to have made a significant allocation for the 2006 Asian games.

Energy risk: Moody's downgraded RasGas's rating to Baa3 on 10 February, citing the limited terrorism and sabotage coverage in recently renewed insurance policies. Short-term, altered risk perceptions may affect some deals' pricing, but the booming hydrocarbons sector will weather any storms. Concern has been expressed that EU plans to move towards more short-term gas supply contracts will reduce the security of investment returns. By 2007 Qatar's aims to attract $4.7bn investment for the North Field gas development, $2.5bn for petrochemicals, $4.1bn to enlarge refineries and $825m for natural gas liquids.

Liberalisation: Privatisation of power distribution assets is planned. The government plans to launch the sale of some petrochemical assets H1 03, with fertilizer, steel, health and education assets also earmarked. Further IPOs can also be expected, while 100% private ownership in the agriculture, and tourism sectors is mooted. There are also plans to encourage foreign companies as strategic partners in export-orientated projects; the government and strategic partner will take 25% stakes, with the remaining 50% held by private sector investors.

Qatar: Key Projects

LNG: Two 7.5m t/yr trains Qatargas II LNG project being studied by QP and ExxonMobil, with first deliveries targeted for 2007. A third train at Ras Laffan is well under way. Capacity will reach 10m t/yr with RasGas' fourth train, for 2005 completion.

Petrochemical projects: The $1.62bn Q-Chem I project was inaugurated Jan 03. New projects include the $1.1bn Q-Chem II (EPC award expected Q4 04); $550m Qatofin low-density polyethylene project (partners Qatar Petrochemical Company, France's Atofina and QP); and $470m 1.3m t/y Ras Laffan ethane cracker. All three anticipate a 2007 start-up.

Ras Laffan IWPP: Qatar's first independent water and power project will have an initial 750MW and 40m g/d capacity. First power is expected in April for full operation May 2004.

GTL plants: Qatar hopes to become "the capital of gas-to-liquids". Seven plants are envisaged for Ras Laffan. The most advanced, led by Sasol, closed a $700m financing in January 2003. A FEED contract is expected 2003 for an ExxonMobil-led plant while Shell, and Ivanhoe Energy are both presently undertaking feasibility studies and Conoco, Marathon and Sasol/Chevron are also looking at new plants.

2006 Asian games: This major event implies massive infrastructure requirements including a $233m sports complex in Doha, $30m shooting range, and redevelopment of Doha's stadiums. Work has been accelerated.

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.

QATAR: Selected Economic Indicators ($ million)

	1999	2000	2001	2002[1]
Total GDP	12,389.5	17,756.1	17,121.7	18,810.8
GDP growth(%)	20.9	45.6	-3.6	9.9
Budget[2]: of which: receipts	4,191.1	6,435.0	5,306.2	7,286.5
Total expenditure	4,762.4	5,023.3	5,292.5	5,501.2
Balance	-571.3	1,411.7	13.7	1,785.3
Exports (fob)	7,212.3	11,590.2	10,867.9	11,027.2
Imports (fob)	2,252.1	2,927.8	3,383.7	4,323.0
Trade balance	4,960.2	8,662.4	7,484.2	6,704.2
Current account	2,169.7	5,471.0	4,262.6	4,268.1
Balance of payments	2,458.1	3,589.7	2,735.5	2,232.9

[1] Central Bank of Qatar preliminary estimates. [2] Fiscal year (April-March)

Source: Central Bank of Qatar.

Saudi Arabia — Risk Management Report

GSN Risk Grade — C/2-: War plus unemployment raises pressure, but oil receipts booming

Political And Social Development

Overview: With war in Iraq under way US forces have been allowed to use Prince Sultan Airbase near Riyadh. Publicly the Al-Saud ruling family is against the war in Iraq and deployments along the Iraqi border (which include US Special Forces teams) have been explained as necessary to help police the Iraqi no-fly zones and stem the threat of a refugee crisis. Problems with radical Islamists, largely denied by the authorities, are a cause for concern against a background of growing poverty, unemployment and grassroots hatred of the US military presence. Security has been increased and senior Al-Saud princes and the ulema (religious establishment) have warned zealots not to react to the war. But civil unrest may become harder to control if war is protracted.

Government: Crown Prince Abdallah bin Abdelaziz (CPA) has drafted a Charter for Arab Reform that sets goals for the Arab world and could launch internal reforms; the war has postponed its formal unveiling. The prospect of elections has been mooted – it was included in a petition for reform by 104 liberal and Islamist intellectuals issued in January – first at municipal level, followed by the 120-member Majlis Al-Shura. A government reshuffle expected mid-year is expected to see the promotion of some more reform-orientated, Western-educated technocrats; progress on educational and human rights reforms is also expected. Divisions within the Al-Sauds, however, continue to act as a brake on reform progress.

Internal security: Although the extent and cohesiveness of the underground Islamist movement is unclear, a significant degree of sympathy for Osama Bin Laden is apparent. Militancy is on the increase. Jihadi support is believed to be particularly strong in the far north, the south-west and conservative parts of Najd. Interior Minister Prince Nayef Bin Abdelaziz claims there are no active or dormant Al-Qaeda cells in Saudi Arabia. But Islamists were responsible for some recent bomb attacks, possibly including those blamed on Western bootleggers. In addition to the usual Saudi staples – unemployment, poverty, anger at the American presence in the Kingdom – the war in Iraq is a significant destabilising factor that could pose series problems if it becomes protracted. A recent message attributed to Bin Laden said the Al-Saud regime was not Islamic and should be converted or replaced.

Economic Outlook

Overview: Despite high oil prices, finances remain strained with budget deficits pushing up debt to an estimated $168bn. Unemployment pressures remain unchecked – at over 30% – while population growth is 4-4.4%. The powerful Prince Nayef plans to substantially reduce the number of foreign workers by 2013. Saudi American Bank (Samba) forecasts 3.8% GDP growth in 2003. The government says it is committed to supporting OPEC's oil production rates during the war; Saudi Arabia is allowed to produce 7.963m b/d under the OPEC quota arrangement.

Unemployment: According to the Saudi Monetary Agency (Sama) unemployment has reached 31.7%, significantly higher than past estimates, which varied between an official rate of 8.1% and 20%. The Sama study recommends a review of the sponsorship system and increased Saudi-isation. The Interior Ministry has announced plans to limit foreign residents to 20% of the indigenous population within ten years, with any one nationality limited to one-tenth of the total. One recent measure to be announced was a ban on all expatriate taxi drivers. It is estimated that there are around 6m-7m foreign workers in the Kingdom alongside 17m Saudi nationals.

Finances: The 2003 budget is based on a $17.5/bbl oil price, with a $10.4bn deficit envisaged. The government will borrow to cover this if necessary. Total 2003 revenue is projected at $45.3bn, with expenditure at $55.7bn. Finances are stretched and transparency remains an issue. CPA is attempting to rein in public spending but to no obvious immediate effect. The Saudi Stock Exchange (SSE) has held up well, closing March on 2,768.14 points, its highest level since July 2002.

Liberalisation: The Supreme Economic Council has announced plans to open more sectors to foreign investment. These include some telecoms services (including IT-related areas, but not GSM and fixed-line services), insurance, educational services and publishing. Some sectors, including insurance, will require new laws before they are declared open. Saudi Telecom was listed on the SSE in January, but state and entrenched interests are still dominant in the economy and Saudi membership of the World Trade Organisation remains problematic.

ZUAIR RELEASE: The Saudi authorities have released Islamic dissident Said Zuair after eight years in prison *(GSN 706/10)*. Zuair was detained in 1994 during a crackdown on Islamists but was never charged. Officials have not given an explanation for his release. Zuair's son said it was designed to placate public anger stirred up by the war, while his lawyer said it stemmed from a law suit filed in London against Interior Minister Prince Nayef, alleging torture and illegal detention.

Saudi Arabia: Selected Economic Indicators

($ billion)	1999	2000	2001	2002
Nominal GDP	161.0	188.4	186.2	182.8
Nominal GDP growth rate (%)	10.4	17.1	-1.2	-0.5
Real GDP growth rate (%)	-0.8	4.9	1.2	0.7
Current account	0.4	15.6	14.5	10.5
Central gov. domestic debt	44.4	43.8	45.6	48.8
as percentage of GDP	119.0	87.0	90.0	95.0
Oil price Saudi Average ($/barrel)	17.45	27.0	21.5	21.8
Official Foreign Assets	69.4	73.5	82.6	78.5
Cost of living (% change)	-1.2	-1.0	-0.8	-0.4

Source: Saudi American Bank, Ministry of Planning, Central Department of Statistics, Saudi Arabian Monetary Authority, IMF

Saudi Arabia: Key Projects

Gas Projects Initiative: Final technical negotiations for the Shell-led Core Venture Three (partners ConocoPhillips, TotalFinaElf) are under way, with technical talks on the ExxonMobil-led $15bn Core Venture One South Ghawar project (with Shell, BP and Phillips Petroleum) expected soon. The $5bn Core Venture Two Red Sea project, also led by ExxonMobil (with Marathon and Occidental), has been postponed. Saudi Aramco (backed by Al-Saud conservatives) privately opposes the IOC influx.

Butanediol plant: Kvaerner E&C in talks with Saudi International Petrochemical Company over a plant in Jubail, to be completed 2005. Output will include 75,000 t/yr butanediol, 5,000 t/yr gammabutyrolactone and 5,000 t/yr tetrahydrofuran.

Jubail petrochemicals: An MoU was signed between Germany's Linde and the local Project Management & Development Company in February for new facilities including an ethylene cracker,methanol, polypropylene and aromatics units. A pre-feasibility study is planned.

Jubail LAB complex: EPC contract award expected by mid-year for Farabi Petrochemicals Company's linear alkyl benzene facility. Capacity will include 120,000 t/yr of n-paraffin and 70,000 t/yr of LAB. Q4 04 start-up is expected.

Watch Out For Rising Levels Of Domestic Debt

Rising domestic debt in several Middle East economies raises worrying questions, with the plight of **Egypt**, **Lebanon** and **Turkey** highlighting problems that can undermine emerging markets.

Such problems generally attract less attention than international debt crises, but can be equally serious – the 1997-99 Asian crisis was partly caused by domestic debt.

Ratings agency ***Fitch*** calculates that the Lebanese government's debt to domestic creditors has reached 88.6% of gross domestic product (GDP). Local government borrowing in Egypt and Turkey equals more than half of GDP.

While the Gulf has traditionally been cushioned from the worst of debt problems, lack of discipline in government financial management has caused difficulties: even if state agencies maintain payments to their foreign suppliers, liquidity problems will affect their domestic suppliers, who may then face payments problems of their own. This was the case for **Saudi Arabia** in the mid-1990s.

Ministries in Saudi Arabia, notably the health department, have a history of procurement payment that is erratic at best. This has an immediate impact not only on local suppliers but also on the foreign companies providing drugs and other medical items. It thus "flags up" government budget problems at a relatively early stage.

Where a government's payment capacity is in doubt, the authorities may opt for measures that reassure local lenders but increase the risks in the longer term by pegging the debt to some form of index that is almost certain to increase the eventual cost of servicing payments. This has happened in Lebanon and Turkey, according to," Fitch Senior Director **James McCormack**.

In Lebanon, the quick fix solution was to start issuing securities in foreign exchange. This failed to attract capital – so Beirut avoided a potential **Turkish**-style accumulation of hard currency obligations.

McCormack concludes: "It would not do any harm to pay a little more attention to a government's finances."

Credit Ratings And Government Debt, 2002 Estimate

	Long-term foreign currency	Long-term local currency	Outlook	Total govt debt % of GDP	Total govt debt % of revenue	Govt domestic debt % of GDP	Govt domestic debt % of revenue
Bahrain	A–	A	Stable	30.2	96.9	24.1	77.4
Egypt	BB+	BBB	Stable	85.1	318.1	54.7	204.3
Iran	B+	B+	Stable	18.4	81.4	11.0	48.8
Israel	A–	A	Negative	105.5	212.3	77.3	155.6
Kuwait	AA–	AA	Stable	35.0	6.9	34.5	63.9
Lebanon	B–	B–	Stable	160.6	733.5	88.6	404.9
Turkey	B	B	Stable	85.3	311.2	53.8	196.1
Regional median*				73.3	206.3	31.7	109.3
Regional mean*				77.1	271.2	39.3	133.3
Global median				46.5	139.6	28.3	85.0
Global mean				53.9	179.1	33.8	112.4

* Also includes Cyprus, Gambia, Lesotho, South Africa and Tunisia.
Source: Fitch Ratings

Gulf Currency Box

	$	£	€	¥ (x 100)
Bahrain	0.3770	0.5916	0.4068	0.3167
Iran	8144.0	12,780.0	8788.19	6841.11
Iraq	0.3110	0.4881	0.3356	0.2613
Jordan	0.7095	1.1134	0.7656	0.5960
Kuwait	0.3000	0.4708	0.3238	0.2520
Oman	0.3850	0.6042	0.4155	0.3234
Qatar	3.6407	5.7132	3.9285	3.0583
Saudi Arabia	3.7502	5.8851	4.0467	3.1503
Syria	46.000	72.1855	49.6386	38.6409
UAE	3.6731	5.7640	3.9635	3.0855
Yemen	177.890	279.154	191.961	149.431

Source: Financial Times.

OMAN: Germans Lead Sohar Fertiliser Financing

German development bank ***Kreditanstalt für Wiederaufbau (KfW)*** has secured the lead arranger mandate for the $600m fertiliser plant, being developed by ***Bahwan Trading Company***'s ***Sohar International Urea and Chemical Industries*** subsidiary, advised by ***HSBC***.

KfW is likely to underwrite the whole commercial debt tranche in a project structured on a 70/30 debt/equity basis. The debt package will contain an export credit component guaranteed by **Germany**'s ***Hermes*** and commercial loans. The main EPC contractor is Germany's ***Uhde***.

KfW is also in line to back a 70/30 debt/equity-financed methanol project in Sohar, where the German partner is ***Ferrostaal***.

IDB Fund Invests In AES Oasis

In its first big investment, the **Bahrain**-based Islamic Development Bank Infrastructure Fund is to acquire an approximate 32% stake, worth some $150m, in **UAE**-based ***AES Oasis***.

The new company is majority-owned by US developer ***AES Corporation*** and will own AES's two power and desalination plants in **Oman** and **Qatar**, and the oil-fired generating facilities of AES LalPir and AES PakGen in **Pakistan**.

The Fund, working with ***Emerging Markets Partnership (Bahrain)***, expects the acquisition to be completed in Q2 or Q3 03.

INSTITUTIONS

PEOPLE AND PLACES

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Cross-border Information

Gulf States Newsletter

4 April 2003

Volume 27, Issue No 707

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GULF STATES NEWSLETTER

Published fortnightly since 1974

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Iraqi Contracts: Crown Agents Sweep First Crumbs From US Table

LONDON/WASHINGTON—Crown Agents has become the first UK firm to win a subcontract in the US programme to rebuild Iraq. The privatised UK development assistance company will act as a subcontractor to US professional services firm I***nternational Resources Group (IRG)***, for its ***US Agency for International Development (USAID)***-funded contract to provide technical assistance for the planning and management of reconstruction and rehabilitation activities. Crown Agents will help with procurement, transport and warehouse management to support USAID missions, under an estimated $7m contract with work starting in **Kuwait** and then going on to Iraq.

Crown Agents' role was revealed by USAID Administrator **Andrew Natsios**, who was pressed by journalists over concerns that non-US firms were being shut out of the contracting process. "We are using British Crown Agents to do our purchasing in the Gulf, so there's a British company already working for us that was not part of that particular bid," Natsios said. "So it is open."

Tendering is open if one accepts Natsios' insistance that "Federal law requires us to use American companies [as prime contractors] for competitive bids, [while] subcontracts are open to any country anywhere in the world." Within this framework, more than half of the reconstruction work would be awarded via subcontracts, which would be open to "any country anywhere in the world that can competently do the work and bids on it," Natsios said.

By USAID standards this is real flexibility. In answer to a British journalist's question which talked of "some kind of carve-out for US companies", Natsios replied: "We have waived the Federal law… three times in the last ten years. One was in **Bosnia**… I waived it for the reconstruction of **Afghanistan**. There are a number of British firms actually working for AID in Afghanistan right now. And we waived it in January for Iraq."

British business is chasing these subcontracts, with the ***British Consultants and Construction Bureau*** mobilising to ensure that its contractors are considered for work. Major **UK**-based construction firms including ***Amec***, ***Costain***, ***Black & Veatch***, ***Balfour Beatty*** and ***Thames Wat***er are lobbying hard. UK Trade and Industry Secretary **Patricia Hewitt**, a leading ally of Prime Minister **Tony Blair**, has taken the argument to USAID. The potential UK role has also been emphasised by ***Conservative Party*** Leader **Iain Duncan Smith** – officially Leader of the Opposition in Parliament, unofficially sounding like Blair's spokesman on Iraq to the *Today* programme and other British media.

How this squares with ***European Union*** and other efforts – including those of the UK – for the ***United Nations*** to take a lead remains to be seen. In private, UK officials say they are praying the Bush Administration will give ground to a genuine multilateral effort. The New Labour government's battered conscience, International Development Secretary **Clare Short**, decided not to resign in protest at the war to push for a multilateral approach *(GSN 706/20)*.

Blair is a big hitter in the conflict – using up much of his domestic political capital in the process. How much other UK voices are heard in Washington is questionable. At a 25 March press conference, USAID's Natsios was clearly unfamiliar with other senior Brits. He observed: "I gave the two British ministers who called, **Mike O'Brien** and Patricia Hewitt – I think they're Secretaries of State in the Foreign Office, one for economic affairs and one is **Jack Straw**'s deputy, I guess. And one came to visit and one we talked over the phone. And I provided them actually with a document showing that we had waived the law."

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