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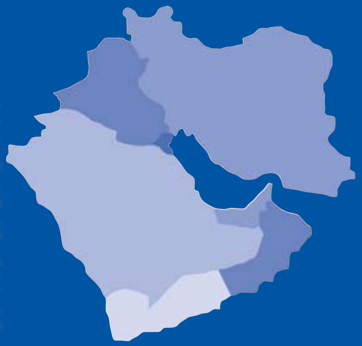

GSN

Companies & People

Europe's "New Realism" On Iran Could Yet Frustrate USA

US reports of a "new realism" in ***European Union*** security doctrine are patronising and premature – unless Washington really does maintain the monopoly on realistic approaches to dealing with Iran's nuclear programme. The 25 June meeting between President **George W Bush** and ***European Commission*** President **Romano Prodi** gave an important opportunity for the White House to incorporate a European dimension into the blend of pressures it is building to confront Tehran's nuclear programme *(GSN 711/8)*. Recent moves seemed encouraging: **Germany** and **Italy** are emerging as recent converts to the Iranian threat – long recognised by the **UK** and **France**, which have promoted a "constructive engagement" approach. The EU has been dragged into bundling the issues of terrorism and weapons of mass destruction (WMD) as inextricably linked issues.

Brussels has gained some credibility in Washington for staking the future of EU/Iranian technical and economic co-operation agreements on the outcome of the nuclear crisis *(see page 11)*. In a White House that lacks an effective suite of either sticks or carrots, this move represented a major boon.

Continued on page 5

Across The Region

Saudi Crown Prince Abdallah's "national dialogue" on reform produced few tangible results but gathered a diverse set of voices behind his ambitious agenda for reform. The presence of Defence Minister Prince Sultan at CPA's palace after the talks indicates the hard-line Wahabi camp may have begun to accept some arguments for liberalisation. Page 10

The Saudi "national dialogue" could represent a major step forward, but CPA and his allies will have to show great application to force through reform in the face of opposition. GSN View, Page 2

An unexpected change of leadership in Ras Al-Khaimah could point to a more favourable business climate in one of the poorest emirates. However, this could be at the expense of political reform given new Crown Prince Sheikh Saud's conservative take on politics and his predecessor, Sheikh Khaled's more liberal social agenda. Page 8

Trade talks between the EU and Iran is aimed as much at pressing the Islamic Republic for political reform as it is at strengthening economic ties. Page 11

Yemen's President Saleh is seeking a new deal with the opposition in the face of huge development challenges. *GSN* maintains its D/3 Risk Grades. Risk Management Report, Page 15

Trouble in RAK should not deflect from the UAE's overall reputation for stability. *GSN* maintains its B+/2 Risk Grades. Risk Management Report, Page 14

Emirates and Qatar Airways steered $24bn in orders to Airbus, increasing the woes of US manufacturer Boeing. But both airlines face stiff headwinds in their aspirations to become international hub carriers. *GSN* talked to market analysts to assess the potential for two very ambitious Gulf carriers to meet their aims. Page 12

Oman has abandoned plans for a privately financed overhaul of its sewage network, and will seek conventional bids for the project in July. Page 13

Two years ago, outgoing FBI director Louis Freeh was hoping to tie up the 1996 Al-Khobar bombings case – a complex affair with potential geopolitical consequences for Iran and Saudi Arabia. Perspective, Page 2

GSN's Analysis

Security remains the big issue in Iraq. *GSN* has carried out detailed analysis of attacks during the last two months which shows, predictably, that violence emanating from organised, mostly Sunni forces is on the rise. The 24 June attacks on British troops in the south showed the potential for Shiite violence, but for now it is the Sunni heartland that is most dangerous. Civilian Administrator L Paul Bremmer has stepped up US military action to meet the attacks, though so far with only mixed results. Page 3

Riyadh's current focus on internal security means there will be few new arms deals like the $1.2bn aircraft purchase signed recently. This will not please US vendors, but the Kingdom must concentrate on reform of its expensive military infrastructure as well as on political change. Page 6

Following strong political victories, Bahrain's majority Shiites will push an agenda of constitutional and social reform. Questions of Islam will follow in the longer-term, and could fragment an effective coalition. Page 20

MIDDLE EAST ENERGY

Oil production in Syria could soon drop below the 500,000 b/d mark. Damascus is working hard to attract new investment to upstream oil and potential gas developments, but so far with few solid results. The government is accelerating the pace of talks with IOCs and even offering Mediterranean offshore acreage. Page 17

International oil companies are lining up for a range of new contracts in Iraq, as a new effort to raise output and improve the political signals coming from an embattled Interim Administration gets under way. Page 16

The issue of where Iraq's battered oil sector will eventually stand in relation to OPEC is among questions being raised as governments and analysts seek to assess the industry's future direction. Page 17

MEE Pointers on Saudi power plants, a new Kuwaiti refinery, Marathon in Qatar and BG's push to sell Palestinian gas to Israel. Page 16

GSN View

A sense of how to catch the tide of events and make your own luck is an invaluable asset in politics – and Saudi Arabia's Crown Prince Abdallah (CPA) is now revealing just such deftness as he seeks to push the reform process forward in the Kingdom. A mid-June "national dialogue" in Riyadh – organised at CPA's behest – could turn out to be one of those pivotal political moments, when a slight but well-timed nudge of the tiller produces a decisive shift of course.

Democratisation and widening media freedoms have been on the Saudi agenda for some time, and certainly since the 11 September 2001 attacks. Western allies, who for years showed little interest in exerting serious pressure for change, no longer have any qualms about publicly insisting on the need for a radical overhaul of the Kingdom's governing structures and mechanisms for transparency and accountability. Some comments of US Ambassador Robert Jordan since the mid-May Riyadh suicide bombings would have been unconceivable only a few months ago. Equally, Saudi officials are being unusually vocal abroad on the potential for political and media reforms *(see page 10)*.

But CPA is only *primus inter pares* among Saudi princes. He cannot simply impose reform either on his more cautious fellow princes or on what remains a deeply conservative society. He has had to persuade and encourage centre-ground opinion to prepare the path for his own actions as head of the government. Royal hard-liners such as Interior Minister Prince Nayef Bin Abdelaziz have continued to fight their corner. But recent events, notably the US conquest of Iraq and the extremist bombing of expatriate residences in Riyadh, have weakened the conservative camp. Some elements of the local media have even been emboldened to openly attack the Mutawaa religious police *(GSN 711/6; 710/3)*.

Holding a "national dialogue" in such a receptive climate was thus an important step forward for CPA's case, and not a small victory in the push for reform. The meeting produced results that were supportive of CPA's moves towards reform – in the shape of a 21-point agenda of issues to be addressed, including women's rights and the widening of political participation.

But the very nature of the dialogue was as important as the proposals it produced: not only did it bring together the usual protagonists in the Saudi reform debate – Wahhabi Sunni clerics, liberals and technocrats – it also included representatives of the Shia and Ismaili communities. Their very presence at the talks as equal participants marked an important breakthrough.

In effect, the Riyadh meeting began to develop a new concept of the Kingdom's role as an avowedly Islamic society and defender of religious principle. The dialogue reasserted Saudi government authority in this respect – by insisting that only the Ruler, and not individual clerics, could authorise *jihad* (holy war). But at the same it asserted concepts of intellectual and religious pluralism and minority rights.

It was notable that a key Sudairi rival, Second Deputy Premier, Defence and Aviation Minister Prince Sultan Bin Abdelaziz – who has recently been associated in the USA with promoting radical Islamist values, following years when he was more associated with brokering Western arms deals – was present, alongside CPA, when he received the dialogue findings in Jeddah.

It is too early to say for sure, but this month may prove to have been the point when reform moved from being the subject of debate, encouraged by CPA, to becoming fact, a process that is actually starting to happen. But this being Saudi Arabia, the good news may take some time to filter through.

Perspective: Two Years Ago

Federal Bureau of Investigation Director Louis Freeh leaves the FBI just as the case in which he has invested most personal energy enters a new phase. Clinton-appointee Freeh's determined efforts to bring the 1996 Khobar Towers bombers to trial are finally set to bear fruit, with federal prosecutors issuing Grand Jury indictments against 13 Saudi militants and one Lebanese chemist (who allegedly built the bomb)… Freeh took a close personal interest in the case, working with Saudi Ambassador Prince Bandar Bin Sultan Bin Abdelaziz in the face of what he complained was foot-dragging in Washington DC.

It will add complications to Saudi-Iranian ties. A Khobar trial focusing on Saudi Shiite dissidents and their alleged Iranian backers would supply powerful ammunition to US lawmakers and lobbies who want President George W Bush to renew sanctions this summer. Tehran has repeatedly denied any involvement in the June 1996 bombing of a US Air Force housing complex in Al-Khobar, which killed 19 military personnel. Members of the Islamic Revolutionary Guards Corps (IRGC or Pasdaran-e Enqelab-e Islami) were said to be involved. This analysis forms the core of the indictment presented by Attorney General John Ashcroft on 21 June, who argued that "elements of the Iranian government inspired, supported and supervised members of Saudi Hizbollah." The USA has not, however, named any Iranian co-conspirator (unlike Germany in 1997).

The US authorities have long seen an Iranian hand in such incidents, pointing to the Intelligence Ministry and IRGC's external covert operations departments. The Pasdaran's external operations units include the Special Qods Force led by Ahmed Vahidi, whose loyalty is directly to Rahbar (Supreme Leader) Ayatollah Ali Khamenei. Earlier reports suggested that at least one Iranian would be indicted.

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Geopolitics

Patterns Of Iraqi Resistance Begin To Form

British Prime Minister **Tony Blair** dropped into Basra for an uncomfortable moment, but his new International Development Secretary **Baroness Valerie Amos** postponed a planned visit in late May because of the threat of attack by "**Saddam Hussein** loyalists". **US** President **George W Bush** wowed the troops in **Qatar** during his recent Middle East tour, but avoided setting foot in the country they had just liberated. The travel agents currently lining up visits are corporate security companies such as ***Risk Advisory Group***, taking in small groups of intrepid businessmen – whose companies are increasingly coming to understand that it will be at least 18 months to two years before the majority of big contracts start to flow outside the ***US Agency for International Development*** framework.

Security is the big issue in Iraq. It will make or break counter-terrorism specialist **L Paul Bremer III**'s term as Civilian Administrator of a country under uneasy military occupation. Bremer knows this and is taking a tougher line than his short-lived predecessor **Jay Garner**, whose mission was developed during a short pre-war period when it was widely felt in Washington and London that Saddam's regime would be toppled from within as pressure mounted. That coup would have allowed the Coalition to take over a more pliant, functioning state for a limited amount of time.

Garner thought he could impose a new Iraqi government quickly, with the ***Iraqi National Congress (INC)*** playing a big role; Bremer knows he cannot and is working now to select an interim government, not elect it. Local allies like the INC and Kurdish groups are feeling alienated

Even the most bullish US ideologues are coming to accept that reconstructing Iraq will be a very long haul. To allow reconstruction to start in earnest, the Coalition launched a series of high-profile 'search and destroy' operations during June to disrupt increasingly dangerous resistance activities originating primarily from the Sunni community. This represents a major escalation in the Coalition's pacification effort, involving thousands of troops and the most combat activity since *Operation Iraqi Freedom* ended.

Large counter-insurgency operations are a troubling indicator; they suggest that non-coercive 'hearts and minds' operations are not significantly reducing violence, pointing to a future deterioration in Iraqi security. The response from the underground is also deeply troubling.

The 24 June killing of six ***Royal Military Police*** officers in Al-Majar Al-Kabir, south of Amara, and an earlier attack the same day on paratroopers in the same town, showed that British policing of its southern mandate, while more successful than the US operation around Baghdad, was far from invulnerable. The incident followed weapons searches – including the use of sniffer dogs – which prompted demonstrations by local Shiites.

A review of peacekeeping tactics was under way as *GSN* went to press, with the prospect that the 12,000 British troops now in southern Iraq would be reinforced, while security was tightened – undermining the much-vaunted **Northern Ireland-**style hearts and minds approach.

Hundreds of incidents

Between the formal cessation of hostilities on 14 April and 25 June, Iraqis undertook 136 identified attacks on Coalition forces, killing 25 Coalition personnel and wounding 82 others, according to data compiled by *Gulf States Newsletter*.

As of 25 June, 99 identified attackers had been killed and 154 wounded.

The majority of attacks are linked to Sunni rather than Shiite communities, both by location and by the identity of killed, wounded or captured attackers. For now, Shiite movements and leaders such as the ***Supreme Council for Revolution in Iraq (Sciri)***'s **Ayatollah Bakr Al-Hakim** and ***Jamiat-i-Sadr Thani***'s **Moqtada Sadr** pose more of a political challenge for the Coalition – although that could change as tensions mount.

More attacks like the Al-Majar Al-Kabir incident could reflect the emergence of a violent Shiite underground – the nightmare scenario for Bush and Blair, but for now the violence trendline maintains its Sunni focus.

Sunni focus for 'violence hotspots'

At least 79 of the 136 attacks recorded by *GSN* between 14 April and 25 June can be linked to Sunni attackers, and many of the balance too. Only four attacks were strongly identified as Shiite.

This included almost all of the attacks in Greater Baghdad – which Baroness Amos told the *Financial Times* was "very much a Saddam stronghold".

The nature of Sunni activism appears to be self-organising, with loosely related groups coming together to fight because of local frictions with the Coalition, due to discontent over loss of status, or because of tribal or religious affiliations.

Although there are few indicators of local Sunni groups taking direction from either local Baathist diehards or any remnants of Saddam's leadership cadre, Coalition intelligence analysts have noted the potential for disparate groups to network, share resources and copy each other's tactics.

The location of attacks points to a particularly localised threat that will assist the coalition in targeting their counter-insurgency efforts without overstretching forces across Iraq. The vast majority of attacks are located in the Sunni heartland of the Baghdad-Falluja-Qaim-Mosul pocket. The most likely locations of attacks are Baghdad (with 23 recorded attacks), Falluja (14), Tikrit (nine), Mosul and Samarra (seven each), plus areas such as Hillah, Bayji, Balad, and Taji (two each).

North-western Baghdad, particularly the neighbourhood of Aadhamiyeh, has been identified as a violence hotspot, in which a group known as ***Jeish Mohammad (Army of Mohammed)*** is believed to have coalesced with support from the local Abu Hanifa Mosque. Rare reports of ***Baathist*** organisers – described as "outsiders", who are probably ***Saddam Fedayeen*** – have been received in this area and Falluja.

Very few attacks have been recorded in western or northern Iraq, and almost all resistance activity has occurred wherever a high concentration of Coalition forces are stationed close to a high concentration of Sunni Iraqis.

Shiite communities have shown a propensity for political opposition – and organisation, helping local government, health and education services to resume in actions which, at times, contrast very favourably with the occupiers' efforts.

ATTACKS SHOW INCREASED SOPHISTICATION

In a concerning development, the sophistication of Iraqi attacks have sharply increased, leading to an acceleration of coalition deaths plus attacks against a wider group of Coalition targets.

The most common forms of attacks have targeted troops at checkpoints and troops moving in convoy; the latter type of attack is likely to increase as Coalition troops stage more tactical movements as part of patrols and search and destroy raids.

Shooting incidents have increasingly been supplanted by what military analysts term "quality attacks" – involving a tactical plan (typically an ambush) that includes a means of withdrawal, the direction of fire against the most profitable targets, and the use of heavy weapons. The intimidation effect of Coalition troops and their armoured and air support is diminishing as Iraqis recognise their vulnerabilities. Coalition armoured vehicles have been attacked with increasing confidence by Iraqis armed with anti-tank weapons, particularly in the Balad area, which is equidistant between Baghdad and Samarra. On 13 June, Iraqi attackers there used a remote-detonated mine to attack a US tank in a variation of the highly effective ***Hizbollah*** tactic of using road-side bombs.

Attackers seem imbedded in these communities. An increasingly celebrated sniper in Baghdad, believed to be a former ***Special Republican Guard*** known as '**The Hunter**', has claimed several victims and then melted back into the community.

Nor is Coalition air support immune to attacks. A US Apache helicopter was shot down (with no US loss of life) on 12 June in north-western Iraq.

Coalition forces have proved to be secure when inside their fortified bases, though some incidents of mortar fire indicate the potential for future attacks on these facilities. Of greater risk is the potential for violent crowd incidents at known locations used by coalition forces.

Major protests have been broken up with lethal force at Mosul and Falluja, with lesser incidents at Hit and Baghdad. The killing of unarmed protesters is becoming a fact of Iraqi life that should trouble the US authorities, as well as Iraqis who backed the overthrow of Saddam and human rights groups.

In a 20 June statement timed to coincide with the ***World Economic Forum*** Middle East meeting in **Jordan**, ***Amnesty International*** said "the occupying powers, the USA and the UK, are not living up to their responsibilities in ensuring the security and welfare of the Iraqi population."

Amnesty expressed concern that more than 2,000 Iraqis were still held by Coalition forces at Baghdad International Airport and other holding centres "with no access to family or lawyers, and with no access to judicial review". Amnesty's Deputy Middle East Director Dr **Abdelsalam Sidahmed** said the notorious Abu Ghraib Prison was again cut off from the outside world, and reported that during a 13 June protest there US troops killed one person and wounded seven.

BLAME AL-JAZEERA?

In some cases, the protests show indications of having been stimulated with the intention of drawing US fire. Traumatised US combat troops – who had expected to return home by now, leaving policing to specialist units – speak of Iraqi parents sending out their children to stone them in towns like Falluja. Al-Jazeera Satellite Channel and other Arab television stations have capitalised on these incidents by interspersing coverage of **Palestinian** rock-throwing and **Israeli** return fire with similar pictures from Iraq.

The Coalition has sought to avoid these damaging images by banning official protests of 15 or more persons, but this will only reduce a certain proportion of riotous assemblies.

Bremer has promised to get tough. The gun amnesty which concluded on 14 June turned up a disappointing number of weapons – 634 firearms, 219 heavy weapons and 381 grenades, in a country with hundreds of thousands of military weapons in circulation. Recent search and destroy operations have injected a more proactive element into the search for proscribed heavy weapons, Baathist fugitives, and local resistance fighters.

NO MORE MR NICE GUY

In early June, the US quadrupled the size of the force it positioned in Falluja, bringing in the Third Infantry Division's 4,000-strong 2nd Brigade. This deployment was followed by *Operation Peninsula*

Strike, which involved a US brigade-sized force – Task Force Ironhorse – sweeping the area between Baghdad and Samarra, including the troublesome towns of Balad and Thuluya.

The sweep involved preliminary intelligence gathering by Coalition intelligence personnel, Iraqi policemen and local informers. Thereafter blocking forces surrounded targeted areas and combat aircraft and helicopters provided aerial reconnaissance and fire support; attack helicopters and unmanned aerial vehicles spotted Iraqis leaving targeted villagers and 'flash check points' were deployed by helicopters to block their escape. Assault units closed on target areas by helicopter, ground, and river insertion. The operation resulted in 400 arrests, with 30 long-term detentions.

The three-day *Operation Desert Scorpion* then began, involving simultaneous counter-insurgency operations and humanitarian assistance, comprising payments to civil servants, repairs to infrastructure, and provision of escort to humanitarian convoys. This large-scale operation involved over 60 raids, resulting in over 400 arrests.

Perhaps the most significant fruit of the operation was the 16 June capture at Tikrit of Saddam's personal secretary and regime security advisor **Abid Hamid Mahmud**, by far the most senior of the 30 Iraqis captured so far from the US "wanted" list of 55.

US interrogators will be hoping that Mahmud's capture can unlock the location of Saddam Hussein and his sons **Qusay** and **Uday**. There was even talk that Mahmud had been taken in a move to broker a deal for Saddam's capture. Similar reports emerged when ex-deputy premier **Tariq Aziz** was rounded up in April. For now, Saddam remains elusive.

The raids have allowed the USA to escalate the rate of engagements with resistance forces and dictate the circumstances under which they occur. This has resulted in what US analysts see as favourable kill-ratios, with 99 local "attackers" killed and 154 wounded.

Running from Coalition forces has become a dangerous course of action, and a number of Iraqis have been killed while trying to evade sweeping operations. It is unknown how many of those killed or wounded have been attackers as opposed to common Iraqis with little or nothing to hide, seeking to avoid a short internment by US forces.

In a remarkable report published in the London *Evening Standard* on 19 June, a group of GIs from the ***3/15th US Infantry Division***'s Bravo Company described their kill or be killed attitude, including shooting wounded and civilians during the conflict. "You don't want any prisoners of war," Specialist **Michael Richardson**, aged 22, was quoted saying. Traumatised by the conflict, their views reflected a wider hardening of attitudes. GIs were experiencing psychological problems, but despite appeals had not been removed from the theatre, the boys from Bravo Company told journalist **Bob Graham**.

'Search and destroy' is back

The sort of sweeping 'search and destroy' operations now being used by US forces to re-impose their will on Iraq have not yielded decisive results from the US intervention in **Vietnam** through to the intensive clearing operations undertaken more recently by the **Algerian** army in its conflict with the Islamist underground.

If Saddam Hussein, his sons or chemical weapons are discovered due to the efforts of search and destroy missions, the USA will deem them a small price to pay. But that assumes that Iraq's resistance attacks are motivated by residual inspiration based on the Baathist regime, rather than the uncomfortable realities of being a Sunni in post-war Iraq. For every success the new search and destroy raids deliver, their invasive and heavy-handed nature generates a cost in terms of engendering added antipathy in the predominantly Sunni communities they affect.

Although US Secretary of Defence **Donald Rumsfeld** described the raids as "rooting out pockets of dead-enders", such raids may in fact feed the recruiting pool of resistance groups.

Wise heads are saying it's the economy that matters: get that right and Iraqis will fall into line. A donor conference is planned for autumn to push economic development along. Whether the country will be safe for number crunchers and project developers by then remains in question.

US/EU Policy On Iran

Continued from page 1

Yet the results of the 25 June White House meeting were predictably underwhelming. A weak joint communiqué signalled that the EU position may not move any further.

The USA is ready to allow Iran to develop nuclear power, but is depending on **Russia** to limit its freedom to modify delivered nuclear fuels, and Europe to pressure Iran into accepting enhanced ***International Atomic Energy Agency*** safeguards and inspections, and abandoning its indigenous fuel fabrication process. This remains a step too far for the EU. Washington is probably correct in thinking that Brussels will accept eventual and grudging Iranian acceptance of enhanced safeguards alone as a victory of moderation. Iran's sophisticated policy planners will likely cede Brussels a tactical sacrifice. Both Tehran and Washington know that enhanced safeguards alone will only give the illusion of counter-proliferation; even if inspectors find evidence of *Non-Proliferation Treaty (NPT)* violations and a parallel covert weapons programme, the issue then becomes subject to the vagaries of ***UN Security Council*** politics. With an indigenous nuclear fuel cycle in place, Iran can legally leave the NPT and achieve nuclear breakout in a period of months, producing a handful of weapons.

Washington sees EU technical and economic ties as one of the only carrots available to moderate Iranian behaviour – and believes the EU is selling itself too cheaply. The EU knows that an essentially pragmatic Iranian establishment will not cross the nuclear threshold to confront Europe. From a White House that cannot back away from rhetorical support of Iran's counter-revolutionaries or from complete military encirclement of the Islamic Republic, things look very different.

Saudi Arabia's Western Defence Purchases Stalled, But Missile Infrastructure Progresses

The first major Saudi arms purchase to emerge for over a year was announced in May, resulting in a commitment to purchase $1.2bn worth of airborne early warning aircraft from a **Swedish** consortium comprising ***Saab*** and ***Ericsson***'s ***Microwave*** defence subsidiary.

The contract marks the end of a long hiatus in Saudi procurement, yet further sales are unlikely: a raft of major Saudi arms deals will remain dormant and show no sign of being resuscitated while the Saudi royal family is firmly focused on internal security and succession politics.

The prospect of new, high-value arms deals is particularly remote for **US** vendors, as reflected by the Swedish procurement. Given the Saudi market's global significance this is a major blow to the US defence industry.

Saudi Arabia has long been one of the reliable linchpins of Western arms manufacturers and remains the highest defence spending Gulf state. Saudi Arabia's extremely large military forces are expensive to maintain, leading to annual defence spending of over $20bn even since the Kingdom's procurement programmes were sharply curtailed during the mid- and late 1990s.

Following defence spending of $24.2bn in FY2001, when the budget returned to deficit, a number of major projects have been reined in and are unlikely to be realised until at least the 2006-10 five-year plan period.

A major revision in the threat assessment and military expectations of the royal family appears to have underpinned a willingness to delay new procurements. The royal family is now entirely cognisant that the principal threat to the regime is internal – from Islamic radicalism, mismanaged political reforms and economic stagnation.

Even a nuclear-armed **Iran** is seen as a lesser threat, and the **Al-Sauds** appear willing once again to entrust their external security to Western guarantees and the growing stability in Iranian/Saudi relations.

As a result, Saudi Arabia is likely to divert even greater increments of its national security spending into the regime security arena, which already consumes an estimated $7bn/yr. This represents a strong market for consultancy and project management firms such as the Fairfax, Virginia-based ***Vinnell Corporation*** – the powerful company closely associated with the ***Saudi Arabian National Guard (SANG)*** plus a range of security equipment and service providers as airport, seaport, border and point defence security is tightened across the Kingdom.

Against the background of changing national security priorities, the question of Saudi military reform looms large. The Kingdom cannot sustain over $20bn/yr military expenditure indefinitely, and the leadership is believed to have slowly re-assessed the utility of large conventional forces.

In the 1991 Gulf War's aftermath, enthusiasm for the development of advanced armed forces remained high; very close co-operation with the US military seemed to offer a conduit for advanced defence planning and force management support. But as faith in a ***NATO***-style US/Saudi relationship has declined on both sides, the royal family has increasingly recognised that building and maintaining advanced conventional forces capable of deterring northern Gulf aggressors is simply too demanding on Saudi financial and manpower.

Most of the projects outlined in the US-Saudi Joint Security Review – where the ambitious Saudi defence policy of the early 1990s was conceived – were unfinished; the defence budget was under-funded by an average of 13%/yr during the 1996-2000 five-year plan period.

No 'Islamic bomb' but delivery systems progress

External existential threats to the Saudi regime are low with the decline of the Iraqi threat and rapprochement with Iran. Should one even develop, Saudi Arabia would be faced with two choices: first, and still most likely, it would activate the US and European security guarantees that remain in place; or second, it would mount a conventional defence, while maintaining the possibility of a non-conventional deterrent capability.

There are persistent rumours about Saudi Arabia's access to an 'Islamic bomb' in the form of a nuclear device procurable from Pakistan. But this would mark a seachange in Saudi defence procurement policy.

Security and proliferation experts canvassed by *GSN* largely agreed that no decision on the procurement of a **Pakistani** warhead could be made outside of crisis conditions or until succession disputes in the royal family were resolved.

On the supplier side, Pakistan may be less than willing to transfer nuclear technology to Saudi Arabia, having no known record of proliferation, no formal mutual defence treaty with Saudi Arabia, and having painful experience of previous crackdowns by Washington.

China, considered an outside possibility as a provider, would baulk at endangering its growing nuclear ties with the US that include much needed transfers of civilian nuclear technology, and is increasingly careful to head off destabilising actions in the Middle East due to it growing dependency on the region's oil and construction markets.

In the meantime Saudi Arabia has developed delivery system that could potentially be used for weapons of mass destruction.

The Kingdom maintains a force of 50-60 Chinese CSS-2 East Wind intermediate range ballistic missiles (IRBM), which were procured between 1986-88 in a $3bn deal arranged by Ambassador to the USA **Prince Bandar Bin Sultan Bin Abdelaziz**. The missiles are deployed at up to three bases in southern Saudi Arabia.

The majority of missiles – and a commensurate share of Saudi Arabia's eight to 15 fixed site launchers – are likely to be deployed at Sulayyil in south-western Saudi Arabia. This remote desert base was originally slated to be developed into a further ***Royal Saudi Air Force (RSAF)*** Tornado base in a cancelled portion of the Al-Yamamah raft of arms deals with the **UK**.

Other missiles may be deployed at Al-Juafa near Al-Kharj, or within King Khalid Military City. A training site is located at Al-Liddam, also in the south-west. The programme is largely maintained and operated by Chinese technicians, who are likely to have upgraded the CSS-2 during their time in Saudi Arabia. The East Wind has a range of 2,800km and a circular error of probability of 1km-4km, making it suitable only for carriage of unconventional – that is, nuclear – payloads. The missiles have reportedly become too difficult for Saudi Arabia to maintain, and in March 1997, Lieutenant General **Saleh Mohaya** of the Ministry of Defence and Aviation suggested that the Kingdom was considering replacing them.

Saudi Arabia is not a signatory of the Missile Technology Control Regime.

Possible candidate systems include the Chinese CSS-5 Mod-1 or 2, or the 2,300km Pakistani Ghauri II/Hatf-6 missiles, which both utilise more stable and deployable solid-fuel propellant.

As recently as 1999, Second Deputy Premier, Defence and Aviation Minister **Prince Sultan Bin Abdelaziz** visited the Pakistani ballistic missile plant at Kahuta to inspect the Ghauri missile.

Building a roof for the House of Saud

Aside from these forces, the RSAF represents the single most important service in the Saudi military, in part because the mobility of the air arm is well suited to a large country with a low force to space ratio, and in part because senior members of the Saudi defence establishment – Prince Sultan and his son **Prince Khalid** – served in the RSAF and its sister service, the ***Royal Saudi Air Defence Force (RSADF)***.

RSAF AND RSADF modernisation remains the central pillar of Saudi defence expenditure – indeed the Kingdom will continue to spend over $2bn/yr on military jet engine maintenance alone for the foreseeable future. Saudi Arabia faces one near-term RSAF procurement decision, but appears to have deferred it until at least 2006-10. This involved the choice of replacing the 100 F-5 ground attack aircraft being rapidly mothballed by the RSAF with either an equivalent number of ***Lockheed Martin*** F-16s in a major deal worth $6bn-8bn, or a smaller number of ***Boeing*** F-15S, which are already in service with the RSAF.

Prince Sultan has long been an enthusiastic proponent of the F-16 deal, but its chances are now slim due to reported opposition from Crown Prince Abdallah, who continues to favour his internal security-related SANG, and from the US Congress. While the US arms lobby could probably push through a major advanced arms sale to Saudi Arabia with great expenditure of political capital, the formal Congressional debate on US-Saudi relations that would attend the sale would not be welcomed by either the White House or the Saudi royal family at this time.

Improvements to the RSAF fleet are instead likely to be lower-profile, involving upgrading and rewiring of Saudi aircraft to carry more advanced US ordnance.

Swedish order

The only major new equipment purchase will contribute to Saudi Arabia's early warning and missile defence network – a growing concern should Iran develop nuclear weapons. A Swedish consortium of Saab and Microwave will supply six to eight Saab 2000 airborne early warning aircraft, mounting Ericsson Erieye radar in a deal worth $1.2bn. These aircraft appear to be replacing a previous requirement for a further four US E-3B AWACS aircraft to add to the RSAF's five E-3Bs.

The deal marks a significant break with US technology and defence partnership and may reflect both the difficulty of getting a new deal through Congress and the Saudis' need to save money on the cheaper Swedish package. When complete, the aircraft will allow the RSAF to maintain airborne surveillance over the whole Kingdom simultaneously without the assistance of US AWACS aircraft.

Al-Fagih Thuggery Claim Gets Saudi Week In UK Off To A Difficult Start. Embassy Cries Foul

Movement for Islamic Reform in Arabia (MIRA) Spokesman **Saad Al-Fagih**, no stranger to the media in his exile hometown of London, made headlines in a week when Saudi Arabia was flooding the UK with senior officials and business leaders *(see page 10)*. On 23 June, Fagih reported being attacked at home by two white, "apparently British" men he claimed were "sent by a Saudi prince" and carrying "a message from the Saudi government". He was taken to Saint Mary's Hospital in north London for treatment – including for an apparent knife wound – but his condition was "not serious".

On 24 June, Saudi Arabia's London Embassy issued a statement "categorically reject[ing] any claim that the Kingdom's government had a hand in the attack." Reflecting the sure diplomatic hand of Ambassador **Prince Turki Al-Faisal**, it added: "We have expressed our deep concern to the British Foreign Office over the attack on Saad Fagih. We have also expressed our concern over the safety of all Saudi citizens living in Britain [whose] safety is the responsibility of the British government."

RAK Shake-Up Favours Business Interests Over Political Reform

Personal rivalries and profound disagreement about the direction and pace of reform appear to have been behind the unexpected change of leadership in Ras Al-Khaimah, the northernmost of the seven **United Arab Emirates**. The June 14 appointment of **Sheikh Saud Bin Saqr Al-Qasimi** as Crown Prince, displacing his elder half-brother **Sheikh Khalid**, indicates that social and political reform may be taking a back seat to the progress of business activity in the Emirate.

Family rifts and tussles over everyday government decisions in RAK contributed to the decision to sack Sheikh Khalid, who had held the post of Crown Prince for more than 40 years.

Besides their personal differences, Sheikh Saud and Sheikh Khalid have radically different views over the way forward for RAK and the UAE, particularly when it comes to democratisation and women's rights *(GSN 707/11)*.

The surprise appointment was made by the 86-year-old Ruler **Sheikh Saqr Bin Mohammed Al-Qasimi** who may have been unhappy with Khalid's talk of reform, but who is also rumoured to have become more easily persuadable in his old age.

In announcing the change on a Saturday, Sheikh Saqr ensured that many Ras Al-Khaimans who might have opposed the move had already left to spend the UAE's Saturday-to-Wednesday working week at their jobs and homes in **Abu Dhabi** and **Dubai**. Even so, large crowds protested outside the leader's palace, forcing local security forces to guard the entrance until the arrival of federal reinforcements with armoured vehicles. To disperse demonstrators, troops used water cannon and fired shots in the air – a rare occurrence in the usually tranquil UAE – but the only casualty was a police major in plain clothes.

Despite the widespread public anger, prominent locals rapidly adjusted to the new reality. On 15 June, leading citizens hurried over to the Emir's palace to congratulate Sheikh Saqr and Sheikh Saud and ensure they were seen to be supporting the new leadership.

The new Crown Prince is *de facto* head of government, the ageing Emir having played little role in day-to-day administration for some years. Already RAK's leading businessman and head of the municipal council, Sheikh Saud now wields unchallenged power.

Sheikh Khalid – who retains only the empty courtesy title of "Deputy Ruler" – has made no secret of his anger at being sidelined.

"I will continue to oppose this decision for as long as I live," he told *Asharq Al-Awsat*. "I have been deceived… I don't think this is my reward for 40 years of service."

Soon after his dismissal there were reports from *Reuters* and other sources that he had left for **Oman** – the border is only a short drive away – after receiving a phone call from **Sultan Qaboos Bin Saeed**. Independent Arab sources said Sultan Qaboos had been due to visit RAK on 15 June, but opted to postpone the trip after the surprise events of the preceding day; instead, he reportedly invited Sheikh Khalid to come and stay for a few days, in the hope that Al-Qasimi family discussions could calm things down.

Sheikh Khalid said he had been asked to take his family away from RAK. But subsequently he returned to his home and the authorities made it clear that there was no restriction on his freedom of movement.

The former Crown Prince continued to claim his removal was "illegal". He said he had been in touch with other Gulf rulers, to see if they might intervene in the dispute. He said that "some brothers and some cousins" remained loyal to him, but insisted he would only rely on "peaceful" means in efforts to recover his post. In practise, it is hard to see how this could happen – unless Sheikh Saqr changes his mind again.

Federal role unfolds in newspaper pages

UAE media coverage of the change in RAK's line of succession, while still relatively bland, was far more revealing than would have been the case only a few years ago, and featured hints at the rivalry between the two men and reports of the local protests.

After Sheikh Khalid's interview, Sheikh Saud hit back through his own lengthy chat with *Gulf News*, insisting that his father had secured approval for the change in succession of the venerated UAE President **Sheikh Zayed Bin Sultan Al-Nahayan**. "He consulted Sheikh Zayed and got his blessings," Saud told the Dubai-based daily.

Quite when this consultation took place is unclear. But in assigning federal troops to re-assert public order in RAK, Sheikh Zayed and other national leaders effectively endorsed Saqr's action.

The decision to send federal forces to intervene in the internal affairs of an emirate could hardly have been taken without the agreement of **Abu Dhabi**'s **Crown Prince Sheikh Khalifa Bin Zayed**, federal Chief-of-Staff **Sheikh Mohammed Bin Zayed Al-Nahayan** and federal Defence Minister and Dubai Crown Prince **Sheikh Mohammed Bin Rashid Al-Makhtoum**.

But this does not necessarily mean they were happy with the dismissal of Sheikh Khalid – even if they have been discomfited by his recent open advocacy of the case for democratisation. Leading federal officials may be concerned by the surprise dismissal as the UAE has tried to move away from the political violence and palace putsches of half a century ago. Emirate Crown Prince positions have generally remained with the eldest son in recent years.

But the UAE's federal nature means that emirates cannot overtly interfere in each other's internal affairs. Precisely because oil-rich Abu Dhabi props up the finances of the smaller emirates, the capital's Al-Nahayan leadership cannot be seen to be publicly blocking decisions taken by rulers of the other emirates.

The RAK affair highlights the complexities surrounding politics in a federation of seven dynastic monarchies. Local public opinion may be a powerful force and the President more than a figurehead, but the way forward is ultimately mapped out by seven rulers, their advisers and families along lines that do not always mesh.

The dissonant strains become especially clear when two rival princes of a traditional Gulf monarchy play out a dynastic quarrel through a very modern media duel, using rival newspaper interviews as their weapons.

Trading political reform for economic progress

The split between Sheikh Khalid and Sheikh Saud exemplifies the contrast between the traditional and modern factors in UAE society. There was little love lost between the two men, who are the sons of different mothers. As Sheikh Saqr retreated from the Emirate's day-to-day administration, these personal differences evolved into fierce rivalry for the dominant role in government.

Although Sheikh Khalid, as Crown Prince, ran the administration, Sheikh Saud was head of the Emiri Diwan (Ruler's office) and had also become Chairman of the recently-established Municipal Council. Sheikh Khalid is said to have blocked some decisions Saud took as Council Chairman.

The two men have sharply differing visions of politics and the future development of RAK. In style and mood, the 63-year-old Sheikh Khalid represented stability and continuity in RAK, having been Crown Prince for four decades.

Besides being a passionate advocate of emirati rights to the Gulf islands occupied by Iran, two of which – the Greater and Lesser Tunbs – are claimed by RAK, Sheikh Khalid oversaw a drive for economic modernisation, with the creation of a free trade zone, higher colleges of technology for men and women, and the foundation of the technology-oriented ***Ittihad University***. He chaired UAE economic entities such as ***National Bank of Ras Al-Khaimah***, RAK's ***National Oil Company*** and the Gas Commission.

By contrast, Sheikh Saud, aged 48 with a degree in political science and economics from ***Michigan University***, is more the technocrat. He has developed a dynamic business career alongside his government role, and chairs the boards of ***RAK Ceramics*** and pharmaceuticals company ***Julphar*** – among the UAE's top manufacturing and export success stories – and has been involved in the $32m Manar Mall retail project. He is also involved in tourist resort ventures.

But Sheikh Saud had clearly become impatient with the pace of recent developments in RAK and felt that his elder half-brother was placing too much hope in a renewed oil and gas exploration drive. Talking to *Gulf News* after his appointment as Crown Prince, he stressed the need to further develop tourism and expand industry.

While repeatedly praising the national leadership of Abu Dhabi's Sheikh Zayed, Sheikh Saud made no secret of his admiration for the Dubai economic model, with its entrepreneurial approach to business and open door to investors: "Look at **Singapore**, it has no oil but is still a rich country. I am optimistic of finding oil in the Emirate, but this is not crucial for our development."

Historically, RAK – with its population of 174,000 – has been relatively prosperous, thanks to its location near the Straits of Hormuz and the mountain rainfall that has made it the market garden of the lower Gulf. But in the modern era, without substantial oil or gas reserves, it has been among the least affluent emirates; many locals are forced to seek work elsewhere and some 60,000 Ras Al-Khaimans now live in Abu Dhabi. Sheikh Saud believes radical modernising action is needed to create more jobs and prosperity at home.

Cherchez la femme

When it comes to political and social change, the picture is rather different. It is Sheikh Khalid who has been the outspoken advocate of political reform. His wife, **Sheikha Fawqai**, a playwright in her early forties, has led a women's organisation and campaigned for women's rights.

This appears to have angered Sheikh Saud – and it may also have been a factor behind a reported rift between Fawqai and one of Sheikh Saqr's wives, **Sheikha Muhra Bint Ahmed**.

Sheikh Khalid led a peace march in protest at the **US/UK** invasion of **Iraq**, but it is his pro-democracy views that most unsettle traditionalists. He first spoke of elections several years ago, and met a stony reception from most of the UAE ruling elite. But since then, **Bahrain**, **Oman** and **Qatar** have embarked on democratic change, increasing the pressure on Emirati leaders to face the issue.

That gave a much sharper edge to Sheikh Khalid's explicit advocacy of reform a few months ago. In public remarks to a meeting at the ***RAK Research and Follow Up Centre***, he said UAE nationals would elect the Emirate's members of the Federal National Council – the UAE's nominated national assembly – and that women would have the right to vote.

"It is the right time for the UAE government to start studies to find ways to implement this for the good of nationals," he said. "It is essential for women to take part in these elections."

Sheikh Saud has markedly different views. In conversation, he has been known to dismiss any need for early democratisation. It is not hard to imagine that for the 86-year-old Sheikh Saqr, this conservatism appeared more reassuring than Khalid's ideas. Sheikh Saud's model appears to be the top-down leadership style of Dubai's Sheikh Mohammed, in which dynamic success in economic development satisfies the bulk of the population and leaves political change sidelined.

Saudi Dialogue Brings Many Voices To Bear On Reform

Though tangible results are as yet hard to discern, the reform programme being pushed by **Crown Prince Abdallah Bin Abdelaziz** gathered momentum in Riyadh with a mid-June "national dialogue" attended by representatives of a broad spectrum of Saudi opinion.

For the first time, clerics and intellectuals espousing various shades of the official Wahhabi strand of Islam met formally to debate with representatives of the minority Shia and Ismaili communities, as well as liberals and technocrats.

The meeting was staged over four days, with ten discussion sessions. Speakers were each allotted five minutes to make their point, with two minutes set aside for a rebuttal. Notes were taken throughout and each evening these were circulated so that participants could check that their remarks had been accurately represented.

This highly structured debate produced a crowded reform agenda that was remarkable at least for its intellectual pluralism. Conferees called for a further push for political enfranchisement and women's rights, a more independent judiciary and the more equitable sharing of resources. They also sought to sideline extremist radicals by reclaiming the state's sole authority over *jihad*.

The conference represented a political success for Crown Prince Abdallah, whose hand has been strengthened by the widespread shock among ordinary Saudis at the recent terror bombings in Riyadh *(GSN 712/7; 711/6; 710/3)*. The security forces' failure to capture extremists before they could launch attacks has weakened the hand of the traditionalist "securocrat" camp, led by Interior Minister **Prince Nayef Bin Abdelaziz**.

CPA has argued that stability can only be achieved through broader participation in politics and through action on social concerns – not through tougher policing and the hard-line re-assertion of conservative Wahhabi principles. He has made the case bluntly in print for an international audience, through his circular to fellow Arab leaders early this year. He has adopted a less vocal approach within Saudi Arabia, preferring to cultivate potential allies – whose own public statements help foster a climate for change.

In a receptive climate already warmed by **King Fahd**'s recent promises of reform, CPA pushed for the organisation of the national dialogue and provided its inaugural speech – read for him by Majlis Al-Shura Chairman **Sheikh Dr Salih Bin Abdallah Bin Huayd**. Further dialogue sessions are planned, with permanent administrative support.

After the close of the conference the Crown Prince received participants at his palace in Jeddah, where they presented him with 21 recommendations. This two-hour meeting, held after Friday prayers on 20 June, was also attended by Defence Minister **Prince Sultan Bin Abdelaziz**.

Despite his reputation as the key facilitator of Western arms deals and **US** ties, Sultan has been associated with the promotion of hard-line Wahhabi ideas. His attendance on Friday may be a signal that – perhaps nudged by his friends in the US military – he has begun to accept Crown Prince Abdallah's arguments for liberalisation.

The broad range of clerical and intellectual representation gave particular weight to two tracks of the dialogue. It provided a clear rejection of claims to Islamic authority for extremist violence, asserting that only a national ruler authorise *jihad* and that individual clerical *fatwas* could not do so.

At the same time, the dialogue backed political reforms including a stronger role for women and moves towards wider media freedom – a priority signalled in CPA's statement to the talks. He pointed out that in a high-tech world, bans, blocks or censorship could no longer shield a country and its citizens from "harmful ideas" and made a defence of free speech that could have been penned by **Voltaire**: "I believe you all agree with me that the most efficient means to achieve this is through… quiet dialogue that respects the other opinion and allows for free exchange of views."

A further sign of CPA's moves to relax the media climate came at a 24 June official Saudi briefing at the ***Royal United Services Institute*** in London. ***Prince Abdallah Bin Faisal Bin Turki***, ***Saudi Arabian General Investment Authority (Sagia)***, indicated the government was quite keen to approve the opening of more permanent bureaux of foreign news organisations in the Kingdom.

EU Pushes Politics In Tehran Trade Talks

THE EU TRADE AND CO-OPERATION AGREEMENT now being hammered out with Iran is being driven as much by political concerns as by economic and commercial ones, and the result could prove a significant milestone in European efforts to flex muscles other than military ones in the foreign policy arena in the Gulf.

As ***European Commission (EC)*** officials prepare for this autumn's negotiating round with Tehran, the clear message coming out of Brussels is that the agreement is as much a foreign policy instrument to promote human rights and regional security as it is an economic accord. "Both parts have to advance," **Arancha Gonzalez**, spokeswoman for EU Trade Commissioner **Pascal Lamy,** told *GSN*. "They have to start at the same time and they have to end at the same time." The hoped-for agreement would cover both economic co-operation and trade, and human rights and political issues. The talks could hardly come at a more pivotal moment, with Iran under massive international pressure to allow inspectors greater access to the nuclear facilities under development at Bushehr and elsewhere.

The EC is insistent that negotiations on both fronts must form part of a "global package", Gonzalez says: "They cannot be separated and must advance together." Whatever business leaders may hope for, the trading terms keenly sought by both Europe and Iran will be not be allowed to overshadow political issues, with human rights tacked on as an afterthought, the EU says. In other EU accords, notably the *Euro-Mediterranean Partnership (EMP)* initiative, the inclusion of political conditions has slowed economic progress.

Europe's insistence on this dual approach has caused some soul-searching in Tehran, where President **Mohammed Khatami**'s government has a solid command of the economic agenda but finds its political reform initiatives constantly under siege from conservatives. It was only with difficulty that Iranian negotiators secured their superiors' approval even to enter talks that would link trade issues to human rights. But officials' reservations were ultimately outweighed by the powerful economic incentives held out by the prospect of a deal with Europe.

Clear rules, new deal for non-hydrocarbons

Because Iran is not a member of the ***World Trade Organisation*** – the **USA** has blocked any hope of its entry – trade between the EU and the Islamic Republic is not currently governed by any clear set of rules or agreements on issues such as tariffs or preferential access. Iranian exports to the EU are already accorded market access under the EU's *Generalised System of Preferences*, and Brussels now wants to put this on a clear contractual basis. That would help Tehran at a time when the Khatami government is embarking on economic reforms it hopes will create a broader competitive export base.

Outside the energy sector, exports to Europe are at present dominated by pistachio nuts and carpets; manufacturing sales are insignificant. Secure access to sales opportunities in the EU could help to change that and tempt foreign investors to consider Iran as a production base. In return, Europe is seeking concessions on the terms under which its exports, such as high-tech equipment, could enter the Iranian market. Experience of the EU's parallel EMP suggest short-term gains could be limited, while local firms would come under big new pressures.

Delegations from each side have visited the other a number of times, but detailed sectoral discussions have yet to get under way. The next round of talks is expected this autumn, but Brussels has not set any target date for reaching a deal, content to let things play out as they will. "We are going for substance and not for timing," Gonzalez explained.

GCC 'model'

In its ongoing talks with the ***Gulf Co-operation Council (GCC)*** over a trade pact, the EU has been ready to wait years until conditions in Arabia were favourable. The most important obstacle to real progress was removed with last January's establishment of a GCC customs union. Talks have subsequently made good progress and negotiations are now approaching a "critical" point, according to a European source. Only a few difficult issues remain, notably terms of trade for aluminium – where the Gulf has used its access to cheap energy to develop a strong production base.

The service sector is also a key priority for Europe, which wants to maximise access to Gulf markets for its banks, telecommunications and distribution companies and insurers. The terms of Islamic sharia law have caused some complications for the insurance sector. Like the proposed Iran accord, the GCC deal also includes human rights conditions – despite efforts by Gulf states to have such political issues expunged. But recent signs of progress towards democratisation and improved rights for women in a number of states have led Europe to take a less public approach with the GCC than it has with Iran, which has kept tensions lower as a result.

The Challenge For Europe

The strong international focus on Iran makes the negotiations between Tehran and Brussels a major test for both sides. EU governments and the EC see the proposed accord as a means to help the forces in Iranian society that are pushing for more effective democratisation and to strengthen the hand of reformers in the Khatami government – a group Washington seems to have given up hope on. But with trade talks coinciding with international pressure over the nuclear programme, Khatami's reformers are caught between a rock and a hard place. Facing resistance from all sides, they need to persuade the more hard-line nationalists that it is in the Islamic Republic's long-term benefit to open the nuclear industry to scrutiny. Otherwise, the trade talks could well go off the rails.

Iranian nuclear research and development is partly fuelled by a sense of insecurity. Brussels will be hoping that Tehran's unease can be allayed by an agreement with the powerful European trading bloc. – making the agreement a demanding test for the EU's deployment of so-called "soft power", which is countered by the hard realities of US military projection.

Unlike some countries where the EU has imposed tough human rights and democratisation conditions – such as the 2000 Cotonou accord states in former African, Caribbean and Pacific colonies – Iran – middle income, financially strong and the world's third-largest oil exporter – has sufficient muscle to argue with the terms demanded by Brussels. The challenge for Europe is to persuade the Islamic Republic – particularly the more conservative nationalist elements in its leadership – that the economic benefits outweigh the domestic political risks of greater liberalisation and tolerance. If that can be accomplished the EU will have found a powerful new tool with which to negotiate in the region. Iran may benefit, but Washington is unlikely to be impressed.

Ambitious Gulf Duo Make Airbus Boom

Blessed with deep pockets and a penchant for forward planning, the flag carriers of **Dubai** and **Qatar** announced a combined $24bn spending spree at the Paris Airshow in June, intended to catapult the two Gulf states into the upper reaches of the international aviation industry. ***Emirates*** airline's $19bn order for a total of 71 aircraft looks to be the single largest plane order in the sector's history. ***Qatar Airways***' $5.1bn order for 32 aircraft is no less ambitious, given Doha's somewhat dubious pretentions to regional hub status.

Emirates has earmarked $12.5bn of its order for 21 Airbus Industrie products, and all of Qatar's planes will come from the European aerospace consortium. The order helps give Airbus a clear commercial advantage over its struggling **US** rival, the ***Boeing Company***, though the Emirates deal is not quite the shopping fest that some in Dubai have claimed: of the 71-plane order, 33 were previously announced at the 2001 *Dubai Airshow*, just weeks after the 11 September attacks.

Qatar Airways is now an all-Airbus carrier, and the region's first buyer of the A330-300. The full deal saw the carrier sign up for 32 aircraft, according to Airbus, including 18 on firm order and 14 as options. The firm orders include two A321s, eight A330-200s, six A330-300s and two A340-600s. Qatar will also lease two A330-200s from ***General Electric Capital Aviation Services (GECAS)***. The A330 aircraft will be delivered between 2004 and 2008, while the A340-600s will be delivered in 2006-10 and the two A321s after December this year.

Emirates' fleet expansion involves 21 Airbus A380-800s and leasing orders for two more, bringing the carrier's total order for the mammoth triple-deck long-range jetliners to 45.

The airline is also acquiring 26 Boeing aircraft, but 24 of these will be through leasing companies such as GECAS and ***International Lease Finance Corporation (ILFC)***. The expanding order book will increase the Emirates fleet to 125 aircraft by 2012, supporting its drive to triple passenger numbers to 29m by 2010 and cargo volumes to 1.5m t/yr. Deliveries of the A380s start from 2006, with the first A340s arriving this year.

The new order swells Emirates' order book to a headline $26bn, though analysts say the airline will have secured substantial discounts in return for the volume deal in the current depressed aviation market. Emirates bucked international trends to register a 94% profits hike to $247m in FY2002/03.

Emirates Chairman **Sheikh Ahmed Bin Said Al-Maktoum** said Emirates needed "many more aircraft to continue our plans to become a truly global airline". Indeed, if the airline keeps to current expansion plans, it would soon become the fourth largest airline in the world.

The bulk buy throws down the gauntlet to major international carriers like ***BA*** that have steered clear of the A380. Industry analysts predict Dubai's move will send tremors through the established international carriers.

Turbulence Ahead?

Industry consensus suggests Dubai's days of easy growth may be numbered, yet it is far from axiomatic that Emirates airline will not be able to flourish globally. Emirates' order is predicated on a revival of annual traffic growth rates of 4% to 5% – the stuff of dreams since the post-9/11 slump.

"We regard Emirates' projections as extremely ambitious, but not necessarily fanciful," said ***ABN Amro*** aerospace analyst **Sandy Morris**. "If it's going to work, it'll be in two ways. One, there would have to be growth in traffic. Two, they would have to attract that increase in traffic to the Gulf rather than to established hubs like **Singapore** or Frankfurt. It's got to expand, full stop, and come to Dubai."

Emirates' hectic expansion is seen as the only way it can realise its growth potential. "Frankly, the only way they're going to achieve these aims is the way they're doing it – have the best aircraft, have a fantastic airport and make it a very attractive place to use," said Morris.

The expansion is inextricably linked to Dubai's emergence as an international transit point the equal of established European and Asian hubs. Emirates is also broadening its route network, planning flights to New York from next April and San Francisco from August 2004.

Unlike airlines that enjoy hubs like New York, London or Frankfurt, Emirates' home market is small, leading some industry executives to warn that once Dubai reaches its natural capacity, Emirates' expansion will naturally come to an end – a syndrome that affected ***Singapore Airlines***.

But Dubai may have a couple of aces up its sleeve. Unlike European hubs, Dubai is not limited for extra runway space. "Dubai is uniquely positioned to flourish as other main hubs in Europe become more congested," said Morris. "The response by some, such as the UK, is clearly slow to the threat presented by Dubai."

Another rare asset is the Makhtoums' deep pockets, combined with the Emirate's taste for high-profile dirigisme. But those pockets are only so deep. Sheikh Ahmed said funding for the $19bn purchase order would come from "our own reserves, from banks and institutional investors and through operating leases".

Leveraging strengths for financing

Emirates tapped $4.7bn in financing in the 1996-2003 period to underwrite its expansion strategy, launching its first dirham-denominated bond, an Dh1.5bn facility in 2001. Just 12% of the financing was through commercial and Islamic loans, with the biggest single segment – 44% – termed international leverage structures.

Given the strength of appetite for the paper, it is mulling a second approach to the bond markets.

The use of leasing appears increasingly important in Emirates' expansion plans. Sheikh Ahmed told reporters that its use of operating leases would avoid burdening the airline with large amounts of debt. Emirates' Chief Director, Finance, IT and Services **Dermot Manion** said 30 of the 71 planes ordered were already financed, while the financing of four Airbus aircraft comes from the leasing firms.

Emirates would begin the financing programme for the orders in 18 months, probably through the issue of a local or international bond, and securing commercial loans from international banks.

"The bond could be listed in Dubai or elsewhere or both. We have already financed about 40% of the new orders and we still have a long time to the delivery dates," said Emirates Chief Director, Airline Division **Tim Clark**.

Qatar Airways takeoff

Qatar Airways' bid to enter aviation's premier league has gathered pace in the last two years, with estimated passenger numbers rising some 40% to 2.4m in 2002, following a 31% increase in 2001.

CEO **Akbar Al-Baker** regularly boasts that the carrier is the fastest growing airline in the world. It plans to increase its spread to 50 destinations by 2004, from the 33 currently served. Baker said its fleet would carry around 2.7m passengers this year, up a cool 1m from the previous year.

Gulf Currency Box

	$	£	€
Bahrain	0.3770	0.5998	0.4155
Iran	8153.0	12,968.2	8984.61
Iraq	0.3110	0.4947	0.3427
Jordan	0.7095	1.1285	0.7819
Kuwait	0.2997	0.4767	0.3303
Oman	0.3850	0.6125	0.4243
Qatar	3.6401	5.7900	4.0114
Saudi Arabia	3.7502	5.9651	4.1327
Syria	46.000	73.1676	50.6920
UAE	3.6730	5.8423	4.0477
Yemen	178.005	283.135	196.161

Source: Financial Times.

Doha's decision to divest its ***Gulf Air*** stake and back its flag carrier's expansion suggests Qatar Airways may be looking to follow the Emirates route to success – although unlike Dubai, there is little tourism potential to back up Doha's claim to hub status. The new order will bolster a 23-strong fleet, adding a further six A340-600s and two A380s by 2009. "If Qatar is to have a chance, it has to follow the Emirates model or it will just be out-competed," said Morris. "It could be a mini-Emirates, but if it wants to be able to compete it needs to get some A380s, otherwise Emirates will hammer it on price and cost."

Boeing looks for Saudi consolation

Boeing took the real hammering in Paris, without a competing product to the super-jumbo A380.

Largely frozen out of the Gulf's two fastest rising stars, the US giant is hoping that ***Saudi Arabian Airlines (Saudia)*** might favour it with new orders. But anticipated talks about updating Saudia's 747 fleet have failed to get off the ground.

Meanwhile **Iran**, which still operates a fleet of ageing Boeing aircraft, remains off limits so long the Iran-*Libya Sanctions Act* stands.

OMAN: Muscat Ditches Private Finance For Sewage Project

Having abandoned hopes that the private sector might finance construction of the capital's sewage network, Muscat is looking to attract conventional bids for the project in July. After failing to lure investors, the government scrapped plans to structure the project on a privately financed basis two years ago, after talks with a private consortium broke down over rates of return.

This has been a familiar sticking point in the Gulf, though not necessarily in the Sultanate, which has been a pioneer of build-operate-transfer (BOT) deals in the power and water sectors.

The decision to seek bids, though anticipated for some time, still represents a setback for the Sultanate's efforts to privatise public utilities. A new firm, ***Oman Wastewater Services Company (OWSC)***, has been set up to build the network's wastewater treatment plant on a $260m budget, scaled back from the original $600m plan. Under that scheme, a consortium comprising the **UK**'s ***Cascal***, **Australia**'s ***Auscon Consultants*** and the local ***Galfar Engineering & Contracting*** was to have executed the project on a BOT basis.

The first phase of the project involves expansion of the existing Darsait wastewater treatment plant to 50,000 m^3/d capacity from 13,000 m^3/d. The second phase will build a new plant at Al-Khuwair, also to treat 50,000 m^3/d of wastewater.

Talks with the private consortium were broken off in 2001 and the Muscat municipality decided to finance the project itself. The authorities now intend to sell OWSC to private investors once it is up and running.

Risk Management Report UAE

GSN Risk Grade — B+/2: Financial strengths, business dynamism outweigh dynastic rivalries

Political And Social Development

Overview: Ahead of the September World Bank/IMF meetings in Dubai, and despite a dramatic dynastic struggle in one of the seven Emirates, Ras Al-Khaimah, the UAE remains one of the region's most stable countries. The UAE is behind other Gulf countries in pushing forward democratisation reforms; Dubai only recently set up an advisory Dubai Executive Council, while progress on female representation in federal and some emirati policy and advisory bodies has been slow. Palestine and Iraq are issues of great importance; the UAE has been a high-profile provider of humanitarian aid to both.

Succession: There was a mid-June stir in RAK after the ailing Ruler Sheikh Saqr Mohammed Al-Qasimi decided to remove his eldest son, Sheikh Khalid, from the post of Crown Prince, replacing him with a younger step brother, Sheikh Saud Bin Saqr Al-Qasimi. With the Emir in ill health Sheikh Khaled had been RAK's effective ruler for some years. His replacement is more conservative minded on key issues including women's rights. The prospects of such a scenario being repeated in the larger emirates of Abu Dhabi and Dubai are minimal. Both Crown Princes Sheikh Khalifa Bin Zayed Al-Nahayan of Abu Dhabi and Sheikh Mohammed Bin Rashid Al-Makhtoum of Dubai are well entrenched and popular. Sheikh Mohammed is the driving force behind the Dubai government while Sheikh Khalifa is prominent on the Emirati, federal and, increasingly, international stages – reflecting his status as firm favourite to succeed his father Sheikh Zayed as UAE President.

Social forces: Sheikh Zayed's wife Sheikha Fatima Bint Mubarak continues to push for women to join the 40-member Federal National Council – an appointed advisory body with parliamentary potential. It remains to be seen whether RAK, a supporter of the issue, will change its stance with a new Crown Prince in place. A four-month amnesty for illegal immigrants has finished but take-up was not great; the authorities have promised to come down hard on those who remain.

External factors: Relations with Western countries are close, but the UAE continues to lobby behind the scenes about Palestine and Iraq. Relations with fellow GCC members are strong. The UAE extradited six suspected Islamic militants to Yemen in June pointing to a new push on Islamists.

Economic Outlook

Overview: Big-ticket projects are pressing ahead despite a minor slump caused by the war in Iraq, while Dubai has successfully placed its Dh1.5bn five-year bond issue. The economic conditions remain good although the IMF recently warned that a generally favourable macro performance has been undermined by a deteriorating fiscal position. GDP growth of 4.7% has been forecast for 2003, with the non-oil sector growing at 4.2% and the oil sector at 6.7%. The UAE can pump 2.217m b/d under present OPEC quotas, and more if needed. Iraqi reconstruction is expected to create new opportunities for UAE firms to pick up lucrative contracts.

Finances: A delayed federal budget for 2003 was issued in June, envisaging a deficit of Dh2.2bn. Spending has been fixed at Dh23.28bn, compared to Dh23.15bn in the 2002 budget, with revenues forecast at Dh21.07bn, compared to Dh20.98bn in 2002. Abu Dhabi accounts for the majority of the UAE's oil revenue and underwrites other emirates during periods of stress. Dubai's Dh1.5bn five-year bond issue successfully closed in May and listed on the Dubai International Financial Market. The issue was 1.5 times oversubscribed and carries a coupon of 3.11%. The majority of the demand came from UAE-based institutions with some additional regional appetite. The UAE's official reserves were $15.5bn at end-2002. The trade balance in 2003 is forecast to grow to $11.9bn.

Privatisation: Progress has been slow beyond independent water and power projects (IWPPs). Telecoms company Etisalat is traded on the DFM, but is still majority state-owned. Oil firm Zadco, Abu Dhabi's electricity transmission system and Emirates Post may be part-privatised. An IPO saw the state-owned Commercial Bank of Dubai listed on the DIFM in April.

Investment: The UAE is a WTO member. Foreign investors can hold 100% of companies in the free zones and 49% elsewhere. Sharjah is a manufacturing hub for SMEs, as are the FTZs. The Dubai Economic Council was created in March to help further boost private investment. The IMF has commended the banking sector's strength, profitability, supervision and capitalisation, but foreign banks say the UAE is over-banked. The GCC Customs Union became effective on 1 January.

UAE: Power Projects

Al-Taweelah A1 IWPP: Developers Total and Tractebel are commissioning the $1.5bn Al-Taweelah A1 independent water and power plant.

Umm Al-Nar IWPP: Group led by the UK's International Power (IP) is operator, with existing 855MW unit to be replaced by 1,550MW new capacity. Desal capacity will be 95m g/d (including a new 25m g/d unit) for completion in 2006 and financial close in mid-2003.

Jebel Ali L IWPP: EPC orders awarded in May to Toshiba Corporation with Mitsubishi Corporation for the 700MW power plant, and to Italy's Fisia Italimpianti for the 70m g/d desal plant. Completion is expected 2005.

Other power and water schemes: EPC award for phase two of Fujairah's Qidfa power/desal project expected 2003. Expansion of Abu Dhabi's Mirfa plant is planned as an IWPP; requests for proposals are expected in Q3 03. Abu Dhabi's $1.6bn 1,500MW Shuweihat S1 power and desalination project is to start 2004 operated by the US' CMS Energy and IP.

Dolphin Energy: $3.5bn project to import Qatari gas is progressing. Partners are Occidental, Total and UAE Offsets Group. Omani gas will supply Fujairah plant from Q4 03 until Dolphin gas comes onstream in 2006.

GCC grid: Tender documents being prepared for connection of the UAE's five grid systems by Q4 05. The UAE national grid will then be connected to Oman under phase II of the GCC electricity grid. Electricité de France is the consultant.

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.

UAE: Selected Economic Indicators

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

[f] = Forecast.

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

Yemen Risk Management Report

GSN Risk Grade — D/3: Saleh accommodates opposition, big development challenge remains

Political and Social Development

Overview: 27 April parliamentary elections returned President Ali Abdallah Saleh's General People's Congress (GPC) to government with a comfortable majority. Electoral abuses and violence appeared on a smaller scale than previous years as the authorities sought the approval of Western allies and donors. Prime Minister Abdelqader Abdelrahman Bagammal has been re-appointed; he is regarded as a natural foil for Saleh and helps to ensure that southern interests are represented. Key portfolios were all unchanged.

New Parliament: The GPC amassed 58% of the vote and 226 seats, a gain of two on the outgoing parliament. The opposition, led by an alliance between the Islamist Al-Islah and the Yemeni Socialist Party (YSP), was neatly contained; Al-Islah returned with 47 seats. It previously held 63, but lost ground in the Marib, Jawf and Shabwah tribal areas, though it managed some humiliating defeats on the GPC in Sanaa. The YSP, which boycotted the previous ballot, won seven seats.

Security: Yemen remains a risky place, with tribal violence and general lawlessness still chronic maladies. In mid-June, police defused a bomb outside the Hadda hotel in Sanaa. Parliament has approved a government programme to increase spending to fight terrorism. Extra funds will be directed towards formally establishing an anti-terrorism unit in the Interior Ministry. The UAE recently extradited six suspected Islamist militants. The government has been investing in grassroots education and health services to help tackle Islamist discontent and radicalism. The USA has provided significant funds and expertise to help increase security; a permanent FBI office has been mooted. The trial of Ali Ahmed Jarallah, accused of killing YSP deputy leader Jarallah Omar, is under way.

External factors: Western governments strongly support Saleh as an ally against terrorism and are pleased with economic progress. The EU is considering opening a delegation in Sanaa. Yemen is keen to maintain an improved relationship with Saudi Arabia, including extraditing criminals and suspected terrorists. Relations with other neighbours are cordial; Qatar's Emir Sheikh Hamad Bin Khalifa Al-Thani, Iran's President Khatami and FBI Director Robert Mueller were among recent visitors.

Economic Outlook

Overview: The re-elected GPC government is charged with continuing economic reform – a big challenge: the World Bank estimates 42% of Yemenis live below the poverty line; unemployment is estimated at 25-30%, with university graduates hit particularly badly. A downward trend for oil output is a real concern; the government forecasts 500,000 b/d for 2003 but the World Bank has warned that output could fall to 198,000 b/d by 2008 unless more work is undertaken. A creditable payments record, low debt service ratio and careful use of oil revenues are encouraging signs. GDP growth of 4.1% was recorded in 2002. The government anticipates real growth of 3.2% for 2003.

Development: An IMF Poverty Reduction Strategy Paper for 2003-05 underlines the need for structural and governance reforms. Donors pledged $2.3bn over three years last October. In early June the World Bank approved a $24m credit to improve water management in the Sanaa Basin. There are plans to reopen the US Agency for International Development office in Sanaa after a seven-year hiatus.

Finances: The 2003 budget is based on a $21/bbl oil price, and envisages a YR64.1bn deficit, with spending of YR668.4bn and revenues of YR604.3bn, including YR207.4bn from oil. Total external debt was $4.95bn at end-2002, compared to $4.87bn at end-2001. Forex reserves were $4.29bn, 20% up on 2001.

Investment: Security concerns hurt investment despite the authorities' attempts to protect business interests. The government claims it has agreed with insurers to lower the crippling premiums on shipping using Yemeni ports; the government will deposit $50m in a London bank in return for assurances that premiums will be reduced to 0.0875% for cargo ships and to 0.165% oil tankers, from 0.025% before the October 2002 Limburg attack.

Liberalisation: The EU is providing €7m ($8.1m) technical assistance to help Yemen on its long road to World Trade Organisation membership. The IMF's Article IV assessment pressed for budget reform, reduced energy subsidies, a clearer public spending focus, poverty reduction and efforts to cut the non-oil deficit. Reforms to the civil service and judiciary, tax system and customs service are planned.

OPPOSITION: A more urban-based opposition emerged from the elections; the Al-Islah/YSP-led Coalition for Reform was deemed a success and is likely to continue. The Islah campaign focused on corruption and the need for reform more than on religious issues. President Saleh is courting the exiled opposition. In May he pardoned 16 exiles connected to a failed 1994 southern secession bid. He later met with five of these men in the UAE at a meeting of some 50 opposition figures, many of them connected to the YSP.

YEMEN: Selected Economic Indicators

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

[e] = estimate [p] = projection * As % of GDP.

Sources: IMF, Yemeni authorities

Yemen: Key Projects

Aden port: The southern hub's container terminal is privately managed by Port of Singapore Authority (PSA); container throughput reached 388,000teu in 2002, an average of over 32,300teu/month, representing 2.8% growth on 2001. But the Limburg attack in October had a serious impact; throughput fell from 42,502teu in September to 8,064teu in December. PSA (which has a 49% shareholding) has been forced to make a $125m provision for impairment loss; some 280 workers have been laid off, while alternative gateways such as Oman's Salalah trans-shipment port, have benefited.

Hydrocarbons: Established operators include Canadian companies Nexen and TransGlobe Energy Corporation, and Occidental Petroleum and Hunt Oil of the USA. Oil exploration has increased since production-sharing agreement terms became more favourable. Settlement of the Saudi border has opened potential exploration zones along the fringes of the Rub Al-Khali (Empty Quarter). Total has a long-planned LNG project, but risk mitigation questions persist even if markets can be found. A new oil refinery is planned at Ras Isa.

Power projects: Contract awards are expected in mid-2003 for a 300MW gas-fired plant in Safar (Marib region) and a 200km 400kV Marib-Sanaa transmission link. The Arab Fund for Economic and Social Development is providing an $84m loan, while the Saudi Fund for Development is also expected to provide financing. Contract awards also awaited for 60MW Sanaa South and 60MW Aden Al-Arish power plants.

MIDDLE EAST ENERGY

POLICY, RISK AND PROJECTS IN THE GULF AND LEVANT

SAUDI ARABIA: After the GIP, a brave face on power

Saudi plans to build new power plants are being pushed forward after the Gas Initiatives Project (GIP)'s apparent demise (*GSN 712/16).* Commerce and Industry Minister **Hashim Yamani** on 24 June emphasised that power projects continued regardless of progress on gas schemes. If gas wasn't available then oil was – so dual fuel oil/gas plants are planned. As ever, the Kingdom is thinking big: Yamani's current dataset sees investment worth $93bn to add 73,000MW over the next 25 years.

KUWAIT: Fourth refinery plan

Kuwait National Petroleum Company (KNPC) is planning a 350,000 b/d fourth oil refinery, costed at about KD800m. KNPC's **Sami Al-Reshaid** said peak production capacity had returned to normal – around 920,000 b/d – but much more was needed.

QATAR: Marathon GTL

Marathon Oil Corporation is continuing discussions with ***Qatar Petroleum*** over a possible joint venture to process natural gas into some 120,000 boe/d of liquid fuels. Oil Minister **Abdallah Bin Hamad Al-Attiyah** on 23 June said the partners were "exploring" a $4.3bn joint venture. Marathon said reports of a signing were premature. It will likely need partners.

PALESTINE/ISRAEL: BG play

British Gas is pushing on with efforts to supply natural gas from ***Palestinian Authority*** territories to Israel in the face of rivals looking to sell **Egyptian** feedstock. In a letter to Knesset (Israeli Parliament) Economics Committee Chairman **Shalom Simhon**, British Gas Israel General Manager **John Field** argued the field off Gaza offered Israel's safest supply source, with BG retaining full control over the flow of gas from the Ashkelon Control Centre *(GSN 711/16).* Field said the PA's revenue from gas sales would partially replace aid flows, and would thus not actually increase the amounts of money available to the PA.

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Iraqi Oil Seeks Place Between IOCs And OPEC

Crude exports have resumed and there is real progress hiking production, but sabotage coupled with the long-sanctioned industry's frailty means output forecasts are being revised downwards. No wonder the Interim Authority is looking to bring in more international oil companies.

The slow rehabilitation of Iraq's oil sector may soon enter a new phase, as industry sources say a number of companies have been invited to Baghdad to start talks in early July on new crude supply deals.

The Interim Authority has also started to sound out oil companies to assess future development potential. **Algeria**'s ***Sonatrach*** is one firm invited to Baghdad to discuss its contract signed with the former government. The **US** overtures have been "friendly", a senior Sonatrach official told *GSN*.

In a move that could help to raise international confidence over US intentions, the ***US Army Corps of Engineers (USACE)*** will issue a Request for Proposals on 8 July for companies to bid for oilfield infrastructure contracts worth up to $500m on a cost plus award fee basis in the ***North Oil Company*** and ***South Oil Company (SOC)*** areas. This work was included in ***Kellogg Brown & Root (KBR)***'s controversial directly awarded contract. The announcement – posted without great fanfare on a US government website *www.fedbizopps.gov* – points to a marked shift in US thinking.

A conference to outline the project – *Restore Iraqi Oil* – is planned for 14 July in Dallas, Texas (see *www.mhli.org/iraq* for details of this event).

Meanwhile ***State Oil Marketing Organisation (SOMO)*** is looking to seal long-term contracts with international firms in a bid to ramp up production, which in late June averaged 750,000-800,000 b/d.

Export sales were restarted on 22 June from storage tanks at **Turkey**'s Ceyhan terminal. Those sales were made from an estimated 10m barrels of Iraqi oil in storage, 8m bbls of which was deposited before the war.

ChevronTexaco is getting ready to lift the first Basra Light to be exported out of Iraq's Mina Al-Bakr port under its award of 2m bbls of crude in SOMO's 12 June tender – an operation that may be complicated by an unexplained fire that broke out in Umm Qasr port on 23 June.

The revamped Mina Al-Bakr terminal has four very large crude carrier (VLCC) berths.

On 24 June, USACE said it had raised output in SOC's Rumailah fields to 350,000 b/d, from 230,000 b/d.

But ramping up to pre-war output levels of 3m b/d or more by year-end now looks like it may not be achieved. Interim Authority officials have scaled back their more ambitious schedules. US-appointed oil industry chief **Thamer Ghadhban** told a special meeting of the ***World Economic Forum*** in Amman that the oil industry's restoration to a state that could contribute financially to Iraq's recovery would take "at least a year and a half". Ghadhban said Iraq should be exporting 2m b/d by December, based on reaching total production of 2.7m b/d by that time. But post-war damage to the oil infrastructure could undermine attempts to make this ambitious goal. Fires continue to blaze across Iraq as sabotage operations increase

Former oil minister **Issam Al-Chalabi** told a conference in Istanbul that unless serious efforts are taken to deal with ageing reservoirs and badly maintained surface facilities, even this capacity might not be reached within the timeframes now under discussion.

Iraq's relationship with OPEC could complicate the crude export revival. Ghadhban was pointedly not invited to the cartel's meeting in June, a sign that OPEC is reluctant to extend any formal recognition before an administration, interim or otherwise, has been officially legitimised by the Iraqi people. OPEC failed to set out any scenarios for re-establishing a working relationship, although it has said the issue will be discussed at its next meeting, scheduled for 31 July *(GSN 712/18)*.

OPEC members' antagonism to the Interim Authority goes beyond questions of legitimacy. OPEC oil producers suspect the USA may attempt to exert pressure on them through its influence in Iraq. Former ***Shell*** CEO **Phillip Carroll**, who heads the Oil Ministry advisory board, ruffled OPEC feathers in April with unguarded comments suggesting Iraq might consider leaving the cartel.

This would be in keeping with rumblings from US neo-conservatives who might like to use Iraq's vast reserves to challenge OPEC's authority, with the USA promoting unfettered Iraqi oil production that could eventually reach 6m b/d.

Old hands like Issam Chalabi reject such plans. He says it would take Iraq three years to reach even its last OPEC quota level of 3.5m b/d, making discussion of the issue now premature and irrelevant. Backing the aggressive expansion of Iraqi production outside of OPEC could prove self-defeating, stoking a damaging price war.

OPEC leaders will be wary of engaging in a battle with Washington. **Saudi Arabia** could play a key role: it has made some conciliatory moves on restoring Iraq's membership status. Petroleum and Mineral Resources Minister **Ali Al-Naimi** has indicated that Iraq should be allowed to return to its old quota level.

Syria: Dwindling Production Challenges Oil Sector

Syria is under growing fiscal pressure to arrest sagging oil production, which could soon drop below the magic 500,000 b/d mark. But Damascus' efforts to lure investors into the upstream are having only mixed results, as production at the biggest fields continues to fall.

Recent bright spots – including the signing in May of a $17m exploration and production-sharing agreement (EPSA) with the biggest **US** independent, ***Devon Energy*** – are almost overshadowed by the dark patches – such as the tepid response to the country's third licensing round, which closed on 15 June.

A ***Syrian Petroleum Company (SPC)*** official told *MEE* that **Russia**'s ***Tatneft***, one **Norwegian** and a **Polish** company were the only firms to have bid for any of the concessions offered in the 12-block round. Some unbid assets will be transferred to the next licensing round, the fourth, expected in "one or two months time", the official said.

Though heightened political tensions between Damascus and Washington loom, Devon Energy said there was no hint of political interference over its decision to sign the EPSA, along with its **US** partner ***Gulfsands Petroleum***. Devon joins about 230 other American companies doing business in Syria, including blue chips like ***ConocoPhillips***, ***General Electric*** and ***Microsoft***. "From the beginning, the State Department has provided guidance and enthusiastic support," a Devon company official said.

The Devon/Gulfsands EPSA deal, announced on 31 May, covers the 11,000km² Block 26 in north-eastern Syria and commits the partners to a four-year programme of geological and geophysical studies, seismic acquisition and the drilling of at least one exploration well. Devon and Gulfsands will pay a total of $17m, including a $1m signature bonus. But the agreement excludes SPC's existing fields located on the block's outer perimeter, which are producing more than 120,000 b/d.

If things go to plan, Devon has mooted further PSAs in Syria. "The Syrian partnership focuses on exploration around areas with proven reserves," said Devon President **James Hackett**. "It could, over time, expand to include co-operation between SPC and Devon on additional development and production enhancement projects in the area."

Industry executives say Syrian assets have to square up as investment opportunities against some quality alternatives in the region, with **Algeria** in particular making waves with its aggressive upstream opening and **Iraq** holding out undoubted temptations.

Syria's oil sector travails relate more to geological and commercial bugbears, rather than the threat of political isolation. Unappealing contract terms have amplified relatively low exploration yields. Complex geology, with a number of accumulations often found in small quantities, has undermined appetite for exploration activity.

The study of complex Syrian reservoirs is a challenge for even the biggest majors. Some existing operators like **France**'s ***Total*** have talked of scaling back their Syrian investments.

Like other regional oil minnows such as **Egypt** and **Yemen**, production from Syria's new fields has failed to compensate for maturing fields.

Output at Syria's biggest producing fields is slipping. The largest producing development in Syria, the ***Al-Furat Petroleum Company (AFPC)*** joint venture comprising ***Royal Dutch/Shell*** (37.5%), ***Petro-Canada*** (12.5%) and SPC, is producing just under 265,000 b/d – down from a peak of 400,000 b/d.

Petroleum and Mineral Resources Minister **Ibrahim Haddad** is eager to get Shell to commit to further investment in the development. Shell's goal is to get production back up to an average 300,000 b/d, but it tacitly acknowledges that this looks a tough task. "Given the nature of the fields in AFPC concessions and the declining production levels, Shell's greatest challenge will be to effectively apply technology and expertise to stabilise, then increase production levels," AFPC General Manager **Chris Haynes** said recently.

Three-prong approach to stimulate output

Haddad is pushing a three-prong programme that it is hoped will raise production levels by as much as 100,000 b/d.

The SPC-led Souedi development is intended to provide additional volumes of between 40,000 b/d and 50,000 b/d and is expected to come on line in about thee years.

A second project covers four fields – Tishreen, Oudeh, Qbeibe and Sheikh Mansour – designed to add a further 30,000-40,000 b/d.

Russia's ***Zarubezhneft*** is reported to have won the Tishreen and Sheikh Mansour contracts, with Canada's ***Tanganyika Oil Company*** taking the 192 km^2 Oudeh field in a PSA signed in May.

The third leg is a "deep and lateral" exploration agreement with Shell and ***Petro-Canada***. The government is looking to complete a contract agreement with the partners soon, and hopes the project will bring in an extra 30,000 b/d.

Shell is also focusing on the possibility of harnessing oil from much deeper structures than those it has historically produced in Syria. But these fall outside the AFPC development rights, so the company now is in talks to annex the fields to its existing contract.

Shell's other options include Block 11, offered up under the open licensing round, on which it is the preferred contractor. It currently produces and operates 38 fields, but these licences are due to expire in the 2008-2014 period.

Slow progress for licensing model

Damascus' attempt to copy Egypt's licensing model to bring in new investors has yet to bear significant fruit – not necessarily through want of trying.

Besides Haddad's three-prong strategy, other recent activity has included a 25-year PSA signed with ***China National Petroleum Corporation (CNPC)*** – fast becoming a mainstay in Middle East hydrocarbons – for the Kebibe field development in the north-east. The two-year trial phase will see CNPC invest $3.5m in work on the field, after which $104.5m will be invested to raise capacity to 10,000 b/d from 4,500 b/d, with the creation of new wells and enhanced oil recovery techniques.

This followed the granting of exploration rights in January to five international groups for sites spread throughout country, including ***Royal Dutch/Shell***, Ocean Energy – subsequently merged with Devon – Canada's ***Stratic Energy*** and **India**'s ***ONGC Videsh***. They will join ***MOL*** of **Hungary** and ***Total***, which is working with ConocoPhillips on an associated gas project in the Deir Al-Zor region.

Gas and offshore potential

Gas reserves are garnering attention. Around half of the country's estimated 8.5trn ft^3 of reserves are non-associated, with the biggest field, the Palmyra area, accounting for about 3.6trn ft^3.

In December, Haddad mooted a tender for development of a series of non-associated gas fields, calling for the production of some 9m ft^3/d for domestic use and export to **Lebanon**.

A number of foreign developers have been in talks about a contract for the past two years, but slow progress prompted the authorities to tempt IOCs with an open tender. Damascus has set its ambitions high, aiming to enlist some $800m in investment. But no firm progress has since been registered, suggesting that the project may fall victim to bureaucratic sloth and inertia.

Gas is central to Syria's efforts to find a new export commodity and potential hard currency earner. Haddad attempted to clinch a gas export deal with **Cyprus** last November, although the Cypriot authorities have cast doubts about the feasibility of the pipeline option bringing gas from the coastal city of Baniyas to Limassol.

The Cyprus government apparently fears Syria will not be able to meet a 2006 target date for supplying Cyprus. Long-term, the island's ***EU*** accession could open up other European markets to Syrian gas exports. But plans to pipe 3m ft^3/d to Lebanon starting H1 04 look likely to be met.

The Syrian offshore is also looming as a potential arena of interest, with work envisaged in the East Med area by SPC. ***Veritas*** of the US, ***Geotechnical Services*** of Canada, the **UK**'s ***Thales Geosolutions*** and Norway's ***InSeis Terra*** are in the running for the seismic survey contract on this deepwater prospect.

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As Bahrain Shiites Push Political Goals, Long-Term Questions Remain

BAHRAIN—Can Bahrain offer a model for Shiite political society? Recent moves offer a distinctive model for the Shia role in a pluralistic society, especially since the island state is the only Arab Gulf country besides **Iraq** in which the Shiite population predominates. While Iraq's majority Shia community has yet to determine its role in the post-**Saddam** political scene, its Bahraini counterpart is already exploring new paths. Bahrain's small size and radically different history should guard against the drawing of simplistic parallels, but the Shiite agenda there does offer an encouraging example of an inclusive political approach. However, there remain more long-term questions of how far to push an Islamist agenda – and these could yet shake up the political landscape.

Shia represent a clear majority of Bahrainis – 60% is a common estimate – and through their main political vehicle, the ***Islamic National Wefaq Society***, led by **Sheikh Ali Salman**, have developed a highly effective campaigning machine that has used their candidates' political and religious credentials to good effect against secular opponents. This secured a crushing victory in the municipal elections of spring 2002. Although it campaigned as a staunch Shia party, Wefaq has since concentrated mainly on issues of constitutional reform. Soon after the election, Wefaq concluded that local victories had delivered little real power – mostly because administrative clout remained with nominated government officials. It found itself in agreement with its erstwhile liberal rivals in rejecting **King Hamad Bin Isa Al-Khalifa**'s new constitutional structure, in which the royally appointed upper house of Parliament could ultimately override the elected National Assembly.

Although the extent to which Wefaq wanted to promote Islamist policies in Bahrain had never been entirely clear, residual religious issues took a back seat to constitutional concerns once the new shape of the political system became clear. As *GSN* has reported at length, Wefaq forged an alliance in opposition to the new Constitution with the secular liberal ***National Democratic Action Society*** and the (ex-Baathist) ***Nationalist Group Society***. The ***Islamic Action Society***, led by **Ali Mahfoudh** and representing Shia returned from **Syria**, also participated. This wider movement boycotted the parliamentary elections and has continued to campaign on the Constitution throughout this year. More recently, it has linked up with the ***Democratic Forum Society*** and (Sunni) ***Nationalist Islamist Society***.

Wefaq has come to see traditional Islamist issues, such as a crackdown on alcohol, as marginal to its main priorities – reforming the Constitution, and tending to the social and economic needs of ordinary Shia, through better access to housing, jobs and public services. This second set of concerns is in line with a strong tradition of grassroots activism in Bahrain, and a lively women's movement, exemplified by groups such as the ***Al-Mustaqbal Society***, which focuses on female social and political emancipation.

Both constitutional and economic development issues represent an agenda where there is broad common ground across most of the Bahraini opposition. In this sense Wefaq, while still the main voice of the Shia population, also acts as the mass membership core of a much broader non-Islamist campaign for more radical reform. Wefaq's present broad social appeal and success in mobilising younger supporters owes much to its superior organisation and grassroots constituency activism. But its initial electoral gains also benefited from the personal reputation of individual candidates, some of who had been prominent political detainees during the repression of the mid-1990s.

It is this sort of credibility some of the main Shiite leaders in Iraq also enjoy. Whether they are prepared to accept the sort of compromises Wefaq has in Bahrain is another question.

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