

# Gulf States Newsletter

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

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## GSN

### Companies & People

#### More Details, Questions Over Palestine Hotel Shelling

More details have emerged of the US shelling of Baghdad's Palestine Hotel – informal base for journalists during the Iraq war. An investigation by the New York-based *Committee to Protect Journalists (CPJ)* indicates US forces fired – killing two journalists and wounding three others – in the belief that Iraqi forward observers were operating from a high floor of the building. The CPJ said US troops had captured an Iraqi radio whose traffic indicated a spotter in a tall building was directing fire at US forces. When they located a person with binoculars on a high floor – probably a journalist – they opened fire, hitting the hotel. Senior officers knew the Palestine Hotel's location and its use as a base for journalists, but commanders on the ground may not have had full information.

*Reuters* news agency, whose cameraman **Taras Protsyuk** was killed, has pressed for a full investigation, but has not received detailed responses from the State Department or Pentagon. Media organisations are considering pressing for an amendment to the *Geneva Convention* that would guarantee war correspondents are treated as neutral observers.

### Across The Region

Iraq's reconstruction and the establishment of an interim authority may have to wait until all the country's regions have been stabilised. **PAGE 3**

Shiite leaders are vying for power in a potentially explosive environment. *GSN* weighs up the balance of forces. **PAGE 4**

Favourable local conditions have helped UK forces to stabilise Basra. **PAGE 5**

The suicide bombings in Riyadh have shaken up international relations in Saudi Arabia. It remains to be seen whether the Kingdom's crackdown will be enough to restore trust, with very mixed signals coming from Riyadh. **PAGE 6**

Kuwait is preparing for elections on 5 July amid speculation that Emir Sheikh Jaber might push through votes for women. **PAGE 7**

Oman's Ambassador to London points out that the eventual succession field may be broader than *GSN* implied. **PAGE 7**

The UAE would prefer to see Iraqi enterprises, not international companies, take advantage of reconstruction opportunities – so Dubai is helping Iraqis set up in Jebel Ali Free Zone. **PAGE 7**

The UAE Air Force is again considering buying British Hawk trainer jets – possibly from Switzerland. **PAGE 7**

Copper stripped from Iraqi facilities is flooding onto Gulf markets. **PAGE 17**

Export credit is flowing, and Iraq's bilateral and commercial creditors seem ready to begin resolving issues of payments and debt relief. But first comes the daunting task of consolidating outstanding debt estimated at around \$120bn and coming to some kind of accurate accounting. **PAGE 18**

Bechtel has opened Iraq reconstruction subcontracting to international firms but still faces charges that the process is biased toward US companies. **PAGE 20**

An attack on Iran's nuclear programme could focus on a number of targets, but military planners may have fewer options than they'd like. **PAGE 10**

Ten years ago, the Saudi government's tough reaction to the Committee for the Defence of Legitimate Rights was heavily criticised. **PERSPECTIVE, PAGE 2**

### GSN's Analysis

Washington is increasingly focused on Iran's nuclear ambitions. Influential elements in the Bush Administration lean towards a confrontation that could include military action, if diplomacy doesn't work. **GSN VIEW, PAGE 2**

Iran's nuclear ambitions appear to be more advanced than many had expected, and military planners in Washington may be considering strikes against it. But such an action could prove more complicated than initially hoped, and past experience shows carrots may be more effective than sticks. **CENTREPIECE, PAGE 8**

An attack would be likely to focus on the nuclear fuel cycle. **PAGE 11**

Oman has economic reform issues to resolve, but new gas developments are moving ahead, with elections in October promising to increase representation. *GSN* maintains its B/3 Risk Grade. **RISK MANAGEMENT REPORT, PAGE 12**

In Qatar, Sheikh Hamad feels secured by his Western alliances and will focus on building a world-scale gas industry. *GSN* maintains its B/2+ Risk Grade. **RISK MANAGEMENT REPORT, PAGE 13**

### MIDDLE EAST ENERGY

Failure to make progress on Jordan's Samra IPP is a blow to reform ambitions. The delay stems less from resistance to private power than from international developers' lack of appetite. **PAGE 14**

There is interest in the sale of Electricité du Liban's generation and distribution assets, but strategic investors will first want to know that management can run a commercial operation. **PAGE 15**

Syria stands little chance of bringing its target 3,000MW of generating capacity online by 2010 without tapping foreign investment, but Damascus has shown scant interest in private power. **PAGE 15**

Iraq may need 6,000MW new capacity by 2005. This might turn it into a regional test bed for private power. **PAGE 16**

Israel Electric Corporation could soon be split up and sold off. **Page 16**

MEE Pointers on OPEC, Iran/UK, Bahrain and Qatar. **PAGE 14**

Never far from Washington's attention, Iran has become the focus for another major debate within the US Administration. This has been compared to the debate over Iraq in the Bush presidency's first year and then again after the 11 September 2001 attacks on New York and Washington. As now seems usual, Donald Rumsfeld's Pentagon is making the running with support from Vice President Dick Cheney (an apparent advocate of dropping sanctions during his Halliburton days). A policy of confrontation looms, with Washington claiming that Iran shelters Al-Qaeda cells and lobbying hard for a tough multilateral stance on the Iranian nuclear programme – adding to pressure on International Atomic Energy Agency (IAEA) Director General Mohammed El Baradei. Major new splits over American intentions towards Iran are apparent in Washington, among Western powers and between the Bush Administration and those sceptical of its intentions world-wide. The UK's "constructive engagement" is threatened. And all this while President Mohammed Khatami is fighting to assert his will over conservative opponents.

The passing of Resolution 1483 in the UN Security Council legitimising the US/UK occupation of Iraq was a diplomatic triumph for the Coalition – emboldening hawks to press home their case for action on other issues. However, since Operation Iraqi Freedom there have been alarming setbacks to US counter-proliferation policy in Iraq, where evidence of Saddam Hussein's programme remains elusive, and in the remaining "Axis of Evil" states, North Korea and Iran. Although nowhere near the threat posed by North Korea – a rogue state memorably likened to a "suicide cult" – US hawks and their Israeli counterparts are focused primarily on Iran's nuclear programme, not least because a range of actors believe something can still be done to prevent nuclear breakout there (see GSN's *Centrepiece article*).

Coupled with this is the view promoted by neo-conservative thinkers that Iran is ripe for a democratic counter-revolution. According to this logic, if Iran's nuclear programme can be delayed it may not come to fruition before the Islamic Republic is swept away. These assumptions may be wishful thinking, but events are

likely to develop rapidly. Iran seems determined to go nuclear, but there is not yet a *casus belli*. The forthcoming IAEA statement is likely to focus on Iran's technical breach of the *Non-Proliferation Treaty*, an underwhelming verdict that will be hard even for the most talented hawks to spin into a mandate for action.

More worrying is alleged Al-Qaeda basing in Iran and continuing US concern over Iranian involvement with Hizbollah in Lebanon, a security threat to Israel. In this environment, it is hardly surprising the White House and Pentagon have given some consideration to limited near-term military options to delay Iran's nuclear progress. Few believe a full-scale "Operation Iranian Freedom" will follow quickly, but a series of diplomatic, covert and proxy conflicts could follow – reflected in the debate over whether to maintain the Mojaheddin e-Khalq Organisation (MKO) as a future 'Northern Alliance' to put pressure on Tehran (GSN 710/20).

Until now, the Iranian government has defused pressure well – with sympathy and intelligence co-operation after 9/11, squeezing the Taliban and Al-Qaeda in Afghanistan, and largely staying out of Iraq. It is likely that Tehran will co-operate over the 12 May bombings in Saudi Arabia (now a regional ally) and hand over those Al-Qaeda operatives it has quietly been keeping captive. Expect new security sweeps in Afghan border areas too.

The situation is delicately poised. The latest in a series of secret bilateral meetings, to be held on 27 May in Geneva, was postponed. A senior Bush Administration official told *The New York Times* that following the Riyadh bombings, "we passed them a message instead of meeting them face to face... that this Al-Qaeda link is very serious." Iran's most senior official based in the USA, United Nations Ambassador Javad Zarif, told ABC News' *This Week* programme that Tehran was co-operating in attempts to control Al-Qaeda, but would not respond to "the language of pressure".

Perhaps not, but maintaining a dialogue will be essential if undoing the Islamic Revolution is not to become a primary goal of a second-term Bush Administration.

## Perspective: Ten Years Ago

If a government ruling a Muslim state in the name of Islam is challenged by non-Muslims, it can deal with them fairly easily. But if it is challenged by eminent and well-educated Muslims in the name of Islam, quoting the Islamic scriptures to back their case, it feels its foundations are being threatened. That accounts for the Saudi government's reaction to the formation of the Committee for the Defence of Legitimate Rights.

Abdallah Al-Masari, the retired judge who headed the Committee, had his legal practice and consultancy licences withdrawn; Abdallah Al-Jibrin of the Dar Al-Ifta organisation was dismissed; two other members of the Committee were sacked from university posts. Al-

Masari's son lost his post at King Saud University and was later arrested. Other arrests have been reported...

Nobody outside Saudi Arabia will do much to help the reform campaign, except for the possible support from Iran for the Shiites who would gain particularly by reforms. Other countries are keen to maintain good relations with Saudi Arabia; Kuwait has expressed approval for the *ulema* condemnation of the Committee. The USA may not back the Saudi regime strongly over the question of the Committee... [But] it is above all among its own people that the Saudi government has risked long-term problems by its recent actions.

*Gulf States Newsletter, Vol. 18, No. 462, 31 May 1993*

# Regional Factors Set To Slow Stabilisation Of Iraq

The arrival in Baghdad of L. Paul Bremmer III signalled the start of a revitalised US approach to establishing order in post-war Iraq. US plans call for security to be established across the country, but the new civilian administrator's team is discovering that great disparities exist between the predominantly Kurdish north, the largely Shiite centre and Najaf-Karbala area, and the southern area around Basra.

Since these regions are unlikely to be declared "safe and secure" simultaneously, Iraq's reconstruction will most likely progress at the speed of the lowest common denominator – currently Baghdad and the Shiite areas south of the capital. Bremmer will not want to risk nationwide democratic elections while there is still substantial risk of factional violence within any of the regions.

The effect has been to slow the political stabilisation and reform process the US intended to deliver. The passage of a new *United Nations* resolution lifting the sanctions on Iraq reverses the originally planned flow of events, which called for establishing a strong interim authority as a precursor to lifting sanctions. Instead, Bremmer has sought to lower Iraqi expectations over the pace of transition to self-rule.

Besides putting off the formation of a transitional assembly, which had been planned for early this summer, control of strategic portfolios such as the oil sector, finance, law enforcement and foreign affairs now look to remain under US control until at least the latter part of this year, and probably into 2004. Non-strategic ministries, however, will increasingly be turned over to Iraqi administration within weeks.

Bremmer will instead concentrate on establishing security throughout the country by taking full advantage of the powers granted to an occupying force under international law. While the USA spent the first five weeks in Baghdad seeking to downplay its role as occupier, the White House now recognises that if it is to be charged with the responsibilities of an occupier, it may as well utilise the rights that come along with such a role.

Bremmer's freedom of action is limited in some cases – thus he is prohibited from devaluing the appreciating New Iraqi Dinar – but he enjoys a firm footing for taking other executive actions within the framework of international law.

To back up Bremmer's top priority of establishing security throughout Iraq, the activity levels and size of Coalition military forces supporting that mission are increasing.

Following US reinforcement, Coalition forces in Iraq are now at their highest level, numbering 160,000 US and 40,000 UK troops. This force is increasingly being tailored to meet the requirements of re-establishing the rule of law, with arriving units reconfigured to fit the role.

The US 1st Armoured Division, relieving the US 3rd Infantry Division on a unit-for-unit basis, is equipped for occupation duties.

The 2nd US Armoured Cavalry Regiment has deployed with an unusually high complement of 300 Humvee armoured trucks, favouring greater patrolling capability at the expense of heavier equipment. A specialised US military police brigade of 4,000 troops has almost completed deploying to Baghdad.

The experienced light forces of the British 16th Air Assault Brigade may deploy to Baghdad later in the summer to bolster the 25,000 US troops there.

Although US forces may be drawn down to 100,000 troops by autumn, with the UK drawing down to 7,000 or less, a number of European partners look likely to contribute forces to offset this reduction. Such replacements will be vital in ensuring that any gains in the rule of law are maintained.

The ratios of stabilisation forces to civilians in **Bosnia & Herzegovina** and **Kosovo** were 1:66 and 1:50 respectively. In Iraq the ratio is 1:115, which would drop to around 1:230 if US and British forces are not replaced with Coalition troops.

The recent increase of US troops has allowed an increasingly robust stabilisation effort in the Iraqi capital. In an average 24-hour period, the USA is now launching just over 400 patrols, conducting six targeted raids, and making 129 arrests. Iraqi citizens have been ordered to surrender rifles, heavy weapons, and explosives, or face detention if caught in possession of such arms. The process of lustration – banning former **Baath Party** members from government roles – has been widened to include 15,000-30,000 ex-Baathist officials.

### TACKLING OTHER COMPLEX PROBLEMS

Besides simply having the muscle to do the job, Bremmer faces a host of more subtle problems in seeking to restore order to the country. Although up to 7,000 Iraqi policemen in Baghdad indicated their keenness to return to the government payroll, for instance, considerably fewer actually want to return to work. According to the *Office of Reconstruction and Humanitarian Assistance (ORHA)* Police Administrator, former New York Police Commissioner **Bernard Kelik**, Baghdad police refuse to operate outside office hours and

only accompany US troops on 15 of their 400-plus daily patrols.

Local police operating without US soldiers often have no means of communicating with each other or with commanders and dispatchers, reducing their effectiveness sharply. Though a number of telecommunications companies and ORHA itself had expected to set up a mobile phone network in the capital within weeks, high-level political concerns have slowed that process.

The US government will probably delay telecommunications development in Iraq until after an interim authority is established, telecoms market analysts told *GSN*. The USA will want to discuss legal issues and operating rights with an Iraqi governing body because of concerns that have been raised over *US Agency for International Development (USAID)* contract awards and other non-transparent contracting practices undertaken before and during Operation Iraqi Freedom.

Another factor slowing reconstruction work has been the lack of military escorts available for USAID contractors *Bechtel Corporation* and *Kellogg, Brown & Root*, particularly in the north, where US forces continue to be occupied in key suburbs of Kirkuk and Mosul.

In Hawijah, an Arab town outside Kirkuk, a battalion-sized US force was recently sent to investigate and suppress determined attacks on Kurdish citizens originating from the Sunni Arab community. In an exhausting night action involving running skirmishes and sniper fire, the battalion fought its way into the village with the help of armoured and attack helicopter support, whereupon the militias promptly melted back into the community. Such engagements effectively prevent the military from supporting contractors in many regions, and are another argument for Bremmer making security his number-one task.

#### REVERSING ETHNIC CLEANSING

Encounters such as the Hawijah battle are likely to continue as long as Kurdish groups are perceived to be gaining the upper hand in Kirkuk, inspiring continued resentment among Arab communities. In accord with legislation recently passed by the *Kurdistan Regional Government (KRG)*, Kurdish groups have begun to “cancel the Arabisation of Kurdistan” and reverse the ethnic cleansing that took place under *Saddam Hussein*.

This is taking a number of forms, including violent evictions, negotiations in neighbourhood committees, property sales in which Kurdish groups are paying inflated prices to regain their leases, and others. A surge in the trend is predicted for July, when schools are closed for the summer in the KRG area and families can attempt to return to their original homes in Kirkuk.

Although Sunni Arabs have maintained a major role in the less symbolic city of Mosul, the parties of the KRG area have acted in close accord to

consolidate their power in Kirkuk. Lacking accurate census figures – which may soon be outdated anyway – the USA is struggling to equitably distribute local power on Kirkuk's 24-member city board and 300-member city council. Six city board seats were due to go to each of the city's four ethnic groups – Kurd, Arab, Turkmen and Assyrian Christian – but this arrangement failed to satisfy either the Kurds, who received a small share of seats compared to their population, or smaller communities like the **Turkish-aligned Iraqi Turkmen Front**, who felt that Kurdish Turkmen parties had received too much representation (three of the four Turkmen seats).

The pro-Kurdish balance of the city board is likely to be repeated in the election of the city council, due as *GSN* went to press. Although 156 seats will be evenly distributed between the four ethnicities, the remaining 144 members will be chosen by the USA, and are likely to include a strong Kurdish representation. The KRG has Western-oriented, pro-US technocrats on hand that are likely to be attractive to the USA. The *Patriotic Union of Kurdistan (PUK)* has already moved elements of its interior ministry to Kirkuk and has taken over operation of its radio station.

In keeping with long-held plans, the *Kurdistan Democratic Party (KDP)* and the PUK quickly pulled their peshmerga fighters out of Kirkuk once it had been liberated, but left behind a large police presence that has merged with the local law enforcement community. Of 500 police officers in Kirkuk, 400 were provided by the Kurdish parties; many are former peshmerga or current Kurdish intelligence and security personnel.

With offices and media in Baghdad, and a ten-year history of intense co-operation with the US, the Kurdish parties are the one element of a prospective interim authority that has functioned better than anticipated.

## Shia Factional Politics: A Long Struggle For Power Beckons

Two key questions remain in the Shiite south of **Iraq**: when and how will the factional politics of the Shia resolve itself, and how soon after that will the USA develop a way to engage this community?

The view in Washington is that once the internal Shiite political picture resolves itself, the USA may have an easier time of winning allies among Shia religious leaders. But the timetable is unclear – and the issue is complicated by the Pentagon and its cheerleader's antagonism towards **Iran** (see page 2).

Within the Shia communities, the key issue remains the rivalry between Iran's Qom seminaries and the long-suppressed and traditionally dominant seminaries in Najaf and Karbala. The man seen by the USA as Iran's principal agent in this struggle – **Ayatollah Bakr Al-Hakim** of the *Supreme Council for Revolution in Iraq (Sciri)* – has moved carefully. US hawks believe he has

failed to make a big impact in Shiite religious politics since the war ended. Hakim's supporters disagree. The Ayatollah has learned to play a long game, and is positioning himself as a moderate with a view to future government.

Marc Reuel Gerecht, who ran *Central Intelligence Agency (CIA)* operations in Iran during the 1980s and 1990s, told *GSN* that Sciri represented less of a threat to US interests than indigenous actors. Sciri has slowly but surely engaged the USA since its paramilitary *Badr Corps* entered Iraq just before the war and its leader made a late and hesitant entry to the country after years of absence, sending his brother **Abdelaziz Al-Hakim** to prepare the way.

Gerecht is a noted hawk on Iran (*GSN 710/9*). He said: "Sciri is a public not a clandestine group. The *Badr Corps* are easy to identify. The local *Daawa* movement, on the other hand, operated in Iraq during Saddam's rule, and knows how to hide. They could generate a lot more throw-weight if they decided to cause mischief."

Daawa's political chief **Karim Salhani** recently stated that if the USA delayed or downgraded the role of the interim authority, Daawa would form "our own interim council".

Gerecht concluded by noting: "The Shiite divine needs charisma. Bakr Al-Hakim has the charisma of a toadstool." Such observations give a taste of hawkish – wishful – thinking in Washington. Hakim and his family have substantial support that goes beyond Iran (and relations with the authorities in Tehran could be strained during the Ayatollah's 23-year exile). Sciri has played a careful hand, maintaining lines of communication with the USA.

Other players include the Najaf seminaries, **Grand Ayatollah Ali Sistani**, who has supported coalition efforts to restore order and stressed that the clergy's role should remain limited to spiritual and not political matters (*GSN 708/5*). This has not added to Sistani's popularity but he carries the authority of his titles.

#### THE SADR FACTION

**Ayatollah Abdelmajid Al-Khoei** had been expected to play a leading role, but the USA and UK's favourite cleric – who came with an impressive background and reputation – was killed in a factional struggle shortly after Najaf was liberated.

The likely perpetrators of the killing – which took place in a highly charged situation on 10 April, when the *Baathist*-appointed Kelidar (custodian) of Najaf's Imam Ali Shrine, **Haidar Raifee**, also died – were supporters of **Moqtada Sadr's *Jamiat-i-Sadr Thani***.

Sadr, who is positioned as a powerful local critic of US occupation, comes from an impeccable line of Iraqi Shiite leaders, many of whom disappeared or were killed on Saddam's orders. This heritage counterbalances the 30-year-old Sadr's youth and lack of theological qualifications – which reportedly made him "jealous" of Khoei.

#### The British Back In Basra

Favourable local conditions in UK-controlled Basra have allowed for a relatively speedy return of services and greater stability. Having had more time to stabilise the area – which was mostly under UK control in early April – and a smaller area to police, the British were able to secure key locations – including oilfields and the vital 140,000 b/d Basra refinery. Well schooled in **Northern Ireland**, the British engaged in stabilisation and "hearts and minds" operations from a very early stage, mounting foot and vehicle patrols in central Basra from 7 April and lowering force protection levels to allow close engagement with civilians, including football games and other events. They have also taken a more flexible view of lustration, reintegrating some ex-*Baathists* into the police force.

In early July, the 1st UK Armoured Division staff will return to **Germany**, to be replaced by the 3rd UK Armoured Division headquarters under ex-special forces and airborne commander Major General **Graeme 'Nails' Lamb**. Alongside multinational forces from Europe, the British command will include a UK mechanised brigade arriving in the autumn. Prime Minister **Tony Blair** was poised to visit Iraq as *GSN* went to press.

The Sadr faction will push for a more political role for the clergy – backed by radical Iran-based cleric **Kadhem Al-Husseini Al-Haeri**. It is represented in Baghdad's populous Shiite district, renamed Sadr City, by **Sheikh Mohammed Al-Fartousi**. He is one of the previously obscure Shia clerics who have played a key role in reorganising Sadr City and other urban zones in crisis – working where necessary with US forces and UN agencies – who are filling the vacuum left by the Baathist administration. As well as reorganising food distribution, schools and street cleaning, Fartousi has announced strict Islamic regulations, including a ban on alcohol and strict dress codes for women.

American and Israeli analysts, terrified at the prospect of a standoff with the Shiite opposition, argue that although successful in Baghdad's Shiite enclave, the Sadr faction has been less successful at leading mass demonstrations against the USA. At the first large post-war Shiite rally, the predominant theme was religious freedom, involving open practice of rituals banned under Saddam, and the Sadr faction succeeded in fielding only a few thousand political protesters in a crowd of 2m.

At this and subsequent events, political anger towards the USA has been low-key, in part because the Hawza, the Shiite religious authority in Najaf, is said to favour a limited political role for Iraq's Shiite leaders. **Uri Lubrani**, Israel's last ambassador to Iran, reflected on recent failures to politicise the Iraqi Shiite community, noting: "Sadr and the Iranians cannot fight against the seminaries in Najaf. Twenty-six years of revolution cannot compete with a tradition six centuries old."

But there is big potential for the political temperature to rise. Despite Pentagon reservations the Sadr factor may make Sciri more attractive as Washington seeks allies. The experience of Iran's revolution shows that given the right leadership, Twelve Shiite clerics have the potential to galvanise a political situation.

# Mixed Signals From Shell-shocked Saudi Arabia

The temporary closure of the US, UK, German and other diplomatic missions after the 12 May Riyadh suicide bombings, which left 34 dead and undermined the Saudi government's claims to be coping with the ultra-radical Islamist underground, was a blow to **Prince Nayef Bin Abdelaziz** (*GSN 710/3*). The Interior Minister has pressed his political ambitions by blending a hard line on opposition with the promotion of Islamist policies that might undercut the anti-Saudi opposition.

In the bombings' wake, many of the Kingdom's usual cheerleaders have stopped cheering. British Ambassador to Saudi Arabia **Sir Derek Plumbly** said the threat of terror attacks "was of a completely new order". A *Metropolitan Police* team is examining the security at compounds and installations frequented by Britons. Other Western governments are doing likewise. US Ambassador **Robert Jordan** told a 28 May news conference that "*Al-Qaeda* is a real and persistent threat here in the Kingdom."

Over 100 suspected supporters of **Osama Bin Laden's** *Al-Qaeda* network have been rounded up, but Jordan observed that "we have not diminished our concerns about the threat level".

Prince Nayef has promised action and as *GSN* went to press it was announced that at least three *Al-Qaeda* supporters were rounded up in an Internet cafe in Medina, including **Ali Abdelrahman Al-Faqasi Al-Ghamdi**, who has been named as a planner of the Riyadh bombings.

Most embassies have reopened, but Western governments are warning against non-essential travel to the Kingdom and expatriates complain that they feel very vulnerable. Such is the extent of the crisis that **Crown Prince Abdallah Bin Abdelaziz** has been invited to attend the 31 May-1 June Group of Eight summit in France.

It is fair to assume that the authorities will crack down hard. But will this be enough for the USA and other governments who are tiring of Saudi arguments that the regime's promotion of radical Wahhabi thinking and support for the propagation of that form of Islam are not linked to the spread of violent political Islamism?

In this environment the 27 May sacking of the editor of liberal daily *Al-Watan* **Jamal Khashoggi** gained considerable prominence. *Al-Watan* – whose Chairman **Prince Bandar Bin Khalid** is son of Asir Province Governor **Prince Khalid Al-Faisal** – has been a notable voice in questioning Wahhabi influence (*GSN 710/4*). Khashoggi's sacking was seen to show the limits to which such criticism

would be tolerated. *Al-Watan* had moved into taboo territory, notably questioning the thinking of **Ibn Taymiya**, whose words coined in the Western 14th century are a wellspring of Wahhabism, as well as a modern education system which promotes a hardline outlook – to the extent that Crown Prince Abdallah has admitted it must be reformed. But his scope for action seems limited.

### NO NEW SOCIAL COMPACT

Liberals and minorities had been looking for a new social compact well before the 12 May attacks.

In the run-up to the 30 April government reshuffle, Shia elements were hopeful of the nomination of a Shiite cabinet minister. In the event – and to few people's surprise – a beleaguered Crown Prince Abdallah opted not to antagonise Wahhabi traditionalists and no Shiite name was included on the list.

Shia reform campaigners argue that the appointment of a few token representatives of non-Wahhabi communities would anyway not have signalled a serious move towards political change. In earlier decades the long-serving presence of the internationally regarded Hijazi lawyer **Ahmed Zaki Yamani** as oil minister did nothing to water down the conservative rigour of the Wahhabi model.

The latest reshuffle has seen the promotion of another prominent Hijazi, former *Jeddah Chamber of Commerce and Industry* chairman **Abdallah Bin Ahmed Zainal**, who assumed the rank of Minister of State Without Portfolio. He is widely expected to act as a chaser and shaper on economic reform.

Exiled Shia campaigners want a pluralistic democracy that ceases to impose Wahhabism and stigmatise other streams of Islam; with no group accounting for anywhere near a majority of the population, they believe no other structure can lay the basis for long-term stability. But they are not optimistic that CPA will seize the chance offered by the shock of the Riyadh bombings to press ahead with this agenda.

Whatever CPA's personal views, and those of his liberal advisers, deep-rooted resistance remains within the ruling family to any change that would expose the dynasty and its patronage machine to scrutiny. This was reflected in Prince Nayef's post-bombing defence of the Mutawa religious police.

From the Najd – where Wahhabi traditionalism boasts a massive following – there is popular pressures for a more "Islamic" Saudi Arabia. That is not the sort of message Western governments, Saudi liberals and minorities want to hear.

## UAE: Uneasy About Iraq

The UAE leadership has been articulating wider Arab unease over Iraq and the **Palestinian** question. **Dubai's** Crown Prince and federal Defence Minister **Sheikh Mohammed Bin Rashid Al-Maktoum** has expressed annoyance at the clamour by Arab and international companies for reconstruction opportunities in Iraq.

"I feel a deep resentment when I hear some say 'I want my share in the reconstruction of Iraq.' What Iraq needs is a assistance and it is morally unacceptable to see it as a booty to be distributed among people," Sheikh Mohammed reportedly told a visiting Iraqi delegation. He urged Iraqis to take matters into their own hands by setting up indigenous enterprises.

The UAE, as ever, is ready to assist. Sheikh Mohammed has lent support to a group of Iraqi investors setting up a \$100m offshore company in **Jebel Ali Free Zone**. **United Iraqi National Company for Investment and Reconstruction** will initially have some 100 shareholders – all Iraqi nationals, representing existing companies and business families. It plans to relocate to Iraq when the business environment is more settled.

The group is said to be looking into investments in tourism, hospitality and shopping complexes, and at projects in the banking, insurance, agriculture, oil and petrochemicals sectors.

**Abu Dhabi** Crown Prince and Deputy Supreme Commander of the **UAE Armed Forces** **Sheikh Khalifa Bin Zayed Al-Nahayan** commented that the Iraqi people should run their own affairs, at the fifth consultative meeting of **Gulf Co-operation Council** leaders in Riyadh. The UAE pushed for a GCC effort to ensure the **UN Security Council** safeguarded the Iraqi people's rights.

The UAE **Red Crescent Society's** humanitarian effort is under the supervision of Minister of State for Foreign Affairs and RCS Chairman **Sheikh Hamdan Bin Zayed Al-Nahayan**.

Post-war support has included the construction of hospitals, setting up of water desalination plants and providing of medicines, medical equipment and other basic supplies.

Meanwhile, the UAE has given qualified support for the Middle East roadmap, with its concerns focused on **Israel's** response to the proposal.

Closer ties are being forged with the next generation of Palestinian leaders. **Sharjah** Ruler **Sheikh Sultan Bin Mohammed Al-Qasimi** has met with several Palestinians in recent weeks.

## UAE Moots Swiss Hawk Deal

The UAE Air Force is said to be again considering buying Hawk trainer jets – but from Switzerland, rather than from **BAE** in the **UK**, where new orders are needed to help protect jobs.

The UAE has been considering expanding its fleet for some time but rejected a previous offer

## OMAN: Succession Precisions

Following *GSN's* analysis of the Omani succession outlook, the Sultanate's Ambassador to London **Hussain Ali Abdellatif** has pointed out that although there is much speculation over who might eventually succeed **Sultan Qaboos Bin Taimur Al-Sayyid**, the **Al-Bousayid** dynasty has never, in 250 years, appointed a crown prince. The Basic Law of 1996 leaves the way open for a number of possible candidates (*GSN* 710/9).

*GSN* reported the widely held view that either of the Sultan's first cousins, **Sayid Haithem Bin Tariq** and **Sayyid As'ad Bin Tariq**, were the likely successors. Ambassador Abdellatif points out that they are eligible, but so are other members of the ruling family's **Al-Sayyid** branch – the only Omanis entitled 'His Highness'. To be eligible, one must be a descendant of **Sultan Turqi** (ruled 1888-1913) and of an Omani mother and father. Being married to a foreigner is no disqualification (as *GSN* had implied), but **Al-Sayyid** children with a foreign parent (even if naturalised) are ruled out.

Under the Omani system, on the death of the Sultan it is for the ruling family council to decide a successor. If they cannot reach a consensus they must accept the late Sultan's nomination, expressed in a letter lodged with the Security Council. "The *Basic Law* gave clarity to the system of succession," Abdellatif told *GSN*. "But only God knows who the next Sultan will be."

## KUWAIT: Women's Vote On Pre-Election Agenda

With candidate registration and campaigning for the 5 July election due to get under way following **Emir Sheikh Jaber Al-Ahmed Al-Sabah's** final go-ahead for the poll to renew the 50-seat National Assembly, there is much speculation over whether the government will push through major reforms in coming weeks (*GSN* 704/8). It is possible that Sheikh Jaber will issue a decree after Parliament is dissolved on 4 June giving women the right to vote and stand for elected office. The Emir may choose to act by decree to force through an issue that has long been the subject of a political tug of war between reformists within the **Al-Sabah** dominated government and conservative factions in the National Assembly – who are likely to return in force after this summer's election. In 1999 the Emir put forward a bill that would have granted women the vote from 2003; it was narrowly rejected by parliament. First Deputy Prime Minister and Foreign Minister **Sheikh Sabah Al-Ahmed Al-Jaber Al-Sabah** recently expressed the leadership's hope that women would soon get the vote and sit in parliament.

The Cabinet has endorsed a law that would allow women to vote and stand for office in municipal elections. But **Kuwait University's** **Dr Mohammed Al-Feeli** was sceptical the bill would get through the National Assembly. He told the local **Women's Cultural Society**: "Maybe this is a reaction to the present political situation in the Gulf and **Americans** might be behind this issue now." At present voting rights are limited to Kuwaiti men of more than 21 years and naturalised Kuwaiti men who have had citizenship for more than 20 years. National Assembly deputies must be literate males over 30. The electorate is around 126,000 out of some 850,000 Kuwaiti nationals.

from **BAE** because the cost of new jets was deemed too high. It seems Switzerland has Hawks to supply at a much lower price. The Hawk can be used to help train pilots to operate advanced **French** and **US** fighter jets. **Abu Dhabi** has ordered both the **F-16 Block 60** and the **Mirage 2000-9** (*GSN* 698/8).

The UAE Air Force has a fleet of Hawk Mk-102 and Mk-61 aircraft procured in the 1980s and 1990s, many of which are out of service.

# Iranian Nuclear Ambitions Tease US Planners, But Options For Immediate Action Seem Few

**T**hough many in Washington believe Iran can still be convinced to abandon its nuclear ambitions, reports now indicate the country's nuclear programme may be more advanced and more extensive than previously supposed. If diplomatic alternatives run out, the Bush Administration could pursue a military alternative.

But US military planners would be left with few options in targeting nuclear facilities – a task that would most likely require far more muscle and a longer engagement than the simple surgical strikes that would be more desirable.

As US counter-proliferation policy turns to the remaining “Axis of Evil” states, Administration hawks and their Israeli counterparts are focused mainly on the threat posed by Iran's nuclear programme, rather than North Korea's. This is primarily because a range of actors – from the President to the Secretary of Defence and Undersecretary of State for Arms Control and International Security John Bolton, the Pentagon's hawk in the State Department – believe two things: that a diplomatic solution can still prevent nuclear breakout in Iran, and that the country is ripe for democratic counter-revolution.

According to this logic, if Iran's nuclear programme can be delayed through near-term policy initiatives, it may not come to fruition before the theocratic regime is swept away. Thereafter, it is believed, a democratic Iran would voluntarily abandon its nuclear programme, as South Africa did after the collapse of the apartheid regime.

Whether or not these assumptions are wishful thinking, the search for policy solutions is underway, and events are likely to develop rapidly. Washington has a number of diplomatic irons in the fire, but none of them holds out much hope of reversing what is clearly a determined, long-term strategic decision, supported by a broad range of Iranian leaders, to develop nuclear arms.

In much the same way that the progress of Iran's Shahab series of ballistic missiles emerged far faster than Western estimates predicted, Iran's nuclear fuel cycle – and, by extension, its nuclear weapons potential – has also outpaced many Western intelligence forecasts.

Germany's *Bundesnachrichtendienst* and Israel's intelligence services appear to have produced the best estimates. These suggest Iran will produce a nuclear weapon by 2010.

In June, the *International Atomic Energy Agency (IAEA)* board of governors will receive a report from IAEA Director General Mohammed El Baradei of Egypt revealing the results of his recent visit to Iran. The US government initially pressed Baradei and the IAEA to issue a stark warning concerning the very advanced Iranian nuclear programme, but Israeli and US counter-proliferation officials told GSN this initiative was scuppered when news of the intense US pressure leaked into the press.

“We really wish that hadn't got out,” an Israeli counter-proliferation official told GSN. “The IAEA is very sensitive to being accused of doing America's bidding, and since it got out, the chances of a good result have decreased.”

As a result, any IAEA statement is likely to be non-committal, focusing on Iran's technical breach of the *Non-Proliferation Treaty (NPT)* – undeclared testing, using radioactive materials, of its newly revealed uranium-enrichment centrifuge technology. As Washington seeks to garner international and domestic support for new coercive measures, this underwhelming verdict will be hard to spin into a mandate for action.

Even if US bluster succeeds in forcing a reaction in Tehran – where the brash Bush administration is treated with some caution – the prospects for a convincing diplomatic solution are not encouraging. Perhaps the best the White House can hope for is an Iranian commitment to sign up to the IAEA's strengthened safeguards system – the so-called Additional Protocol – which expands the range of activities that must be declared to the IAEA and allows more invasive inspections and environmental sampling. This will be scant comfort to the Bush administration, however, where there are few advocates of inspections and the cycles of “cheat and retreat” that are seen to accompany them.

Even if Iran signed up to the protocol, it could delay ratifying the treaty for years – a stalling tactic that will not surprise IAEA analysts – and even then would be able to engage in a concealment effort, incorporating the lessons of Iraq's experience.

Iran's unwillingness to compromise on nuclear issues stems from more than merely a desire to avoid feeling the US stick; it wants to use its “virtual nuclear arsenal” to earn some carrots – just as North Korea did in the mid-1990s. *Atomic*

**Energy Organisation of Iran** Chairman **Gholamreza Agazadeh** recently threatened to end all IAEA inspections unless the US dropped its bilateral sanctions of Iran. As a more extreme measure, Iran could seek to lever further concessions from the US by threatening to leave the NPT – using the three-month notice period as a negotiating tool.

Dealing with such manoeuvrings is not the strong point of the current US Administration, and any diplomatic moves are only complicated by the bombshells – such as alleged basing of *Al-Qaeda* in Iran, and Iranian involvement with *Hiszbollah* in **Lebanon** – that continue to emerge.

In this environment, it is hardly surprising that the White House and Pentagon have given some consideration to limited near-term military options that would seek to delay Iran's nuclear progress.

But the US would likely find it difficult to limit an air operation against Iran to a restricted set of targets. Because of this – and in light of experience in Iraq, both recently and in the December 1998 Desert Fox counter-proliferation strikes – decision-makers in Washington are coming to terms with the need to consider offering carrots when the resort to the stick offers little chance of success.

In addition, the “bitter lesson” of Israel's 1981 airstrike on Iraq's Osiraq reactor, Israeli analysts suggest, is that striking a nuclear programme only tends to spur the proliferating state on, driving the visible programme underground.

This was certainly true after the Osiraq strikes, and following the US strikes on Iraqi nuclear sites in 1991 and the Zafaranyah uranium enrichment facilities in 1993. It was also true following four years of tactically successful Iraqi strikes on Bushehr in 1984-88. From that experience, Iranian planners learned that nuclear programmes must be dispersed and enmeshed with dual-use or civilian infrastructure to survive.

#### **IRAN'S NEW PROLIFERATION PATHWAY**

Baradei's February visit to Iran provided further proof that the country's nuclear weapons programme is younger but technically superior to North Korea's, utilising both **Pakistani** expertise (itself stolen through espionage from Europe since the 1960s) and the Pakistani method of sourcing parts from an extremely wide range of vendors, thus reducing the footprint left on the path to proliferation.

Iran's domestic engineering skills and manufacturing sector complement its overseas efforts. Referring to components and materials needed to pursue proliferation, **Uri Lubrani**, the last Israeli ambassador to Iran and an inveterate Iran-watcher, told *GSN*: “We just don't know how much they will have to import in future. This is a country that makes half a million cars a year. They export speciality metals. They have more industrial capacity than Israel.”

The IAEA visit confirmed that all the pieces

necessary to operate a closed nuclear fuel cycle are now in Iran, in production, or on their way.

Iran has been due to receive 2,000 tons of low-enriched uranium (LEU) fuel rods from **Russia** for its Russian-built light water reactors at Bushehr, the first of which may become operational in the next year. But Russia in the last week on May told Iran it would not deliver the fuel unless Iran agrees to full inspection of all its nuclear facilities. Thus Washington's strongest diplomatic hold over Iran may currently be through Moscow.

If the deliveries go ahead, one-third of the rods would be replaced and sent to Russia for reprocessing each year, thus reducing the risk that highly-enriched uranium (HEU) could be extracted from the spent fuel and kept in Iran as weapons-grade material.

Although this arrangement may remain in place throughout the early years of the Bushehr plant's operation, the discovery of extensive uranium enrichment facilities under construction at Natanz changes the picture, adding a second pathway through which Iran could create LEU fuel for its reactors. This avenue involves Iranian mining and milling of natural uranium ore from mines in central Iran, conversion of the ore into hexafluoride gas UF<sub>6</sub> and enrichment in gas centrifuges, then conversion into fuel rods at a fuel fabrication facility.

This technology base appears to be in place; its effect would be to reduce dependence on Russia for LEU deliveries each year. Though Iran would have been beholden to Moscow to reprocess Russian-supplied spent fuel in Russia, the existence of a fabrication facility would allow it to reprocess its own spent fuel in Iran, placing it fully in control of a sustainable means of producing weapons-grade material.

Alongside development of the light-water reactors at Bushehr, Iran is also putting in place a heavy-water production plant at Arak that could support a heavy-water reactor. Such a system would produce spent fuel that could be turned into weapons-grade material when reprocessed. Though no heavy-water reactor is overtly planned, Iran appears to be maintaining the option.

Without the Russian fuel for Bushehr, Iran would be forced to rely on its numerous small light-water research reactors to produce spent fuel – slowing proliferation drastically – or find an alternative vendor.

#### **UNCERTAIN SCOPE OF MILITARY OPERATIONS**

If the USA – or Israel – finally found it necessary to strike Iran's developing nuclear programme from the air, the operational challenges would be manifold.

Host nation or overflight support would be unlikely for either the USA and Israel (the latter being unlikely to gain a jump-off point over **Turkey**). And for Israel, the ranges involved would make its 1981 airstrike on **Iraq's** Osiraq nuclear

facility look trivial. Many high-value targets could be found in Esfahan, in the country's interior. But Israel would be unable to penetrate **Jordanian** or **Saudi** airspace without detection, nor transit through Iraq, where the USA controls the airspace and would be unlikely to allow a unilateral Israeli violation of Iraqi territory.

Range would be less of an issue for the USA, which would primarily rely on aircraft launched from carriers and the continental USA, and cruise missiles launched from ships or submarines.

The USA, however, would probably be drawn into a far wider range of target sets than at first planned. Unlike Israel, the USA would be required to protect Gulf allies and commercial shipping from Iranian responses, which could involve actions to close the Straits of Hormuz or strike at US bases in **Gulf Co-operation Council** states.

Providing such protection might entail strikes on Iran's Shahab-3 long-range ballistic missiles, on numerous mobile theatre ballistic missiles, on anti-shipping missiles, and possibly on Iranian naval and air units. And because many manned strike missions would be needed to destroy targets that cruise missiles are unsuited for – deeply buried facilities, for instance – Iran's air defence system would need to be disabled. As well as engaging Iran's considerable mobile surface-to-air missile fleet, the US would be forced to take on the **Islamic Republic of Iran Air Force** – a large organisation with a considerably larger role and capability for air defence than the **Iraqi Air Force**.

All these distractions would considerably occupy many of the forces required to strike nuclear targets, prolonging the length of any potential counter-proliferation air campaign.

## Striking Iran: The Shape Of A Potential Attack

If the USA were to launch an attack against Iran's nuclear programme, it would be politically and militarily desirable to conclude the strike as quickly as possible. As many targets as possible would have to be destroyed on the first attempt, even those deeply buried. In striking various points of the fuel cycle, the USA would be faced with a number of options, though few of them would assure quick success.

Judging by **IAEA** comments and satellite imagery from Natanz, the main centrifuge cascade there is likely to be housed in an underground facility. Commenting on the depth of excavations at the site, **US Nuclear Control Institute** President **Paul Leventhal** noted: "These facilities are likely to be 75 feet underground, with walls up to a metre thick. They're going to be very hard to take out with conventional weapons."

Under the rubric of the Hard and Deeply Buried Target Defeat System, the USA has spent much of the last decade developing means to penetrate

multiple layers of reinforced concrete, rock rubble, and earth overburden. Although new systems are under development, the most capable deep penetrating munitions currently deployed with US forces – the GBU-28/GBU-37 – can drill down through 20ft of reinforced concrete or 100ft of packed earth, utilising special fusing to count layers or voids to allow precisely delayed detonation.

The next generation of weapon – the **Northrop Grumman/Lockheed Martin** Deep Strike Hard Target Weapon – will penetrate up to 30ft of reinforced concrete and could be rushed into service as the GBU-28 was in 1991.

Yet, while Iran can camouflage and disperse many of the elements of its nuclear fuel cycle, nuclear reactors remain the weakest link (*see box*). Not only would the two large 1,000MW and two smaller 440MW reactors produce spent fuel, but they would also yield reclaimable UF<sub>6</sub> gas for utilisation in the centrifuges. Vulnerable, fixed, highly visible, and deployed on Iran's exposed southern coast would be up to four planned Russian Bushehr light-water reactors.

Despite strong air defences, the reactor halls and their vulnerable cores would be essentially indefensible to precision-guided weapons. The key limitation on striking these sites would be political: up to 2,000 Russians work on the project and would have to be evacuated. The sites would ideally be struck before they began operation, to reduce the risk of radiological release.

Although a 40MW heavy water reactor could be covertly assembled in Iran, its invisibility during construction would quickly yield to high visibility while in operation. Previous reports have suggested that a covert heavy-water plant might be in production at Tabas, in Yazd province. As the technology used would probably be of the **Canadian Deuterium Uranium** type, the reactor could utilise uranium oxide fuel – non-enriched milled uranium ore – making location near Iran's mines convenient.

The Arak heavy-water production plant is also a vulnerable known location, and future heavy-water production sites would be difficult to camouflage due to their distinctive physical appearance.

If Russia were to cease co-operation or Iran's major light-water reactors at Bushehr were destroyed, Tehran would be forced to either procure spent fuel rods from an outside source or slowly scrape together spent fuel from its light-water research reactors, which include the 5MW US-built Tehran Research Reactor and three smaller reactors at Esfahan: the Miniature Neutron Power Reactor, the Light Water Subcritical Reactor, and the Heavy Water Zero Power Reactor.

These reactors – which represent only a portion of available research reactors – are typically sited on university campuses, making them sensitive targets with high collateral damage potential.

The final stage at which the nuclear fuel cycle could be broken would be reprocessing. A number of factors make this a very difficult potential target. According to the *Institute for Science and International Security's* David Albright, Iran will favour smaller, "disposable" reprocessing plants to large, visible sites with distinctive isotopic and heat signatures.

Iran only needs around 10-20kg of weapons-grade material to build two to four small weapons, and one small site would be able to produce 10kg in around 12 months using light-water reactor spent fuel. Designs for such crude reprocessing plants are available, export controls on their components are relatively lax, and though the facilities would occasionally have accidents (such as releases of heat and radiation into the water table), such releases might not be detected immediately. Plants could remain undetected for much of their short lives.

With up to 180kg of projected spent fuel originating from Iran's light-water reactors – including Bushehr 1 – up to a dozen centres might be required to handle this material, ensuring that a number would avoid detection and attack.

#### CUTTING OFF THE HEAD

Perhaps the most critical target set, capable of causing the most long-term damage, is Iran's community of nuclear scientists.

Iran boasts a number of advanced university syllabuses in the fields of nuclear science and technology and theoretical and high-energy physics, notably Tehran's *Amir Kabir University of Technology* and the *Institute for Studies in Theoretical Physics and Mathematics*. Large numbers of Iranian scientists have also passed through the *International Centre for Theoretical Physics* in Trieste, Italy.

This training needs to be supplemented with expertise in enrichment, reprocessing, and weaponisation – expertise that does not exist in Iran and has had to be imported primarily from Russia and China. In a January 1995 protocol, Russia agreed to train 10-20 Iranian nuclear scientists a year at the *Kurchatov Institute* and the Novovoronezh nuclear power plant. Considerable numbers of Russian, Kazakh and Ukrainian scientists are retained for up to \$20,000/month at the Gorkan (also known as Neka) facility, a site originally surveyed as a potential (but ultimately unsuitable) home for Russian reactors in 1995. The *Atomic Energy Organisation of Iran* reportedly concentrates expertise at Moallem Kaleyah, north-west of Tehran, a site unsuccessfully surveyed for an aborted Indian reactor deal.

Although an unpalatable option, lethal strikes on Iranian scientists might come under consideration as part of any successful strike aiming to inflict medium-term damage on Iran's nuclear programme.

#### Targeting The Fuel Cycle

The nuclear fuel cycle involves a chain of events that any US or Israeli counter-proliferation strike would seek to break. The first stage of Iran's indigenous fuel cycle – mining and milling uranium ore – provides relatively few opportunities to delay Iran's nuclear programme. Iran's principal known uranium deposits – estimated at 5,000 tonnes – are in the centre of the country, at Tabas in Yazd province.

One Israeli military intelligence official told *GSN* that the *Israeli Defence Force* analysed the possibility of disrupting mining activity through strikes on mine-heads and transportation, but concluded that disruption would be minimal, while the danger of killing foreign workers – primarily Chinese contractors – would be high.

Russia has also agreed to supply 2,000 t/yr of uranium ore from H2 03 until 2010 - although it is likely these sales will now be placed under much greater scrutiny than originally envisaged. There are known uranium milling facilities at the *University of Yazd* and the *Tehran Nuclear Research Centre*. Such facilities are relatively cheap to fabricate and easy to conceal.

The next stage in the fuel cycle is conversion into UF<sub>6</sub> – the gaseous format that allows separation using gas centrifuge technology. The main UF<sub>6</sub> facility at the *University of Esfahan's Nuclear Research Centre* represents a primary target for counter-proliferation strikes. As the Esfahan site has been described by Iran as a "pilot site", there are likely to be others, which would be difficult to locate if developed covertly. One known alternative UF<sub>6</sub> location is the *Physics Research Centre at Sharif University of Technology*, in Tehran.

Iran's newly unveiled ability to carry out uranium enrichment using gas centrifuge technology filled a major gap in the nuclear fuel cycle, forcing Russia to publicly rethink its assumptions about Iran's nuclear engineering capabilities and intentions. The Natanz uranium enrichment facility currently hosts 164 working centrifuges and has been designed to hold over 1,000 more when the plant becomes fully operational in 2005.

While Natanz was discovered, other centrifuge cascades may be harder to find. David Albright of the *Institute for Science and International Security* told *GSN* that while Natanz had been under US surveillance for some time, identified as some form of restricted government facility, the site was only identified as a uranium enrichment facility by "a process of elimination; the site had no distinct signature".

Though major centrifuge cascades require large amounts of electricity, subterranean cabling can connect sites to remote electricity generators. Alternatively, such facilities can be highly decentralised, with thousands of centrifuges dispersed among small, nondescript buildings.

Early statements by IAEA Director General Mohammed El Baradei indicate that a pilot centrifuge facility may have preceded Natanz. Possible alternative sites for major centrifuge cascades include the *Karaj Centre for Agricultural Research and Nuclear Technology*, *Rudan Nuclear Research Centre* at Fasa, and the Muallum Kalayeh compound near Qazvin. Attacking the industrial base of centrifuge production may also prove inconclusive.

Well known specialised metallurgical design and manufacturing facilities such as *National Iranian Steel Company (Nisco)* and the *Applied Research Centre* are not required for centrifuge design, which involves relatively simple engineering techniques that have not changed since the 1940s. LEU produced by this process would be forged into pellets and then stacked in fuel rods; the fuel fabrication facility required to undertake this role has no signature recognisable to remote sensing (satellites, aircraft) and no sites have been located.

## GSN Risk Grade – B/3: Gas development moves ahead, elections will increase representation

### Political And Social Development

**Overview:** Oman remains stable, with apparently fewer of the security problems apparent in other Gulf states. Sultan Qaboos Bin Sayyid Al-Sayyid retains a tight grip on policy and security but is regarded as one of the Gulf's more enlightened rulers. Gradual democratisation continues, including the extension of suffrage to all citizens over 21 and the appointment of the first female Cabinet minister, but the Sultan has yet to announce plans to share legislative powers.

**Elections:** Majlis Al-Shoura (Consultative Council) elections on 9 October are set to be Oman's most democratic yet. A decree issued in November lowered the voting age to 21 from 24 and permits universal suffrage. This is a significant step, as during the last elections in 2000 only 25% of the population in each wilaya (governorate) could vote. The 83-member Majlis provides an increasingly assertive forum to question ministers but parties are not allowed and restrictions remain on campaigning. Over 500 candidates have so far put themselves forward. With Majlis Al-Shura members limited to two consecutive terms, new blood is expected in October.

**Women:** In March, Sheikha Aisha Bint Khalfan Bin Jumiel Al-Siyabiah became the first female cabinet minister in the GCC when she was named President of the new National Authority for Industrial Craftsmanship. There are two women in the Majlis Al-Shura. A few more may follow in October, probably from urban voting as rural areas remain very conservative.

**Security:** The USA has issued renewed security warnings to its nationals in the region after the Saudi and Moroccan bombings, but the State Department authorised the return to Oman of non-emergency personnel and Embassy dependents. There is criticism of the government's pro-Western stance, and pan-Arab and pan-Islamic ideas have gained sympathy, but Oman has a deep-rooted tradition of tolerance and religious pluralism. The authorities allowed peaceful anti-war demonstrations. Job creation could become an issue if not continually addressed; an estimated 67,000 young Omanis will enter the workforce in 2003.

**External factors:** Oman maintains ties with a wide range of states and has close relations with Japan and many Western countries. Since 1980 the USA has been able to use ports and air bases under a bilateral defence treaty.

### Economic Outlook

**Overview:** While the war in Iraq was over quickly the impact of lingering regional insecurity may have a negative impact on the economy, particularly tourism. Oil price volatility is countered by a prudent monetary policy but with a budget based on \$20/bbl Oman has little room for manoeuvre should oil markets turn bad in H2 03. The government is targeting non-oil growth – particularly tourism, fishing and natural gas-based industries – while oil sector investment is being encouraged to reverse a dip in output.

**Finance:** The 2003 budget envisages a OR400m deficit, based on \$20/bbl oil, OR3bn expenditure and OR2.6bn revenue. Borrowing of OR150m is expected in 2003, with a five-year Eurobond mooted in H2 by Central Bank of Oman (CBO). A OR80m five-year government bond launched in early May was 25% over-subscribed. Bank consolidation is under way but structural weaknesses remain in the financial sector highlighted by occasional scandals and big provisions.

**Liberalisation:** Preparations to sell a 40% strategic stake in Oman Telecommunications Company have been shelved. The sale of 20% through an IPO in Q4 03 is now targeted. Plans are being reviewed to launch a second GSM licence. In line with WTO guidelines (Oman joined in 2000) wholly-owned telecoms companies are expected by 2005. Reforms are planned to the 1994 Foreign Capital Investment Law to allow 100% foreign investment in banking and insurance, IT services and securities. The law now allows for up to 70% foreign ownership, with 100% in projects critical for economic development. Electricity sector restructuring is underway; three generation companies will be created for sale in 2003-04, plus one transmission and three distribution companies. Privatisation of the national grid is expected by 2004 with sector reform completed by 2005.

**Oil production:** Production including condensate is around 900,000 b/d. Main producer Petroleum Development Oman plans to invest \$1.5bn to 2007. PDO's crude oil output is expected to recover to 724,000 b/d by 2005 and 800,000 b/d by 2007. New phased EOR schemes are scheduled from 2004 starting with the Harweel and Mukhaizna fields; this could push production costs to around \$8/bbl. Bidding for a three-block offshore licensing round closes 15 July.

### OMAN: Key Projects

**OMAN LNG EXPANSION:** Japan's Chiyoda Corporation and Foster Wheeler were awarded the third train construction contract in January for LNG shipments from 2006. A new shareholder structure has been put in place for the third train. Qalhat LNG includes Oman LNG, the government and Union Fenosa Gas. Two more trains are expected later. Debottlenecking of trains one and two is underway.

**SALALAH FREE TRADE ZONE:** A government technical committee and consultants working on implementation after project promoter pulled out.

**SOHAR ALUMINIUM SMELTER:** Detailed feasibility study led by SNC Lavalin is expected mid-year. Mott MacDonald is undertaking a technical study for the proposed facility's 1,000-1,200MW power plant.

**SOHAR REFINERY:** JGC Corporation and Chiyoda Corporation awarded \$879m contract in January for completion of a 125,000 b/d plant in Q2 06. Sohar Refinery Company is seeking a lead arranger for a 14-year multi-tranche financing facility with \$590m commercial debt.

**ENERGY FINANCINGS:** Financings expected during 2003 include Sohar refinery (see above), Sohar fertiliser plant (estimated \$600m debt including German export credit) and Oman Polypropylene's Sohar \$200m-250m plant.

**OIL EXPLORATION:** Licensing round for offshore blocks 18A, 18B and 41 covering a total 45,240km<sup>2</sup> opened in January. Bidding is scheduled to close on 15 July.

### 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 by 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.

### OMAN: Key Data and Forecasts

(\$ million)	1999	2000	2001	2002
Exports (fob)	7,226.7	11,301	11,056.9	8,117.4*
of which: oil & gas	5,523.2	9,361.2	8,866.5	6,249*
non-oil	522.0	644.0	690.2	486.9*
Imports (fob)	4,292.4	4,585.8	5,788.9	4,506.4*
Trade balance	2,934.3	6,715.2	5,268	3,611*
Total revenue	4,664.0	5,946.2	6,595.2	7,026.5**
of which: oil & gas	3,270.0	4,659.6	5,060	5,371.1**
Total public expenditure	5,892.0	6,897.4	7,427.2	6,148.8**
o/w: defence & security	1,784.5	2,099.7	2,422.7	1,967.8**
Fiscal surplus/deficit	-1,228	-951.2	-832	877.7**
Financing: Net loans	–	–	-182.5	-436.5**
Government bonds	–	–	15.1	72.4**

\* Jan-Sep; \*\* Jan-Nov.

Source: Ministry of Finance, Muscat.

**GSN Risk Grade — B/2+: Emir Hamad, secured by US alliance, builds world-scale gas industry**

### Political And Social Development

**Overview:** Emir Sheikh Hamad Bin Khalifa Al-Thani has been keen to emphasise his democratic credentials. A referendum in late April approved the draft of a new constitution that will vest legislative powers in a two-thirds elected 45-member Shura (Advisory) Council while maintaining Al-Thani rule. Elections are expected in Q4 03 or 2004. Qatar continues to make its presence felt in the international arena as everything from the USA's new regional military hub to Al-Jazeera Satellite Channel's impact on the media.

**Constitution:** The draft constitution was approved by a 96.6% 'yes' vote. It envisages a Shura Council elected by universal suffrage of Qatari nationals aged 18 years old and over. All bills must be passed by a two-thirds majority and then endorsed by the Emir to become law. This is a significant move towards pluralism, but it also enshrines real power in Al-Thani hands and settles questions concerning succession. Political parties are not allowed. Expatriates do not have the right to vote but will benefit from equality before the law.

**Social forces:** Qatar appointed its first female cabinet minister in early May when Shaikha Bint Ahmed Al-Mahmoud became Education Minister. This followed the early April election of Shaikha Yusuf Al-Jaffiri to the Central Municipal Council – becoming the first GCC woman to hold a publicly elected position. The new constitution allows women to vote and hold office in national elections but conservative thinking means a flood of women into politics is still by some way off.

**External factors:** Typical controversy was provoked by a May meeting in Paris between the Qatari and Israeli Foreign Ministers. Typical of Qatar, Sheikh Hamad Bin Jassim Bin Jabr Al-Thani also has a relationship with Palestinian Prime Minister Mahmud Abbas that might help play some part in brokering a peace settlement. Qatar has been criticised in the past for diplomatic contacts with Israel. As chair of the Gulf Co-operation Council and Organisation of Islamic Conference, Qatar continues to make its voice heard. High-level contacts are maintained with the permanent UN Security Council members, as witnessed by Emir Sheikh Hamad's May tour of the USA, UK and France. The USA has relocated its Combined Air Operations Centre from Saudi Arabia to Al-Udeid.

### Economic Outlook

**Overview:** The economy is expected to weather regional instability, with strong fiscal and current account surpluses. Nominal GDP growth averaged 13.5% in 1998-2002. Qatar National Bank has forecast 2% GDP growth for 2003, compared to an estimated 4% in 2002; Total debt was around \$16bn at end-2002. Oil production under the OPEC quota production ceiling is 658,000 b/d, effective 1 June.

**Budget:** The 2003/04 budget has a \$474m deficit, 4.8% down on 2002/03, based on a cautious \$17/bbl average oil price. Part of any surplus will go to the Oil Stabilisation Fund. The budget envisages \$5.9bn revenue and \$6.4bn spending, with \$1.69bn set aside for major projects. The government has made a significant allocation for the 2006 Asian Games.

**Energy and project finance risk:** Despite the end of war in Iraq the 16 May attacks in Saudi Arabia highlighted concerns that led Moody's to downgrade RasGas's rating to Baa3 in February, when it cited 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. By 2007 Qatar 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. Ongoing downstream projects are estimated to account for only 27% of the North Field's more than 900trn ft<sup>3</sup> gas reserves.

**Liberalisation:** Privatisation of power distribution and other state assets is planned. An IPO for 15% of Industries Qatar – from the merged state assets of Qatar Petrochemical Company, Qatar Fertiliser Company, Qatar Fuel Additives Company and Qatar Steel Company – has been launched and is expected to raise QR1.2bn. Further IPOs can 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 and services, such as education; the government and strategic partner will take 25% stakes, with the remaining 50% held by private sector investors. Land ownership by foreigners will be permitted with the development of the planned West bay man-made island project.

**THE AL-JAZEERA FACTOR:** The Al-Thani-sponsored Al-Jazeera Satellite Channel continues to irritate Arab and Western governments. The war in Iraq and new 'Al-Qaeda' tapes have further heightened its profile and drawn fresh criticism and allegations, notably that it had been infiltrated by Iraqi agents. During his recent US visit Emir Shaikh Hamad brushed all this aside as a successful experiment in press freedom. But Al-Jazeera's founding General Manager Mohammed Jassim Al-Ali was replaced on 27 May.

### QATAR: Selected Economic Indicators (\$ million)

	1999	2000	2001	2002 <sup>1</sup>
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 <sup>2</sup> : 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

<sup>1</sup> Central Bank of Qatar preliminary estimates. <sup>2</sup> Fiscal year (April-March)

Source: Central Bank of Qatar

### QATAR: Key Projects

**LNG:** THE 15m t/yr Qatargas II LNG project is being studied by Qatar Petroleum and ExxonMobil, for first deliveries in 2007. At Ras Laffan, LNG 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, all anticipating a 2007 start-up, include the \$1.1bn Q-Chem II; \$550m Qatofin low-density polyethylene project (partners QPC, France's Atofina and QP); and \$470m 1.3m t/y Ras Laffan ethane cracker.

**RAS LAFFAN IWPP:** Qatar's first independent water and power project will have an initial 750MW and 40m g/d capacity, with 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 Jan 03. A FEED contract is expected 2003 for an ExxonMobil-led plant while Shell, and Ivanhoe Energy are undertaking feasibility studies and Conoco, Marathon and Sasol/Chevron are looking at plants. Shell said talks for a heads of agreement were "well developed."

**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.

**MESAIEED LINEAR ALKYL BENZENE PROJECT:** FEED work for a 100,000 t/yr LAB unit and 80,000 t/yr paraffin unit underway, with EPC bidding in H2 03 and completion scheduled by end-2005.

# MIDDLE EAST ENERGY

POLICY, RISK AND PROJECTS IN THE GULF AND LEVANT

## OPEC/IRAQ: US snubbed ahead of Doha meeting

The Organisation of Petroleum Exporting Countries has decided not to invite an Iraqi representative – who would presumably have been US appointee **Thamer Ghadhban** – to its 11 June meeting in **Qatar**. This means OPEC will avoid having to engineer Iraq's re-integration into quota schedules, but the move is also seen as a snub to the USA by some of its closest allies in the region. It may stimulate debate among US hawks as to whether Iraq should stay in the cartel. Oil Advisory Board head **Philip Carroll** made waves when he implied this might not be desirable. The Pentagon and any number of lobbies don't like OPEC (*GSN 707/16*).

## BAHRAIN: Power and water privatisation shortlist

Half the power and water restructuring advisory bidders have been shortlisted and meetings will follow in the early summer. They include **PricewaterhouseCoopers**, **HSBC** and **Clifford Chance** (\$3.3m bid), **BNP Paribas**, **Fichtner** and **Norton Rose** (\$3.9m), and groupings led by **McKinsey & Company** (\$4.5m) and **Ernst & Young** (\$7.8m).

## IRAN/UK: North Sea alliance

**National Iranian Oil Company** subsidiary **Iranian Oil Company UK** is to finance half of the £350m (\$572m) Rhum gas and condensate field development in the North Sea; operator is **BP** with both companies taking 50% equity. The move will be much welcomed in Tehran, and sends out a strong political signal from BP when some others are wavering on their Iranian alliances.

## QATAR: Helium plant

A \$115m project with France's **L'Air Liquide Engineering** and the UK's **BOC Group** for a world-scale helium plant, to be financed by **Qatargas** and **Rasgas** (operator), would give Qatar 10% of global helium output, after the **USA**, **Australia** and **Algeria**. Exports are scheduled from Q3 05.

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## Jordan Says No To BOO As Reform Moves Disappoint

Power sector reform in the Levant remains a stop-start affair, hampering efforts to tap private investment in the roll out of new generation capacity.

**A**ppetite for private power in the Levant ranges from the tepid – **Syria** – to the more pioneering in **Jordan**. But the Hashemite Kingdom's ambitious plans to build a 450MW combined cycle independent power project (IPP) at **Kherbet al-Samra** by 2005 were dealt a heavy blow after developer **Tractebel's** withdrawal in Q4 02. The Jordanian government now appears to have scrapped the build-own-operate (BOO) model altogether.

It is likely to tender a scaled down version of the plant on a more traditional engineering, procurement and construction (EPC) basis.

Failure to progress the **Samra** IPP is a blow to the wider region's reform ambitions. The Jordanian authorities had put their faith in the BOO option as a way of guaranteeing a speedy construction time for a plant that was intended to lift **Egyptian** gas, due to arrive by 2005 through the **Egypt-Jordan** gas pipeline now under construction.

The Jordanian Ministry of Energy and Mineral Resources (MEMR) had hoped to ink a power purchase agreement as early as September. The government's conversion to the virtues of private power was not in doubt. More troubling for authorities in the region is international developers' apparent lack of appetite – a trend that is not restricted to the

Middle East alone (*GSN 708/20*).

**Samra** proved a painful experience for **Jordan**. **Tractebel** fled the scene, blaming structural changes at parent the **Suez Group**. MEMR was understood to have had lined up alternative developers, including the UK's **International Power**, but their request for further time to submit bids beyond the 30 April deadline prompted the government to ditch the private model and take the EPC route.

**Samra's** failure is not a desperate blow to **Jordan's** plans to ramp up power.

"You need IPPs in two cases – if you have an efficient and unreliable system or if you cannot finance your urgent expansion requirements," **Amman-based World Energy Council** official **Hisham Khatib** told *MEE*. "Jordan has an efficient and well-managed generation system, therefore IPPs cannot improve on this. Secondly, Jordan found that the cost of financing IPPs is high compared to traditional sources. Interconnection with **Egypt** and **Syria** also reduced the urgency."

The region may have to wait a while longer for its first genuine private power plant to get off the ground. Plans for a second Jordanian IPP, first mooted in H1 02, also look to have hit the buffers. **Amman** plans to boost capacity by 950MW in the next five years, to match demand growth averaging 4%-6%/yr.

In an attempt finally to place the horse before the cart, the government is expected to unveil a new law in 2004 laying down the framework for private investment in the power sector.

Jordan's blueprint for power sector reform follows the standard formula. Under plans drawn up by *NM Rothschild & Sons*, distribution and generation would be turned over to the private sector leaving the state utility *National Electric Power Company (Nepco)* in control of transmission assets.

## **LEBANON: Buyer Beware**

Power-strapped Lebanon is following a similar model to *Jordan*, although state utility *Electricité du Liban (EdL)* is to initially sell a 40% stake of its generation and distribution assets – with full management control – to a strategic investor.

An adviser to Energy and Water Minister *Ayoub Humayed* told *MEE* in late May that the tender documents were being finalised before being reviewed by the government's Higher Privatisation Council. An announcement is expected towards end-June to prequalify for a minority stake.

A separate tender will be issued to potential operators of the transmission network, which will continue to stay in public hands but be offered as a private concession for a set number of years.

Among the groups understood to have expressed interest in the EdL sale were *International Power*, *RWE* of Germany, *Italy's Enel* and *Electricité de France*. A total of 19 firms submitted expressions of interest last November.

Beirut sources warn that the EdL privatisation is progressing slower than it should be, held up by the government's concentration on the sale of GSM phone licences and other state holdings. The initial timeframe envisaged an award by the start of Q3 03, but this is unlikely to be realised. "I doubt we'll see anything come out on electricity before we see how the GSM situation moves," said one senior Beirut-based banker. "The trend is clearly to privatise it in portions – production, distribution and collection – but we still don't have a clear direction on how they intend to do it."

### **PAYING FOR BILLING ERRORS**

The management issue is key to power sector reform. Much of the hard work has already been done, following a clear-out of EdL's administration last year after a financial crisis that led to it being unable to pay for fuel to power its generators. The government subsequently wrote off around \$500m in uncollected revenues owed in the period up to 1996, blaming it on "administrative neglect".

Potential partners will need further reassurance that the company has at least a semblance of a commercial operation. "A strategic investor is needed, but first they have to manage it in proper way," said the banker.

Ensuring efficient revenue collection is critical.

*BNP Paribas*, adviser on the EdL sale, says that around 85% of what is billed is collected.

But billing is still lagging – most estimates say the utility only bills half of its customers. "Collection has got better but improvement is still needed," said the banker.

The government says it will still attempt to recover some \$400m in outstanding revenues owed to EdL for the period 1996-2001.

But investors may still be wary of investing in an operation with such a dubious track record of revenue collection. The government is looking to net at least \$800m from the sale of the stake, possibly more. It also expects to whittle down its own interest in the utility over time.

A successful sale to a private operator would at least boost the chances of seeing new generation capacity get off the ground. But ongoing improvement to the transmission system – with plans to connect *Syria* using 400 kV transmission lines – could facilitate cheaper imports of power and tie into regional high-voltage networks. Lebanon already imports up to 200MW from *Syria*.

## **SYRIA: Little Appetite**

Syrians talk about the need for economic reform but Damascus has hitherto shown scant interest in pushing for private power. It stands little chance of hitting its target of a further 3,000MW of generation capacity by 2010 without a commitment to tapping private investment.

"It will be a long time before IPPs appear in *Syria*," said *World Energy Council* official *Hisham Khatib*. "But Lebanon with its market economy can be something else – if regulatory systems and badly needed reforms are developed – particularly in bill collection, otherwise it will be the government rather than the consumer who will pay for the IPP. I wouldn't be surprised to see IPPs in Lebanon in the near future."

The *Public Establishment for Electricity Generation and Transmission (PEEGT)* has encountered tepid contractor interest on two power plant upgrades and conversions in the past year. It has also been hit by budget restrictions.

A planned 100MW upgrade of the *Tishreen* power plant was thwarted after the two preferred bidders submitted offers far in excess of what PEEGT could afford.

An upgrade and conversion of the 125MW *Nasiriyeh* power station was abandoned last year after just one firm submitted an offer.

Tender documents for the upgrade and conversion of both plants were expected to be issued by Q2 03, but indications suggest a distinct lack of international appetite for *Syrian* project risk.

Although capacity is not a pressing problem for *Syria* – allowing it to divert spare capacity towards *Lebanon* – the distribution network is in a poor condition. Around one-quarter of total generated capacity is estimated to be lost, in part due to poor

quality lines and transformer stations. Yet Damascus has successfully tapped the *European Investment Bank* and Arab donors for some \$265m in aid to expand and upgrade the transmission network, for completion by 2005. The project involves the construction, upgrading and expansion of sub-stations, overhead power lines and underground cables.

The ongoing network improvement should boost Syria's chances of participating in the looming region-wide electricity grid. **Egypt, Jordan, Syria and Turkey** have mooted a regional transmission grid via a 400kV network, but a planned connection to Turkey has been hampered by the Syrians' failure to upgrade their own network in time.

The 400kV Syria-Jordan and Jordan-Egypt interconnections were synchronised in 2001. Linking these countries' grids potentially creates a substantial regional network, making the frequent power outages suffered by many Lebanese a thing of the past. "The Egypt-Jordan-Syria-Lebanon interconnection is already up and working satisfactorily," according to consultant **Hisham Khatib**. "Interconnection with Turkey will take a little bit more time because of distances and the fact that Turkey's main load and generation are back in the north of the country."

## **IRAQ: Tall Order For Bechtel To Restore Capacity To 9,000MW**

Iraq's power generation capacity stood at less than 2,000MW in May, down from an estimated pre-war 5,500MW level, according to *US Agency for International Development* projections. Pre-1991 capacity was around 9,000MW, but this fell to around 1,800MW following the **Kuwait** conflict.

Independent estimates suggest at least 6,000MW of new capacity will be needed over the next three years – a tall order even in the best of times.

The easy bit of the work is re-installing the transmission and distribution networks. Bechtel confirmed that restoring transmission lines would be a priority of its USAID infrastructure reconstruction contract. Bechtel is committed to bringing power to about 75% of the population. Within a year, USAID's contract would require Bechtel to restore power to 75% of the pre-1991 Gulf War conflict level, with 10 power plants rehabilitated.

In the interim, Bechtel is to restore 40% of previous service, which will involve repairing 15% of high- and low-voltage transmission lines, 50% of substations and five generating plants.

But power shortages are likely to remain a facet of life in Iraq. Baghdad's four power plants are supplying up to 60% of electricity needs, though in many areas it is averaging about two hours a day. Even that coverage is only possible because the heaviest industrial users are largely out of action.

Iraq was able to keep a semblance of normality

in its power system through 13 years of sanctions by granting contracts to **Chinese** and **Russian** firms for patchwork upgrades. Baghdad received priority over other regions. Around \$4bn was invested in power between 1996 and 2002, following the implementation of the *United Nations'* Oil-for-Food Programme, allowing generation capacity to increase to 4,000MW-5,000MW.

Much of the recent damage to power infrastructure was caused by regime sabotage. Iraqi electrical engineers say **Saddam Hussein** ordered tiny homing devices to be positioned atop dozens of transmission towers to trick US pilots into thinking they were military targets. More than 40 towers were destroyed or damaged by US bombers during the conflict.

This was followed by widespread looting, removing vital equipment from plants. Such is the extent of the theft of copper cable that it is now impacting on international markets (*see page 18*).

The UN forecasts an increase in demand of around 4%/yr in the next few years, with the prospect of a minimum 1,000MW supply shortfall.

Consultant **Isam Al-Khalisi**, previously a senior engineer with Iraq's *National Electricity Administration*, estimates that some 6,000MW of new plant will be required by 2006.

Iraq could yet turn out to prove a test bed for private power in the region. Khalisi estimates that \$8bn-10bn is needed to restore the sector to full health which, given other calls on the state budget, seems unlikely to be easily met.

### **Israel's IEC Under Pressure**

Israel's power utility is facing a major shake-up that could result in being sliced into several subsidiaries and sold off in a public offering. A Knesset committee has argued that **Israel Electric Corporation (IEC)** should be turned into a holding company that would operate through subsidiaries that should be sold off. Other recommendations included dividing energy distribution between regional monopolies, creating a new generation company and opening up the sector to increased private competition.

The assault on IEC will intensify already strong commercial pressures. IEC suffered a two-notch downgrade in its rating by **Moody's Investors Service** in January, after **Central Bank of Israel** restricted its access to credit under tight single borrower rules. Moody's said the reduction stemmed from IEC's high level of debt and a weak financial profile that has substantially worsened. It mooted another possible rating downgrade.

The credit restrictions mean IEC could be constrained from completing a number of major projects on the drawing board, including the \$510m Thetis Sea gas development and a new gas pipeline estimated at \$400m. Two planned IPPs at Ramah Hovav and Rotem Plain could also face the chop. The company has pushed strongly to conclude a gas sales agreement with **BG International** over gas sourced from **Palestinian Authority (PA)** permits in offshore Gaza – in apparent contravention of the **Sharon** government's stance that no deals can be struck without a full political settlement with the Palestinians. Rival Israeli gas suppliers – including the **Yam Thetis** consortium, which is building a 1.8bn m<sup>3</sup>/yr gas pipeline to supply IEC's Ashdod complex – have lobbied hard to prevent IEC striking a deal with the PA over gas supplies.

## G8 Governments Jockey For Position On Iraqi Debt

**T**hough the profile of Iraq's debt is murky, such are the prospects offered by reconstruction that even the most cautious governments are already pushing export credit into the country. Creditor nations and corporates seem willing to work with the new Iraq even before a clear resolution of the debt situation – or the political situation, for that matter – is in sight.

Iraq's external debt is estimated at around \$120bn, of which some \$55bn is Arab and \$65bn is due to other creditors, not including outstanding compensation payments. But until the painstaking process of consolidation begins, estimates of total outstanding debt will remain murky.

That has not stopped eager bilateral creditors. The **Japanese** government announced that from 19 May it would resume *Nippon Export and Investment Insurance (NEXI)* cover. Reports from Tokyo focused on corporate Japan's reluctance to bid on the expectation that US firms would win the contracts, but also because there was no insurance cover. As pertinent was Japan's willingness to channel new support despite any resolution of Iraq's outstanding bilateral debt – put at \$6bn – and debt to other private institutions.

Normally Japan shies away from countries that have got into debt problems and have rescheduled.

Speaking at a meeting of G8 finance ministers in Deauville, **France**, on 18 May, Finance Minister **Masajuro Shiokawa** said he was reluctant to see debts cancelled – the classic Japanese position – but that a period of non-repayment was inevitable. His tone reflected a wider feeling that after a decade of largely being ignored the debt is an issue that must be included in plans to rebuild Iraq.

The **UK's** *Export Credits Guarantee Department (ECGD)* has agreed some £300m (\$489m) of new cover. As with its restoration of cover for **Iran**, ECGD agreed fresh support before a debt deal was in place.

**Italy's** *Sace* is close to restoring cover – with an initial €1bn limit. Iraq is also to become eligible for backing by Italy's *Mediterranean Finance Corporation (Finmed)*, allowing Italian firms to buy up to 49% of the capital in Iraqi corporates.

Though governments are again coming in, a debt deal will take longer to broker. Bankers expect a substantial “haircut” – with a large proportion of the external debt being written off in a long-term debt restructuring deal, possibly on a par with **Yugoslavia's** two-thirds write-off.

Banks and governments have been dusting off their Iraq files and starting research into the scale and nature of the Iraqi debt, the potentials for its recovery and eventual trade. As with most things

in Iraq, much depends on questions of legitimacy and who takes ownership of the problem.

Given the nature of the debt, which was skewed towards borrowing underwritten by governments (and in the Arab case, Baghdad long argued, grants), the Paris Club of creditor governments should have a leading role to play.

There have been suggestions that Iraq's obligations should be considered “odious debt”, accumulated to pay for **Saddam Hussein's** wars, which an incoming “virtuous” regime should not have to pay. However, with efforts underway to involve multilateral agencies in post-war Iraq, the likelihood is that a formal framework will be followed that involves the Paris Club and commercial creditors grouped in the London Club.

The London Club will focus on bigger instruments such as *Rafidain Bank's* syndications of 1983-85, but a wide range of commercial creditors are looking on.

The Paris Club/London Club formula fits into the Bretton Woods framework run by the *International Monetary Fund* and *World Bank*.

Meeting in Deauville on 18 May, G8 finance ministers – from the G7 of **Canada**, **France**, **Germany**, **Italy**, **Japan**, the **UK** and the **USA**, plus **Russia** – made a start towards formally untangling the Iraqi debt mess.

US Treasury Secretary **John Snow** said “there was broad recognition that we cannot expect Iraq to service any of their debt obligation at least through the end of 2004.” This would give time to put formal debt rescheduling in place.

Asked about divisions between G8 governments over Iraqi debt, Snow commented: “I don't think there was any difference. I think it was broadly accepted that Iraq is not in the position of making repayments.” However, German Finance Minister **Hans Eichel** said the G8 agreed not to implement debt reduction, as had been mooted by the USA and UK. Germany would consider rescheduling but “there is no need for debt forgiveness.”

The G8's joint statement did not mention Iraqi debt and reconstruction. French Finance Minister **Francis Mer** said the IMF and Paris Club needed time to work out how much Iraq owed. More data is expected to emerge when the Paris Club meets in early June. Mer said Iraqi experts would have to be found or appointed as a point of contact for any meaningful discussion of foreign debts.

Snow stressed the need to begin a process for countries to donate funds for reconstruction. This argument will be pushed by President **George W. Bush** when he visits France for the 31 May-1 June G8 summit.

## **Iraqi Contract Chase Goes International**

CONTINUED FROM BACKPAGE

small beer in a region used to major multi-million dollar energy-based projects. "The majority of the tenders will be well under \$1m a piece," Elkins told the seminar.

Bechtel scoffed at suggestions that bigger deals were being held back for favoured US contractors. According to one senior company executive, the "patch-up" nature of the work "just doesn't lend itself to very large contracts". Since the mid-April contract award was announced, the San Francisco-based company has expended much effort to quash conspiracy theories linking the US corporate establishment – of which Bechtel is a fully paid-up member – with the Pentagon and the White House in the rush to war.

Those seeking such connections do not have far to look. Scion of the Bechtel family and current Chairman and Chief Executive **Riley Bechtel**, was appointed a member of President **George W. Bush's** Export Council in March – a platform from which he will advise the government on how to create markets for US companies overseas. Former Bechtel president (and current board member), ex-Secretary of State **George Schultz**, proved one of the most eloquent backers of military action against Iraq in the op-ed pages of the US press.

In December 1983, President **Ronald Reagan's** then Middle East peace envoy **Donald Rumsfeld** was sent on a special mission by Schultz to obtain President Saddam Hussein's sanction for a planned Bechtel-built oil pipeline running to the **Jordanian** port of Aqaba. At this point, Rumsfeld is unlikely to be doing Bechtel's bidding directly. The USAID civil works programmes are not being overseen by the Pentagon – unlike the oil sector where the Department of Defence is playing the dominant role in reshaping the industry.

The US construction giant's contract is geared towards essential repairs, with initial work totalling \$34.6m concentrated on one seaport, five airports, electrical power systems, road and rail systems, water and sanitation, schools and health facilities, government buildings and irrigation systems.

The "patch-up" contract – officially known as the Iraq Emergency Infrastructure Repair and Rehabilitation – is intended to set the groundwork for rebuilding the country's "human and institutional capacity" for the maintenance of infrastructure and service delivery systems. Bechtel, which expects to subcontract at least 90% of the work, says much of its initial focus will be on re-establishing power supply networks. "It's critical to get high voltage transmission lines back up and running," said Elkins. "This early stage is all about installing confidence."

Based out of its temporary HQ in Kuwait City's Sheraton hotel, Bechtel will oversee an operation divided into five sectors: water and wastewater, ground transport, ports, power, and airports. Heading the operation is senior project manager **Cliff Mumm**, with **Terry Valenzano**, an old Middle East hand who headed Bechtel's Saudi Arabian operations until the beginning of this year. Valenzano was reported to have held meetings in April in Kuwait with the now ousted US General **Jay Garner**.

Iraqi contractors are another spectre at the feast. Bechtel – at least in its public statements – is pushing

strongly for significant Iraqi content in project awards, but little thought has been given to enticing Iraqi firms into the reconstruction effort. The maintenance of **United Nations** sanctions against Baghdad until late May absolved Bechtel from having to sound out local firms for contract work; their subsequent removal may presage a revival of pressure from in-country Iraqis to dole out contracts to deserving firms.

According to **Saad Saraf**, a spokesman for a group of Iraqi professionals calling themselves the **Iraq Reconstruction Group**, Iraqis fear corporate America has muscled local talent out of the picture. "There is no mechanism for getting Iraqi technocrats or engineers on board," he said. "The Bechtel portal doesn't even take account that Iraqi firms might not have Internet access."

One seasoned consultant suggested other motives for Iraqis' exclusion. "People talk about a broad mass of well-trained Iraqi engineers, but that's a myth," said the seminar participant. "The truth is, the education system's been decimated in the past 20 years and if you're looking for qualified engineers of international stature, you just can't find them."

Suspicion of US motives goes beyond the Iraqis and the anti-war camp. Contractors of all persuasions are concerned about strict export control restrictions associated with Bechtel's USAID reconstruction contract. All sub-contractors and suppliers have to provide Export Control Classification Numbers and detailed information about where each item was produced and where its parts were sourced – for all items to be shipped in support of work for Bechtel. "This just gives us even more hoops to jump through," groaned one contractor.

A bias towards US contractors can even be seen in the technology used to register for the Iraq programme. There have been complaints that Bechtel's Web portal for interested contractors had refused to accept non-US post codes – a technical glitch that Bechtel chiefs promised would be speedily rectified.

GSN hears that contractors with **Iranian** links could find themselves frozen out. Bechtel's senior London-based executive **Lindsey Holbrook** said Iranian contractors would be excluded under the **Iran-Libya Sanctions Act**. But he could not confirm whether international firms would be barred from Iraq contracts if they used facilities based in Iran. The strict export controls outlined by Bechtel would appear to suggest firms looking towards synergies between Iraqi and Iranian operations should not get their hopes up too high.

### **Pillaged Copper Crosses Iraq's Borders**

Thousands of tonnes of copper pillaged from power networks and buildings are flowing out of Iraq each day, *Reuters* quoted traders in the Gulf saying. One trader in **Kuwait** told the news agency: "It's all coming out of Iraq via people who cut up this copper cable from under the ground and drive it to the border." On 20 May he reported receiving 1,000 t/d of copper scrap – worth more than \$1.5m – in the past fortnight. Some material was also going into **Turkey** and **Iran**, he said. On that basis, copper is coming out of Iraq at a rate equivalent to more than one-third of the world's regular scrap supply. Other traders reported big business with Iran, the **UAE**, **India**, **Pakistan** and **China** – with ordinary Iraqis, not scrap companies, driving the pillaged copper to the border.

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