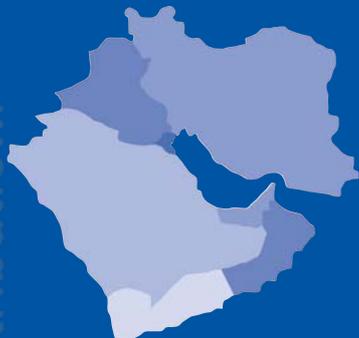


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GSN

Companies & People

NATO Packs Its Toolbox

NATO's scheduled arrival in **Afghanistan** on 11 August to lead the peacekeeping mission in Kabul may mark its farthest-flung mission yet, but the alliance's unprecedented support to **Poland** as it assembles a force for Iraq will try NATO's "toolbox" in the Middle East for the first time. This may constitute an important new model that Gulf governments will need to take note of.

NATO officials say they are well aware of the need to win hearts and minds – the Brussels-based organisation recently set up a Division of Public Diplomacy under experienced **French** Secretary-general **Jean Fournet**. Unlike **Bosnia** and other operations on its strategic doorstep, Afghanistan and Iraq take NATO into regions where the alliance is a largely unfamiliar entity.

As the chief of the **US** Mission to NATO's Political Section **John Heffern** told a 1 July conference at the **Royal United Services Institute** in London, "Since 9/11 there has been consensus that we will deploy forces where there are threats outside the region." And in Iraq itself, a broader array of nations is now contributing to the reconstruction and security effort.

FOR MORE SEE PAGE 11

Across The Region

Syria's President Bashar Assad may soon feel new pressure from US lawmakers, who – along with some in Europe – are again considering sanctions against the country. PAGE 5

Some of the Kuwait assembly's most cohesive factions lost ground in the recent general elections, handing more power to the ruling family. The result may open the door for a move towards reform, however. PAGE 6

With Kuwait's Crown Prince and Prime Minister Sheikh Saad increasingly ill, rumours have it that deputy premier Sheikh Sabah may soon be appointed PM in a move that could constitute an unusual separation of roles for the country. PAGE 6

Kuwait has established a joint government-industry task force to try to strengthen ties to Iraq. The move is designed to build economic links, guard against future conflicts, and help restore Kuwait's own good standing in the Arab world. PAGE 10

Polish troops will soon take command of a swathe of southern Iraq. NATO's assistance in the venture tests the alliance's hand in regions it has not operated in before. PAGE 11

More of "Old Europe" is also moving into Iraq, with new deployments from Italy, the Netherlands, Denmark and Norway coming in the next few weeks. PAGE 11

Iran has given the go-ahead to its parastatals to tap international bond markets, but the companies appear satisfied with commercial bank loans and other sources of credit. PAGE 13

Iran is expected soon to grant foreign banks permission to operate in the Kharg Island foreign trade zone. PAGE 13

Opposition moves have not affected the investment climate in Bahrain. RISK MANAGEMENT REPORT, PAGE 14

Amid political unrest, Iran's economy remains flexible. RISK MANAGEMENT REPORT, PAGE 15

The thorny question of energy subsidies – and their politically unpopular reform – is making life difficult for Iranian consumers and legislators alike. BACKPAGE, PAGE 20

GSN's Analysis

In Iran and elsewhere, the EU is seeking to strengthen its hand in the Gulf, hoping for a role as a counterweight to US influence there. PAGE 3

The setbacks for both Kuwait's liberal and Islamist factions in the recent general election have reshaped the balance of power in government and made it difficult to read voters' wishes. PAGE 7

A detailed look at Kuwait election results. PAGE 8

Both Washington and Damascus spoke softly in the aftermath of the US military strike that wounded five Syrian border guards, indicating both countries' wish to avoid more direct confrontation. PAGE 9

Conditions throughout Iraq are slowly improving, but there is still much to be done in the reconstruction effort. PAGE 12

The UK's new Secretary of State for International Development, Baroness Amos, gave a mixed assessment of living conditions in Iraq. PAGE 12

Divisions in OPEC could lead the cartel to fight competition by driving down oil prices, analysts say. The move would echo the early 1990s, when low prices drove high-cost producers out of the market. GSN VIEW, PAGE 2

Three years ago, George W Bush won the Republican nomination to stand in US presidential elections. PERSPECTIVE, PAGE 2

MIDDLE EAST ENERGY

Qatar's gas fields look more like gold mines, as the country continues to sign gas sales deals despite stiff international competition. PAGE 16

Industry and government experts feel Iraq's oil sector would benefit from the introduction of market mechanisms, though this would inevitably lead to tensions with OPEC. A decision on OPEC membership could ultimately depend as much on politics as economics. PAGE 18

An article in Saudi Aramco's magazine may shed light on the kingdom's dim view of prospects for Iraqi oil production. PAGE 18

Readers are in for a busy couple of weeks ahead of OPEC's extraordinary 31 July meeting. After more than four years of relative coherence in the cartel, centred on restoring price strength through strict quota discipline, new pressures now threaten to fracture that unity, and may even reverse some of the gains the cartel has been clinging to so fiercely.

The mood music from the Gulf suggests Saudi Arabia and Iran – the two OPEC heavyweights whose co-operation has proved so critical to the organisation's strict adherence to the \$22-28/bbl price band – may be ready to sacrifice price discipline in order to defend the cartel's market share against grasping non-OPEC members.

Driving the price of oil down to about \$15/bbl would do this, argues PFC Energy's senior economist Fareed Mohamedi. Addressing a Chatham House conference on Iran in early July, Mohamedi floated the possibility of a return to the situation of the 1990s, when OPEC effectively curbed high-cost production world-wide through low prices, making it too costly for non-cartel producers to ramp up output.

Mohamedi argued that a couple of years of \$15/bbl oil – however painful for Gulf states' budgets – would deprive the market of some 2m b/d of high-cost capacity – whether in West Africa, Oslo or Moscow – and allow OPEC to regain a significant share of production.

Releasing the taps would also help solve a domestic difficulty for the cartel. Algeria, Nigeria and Libya are all straining at the leash, with rising production capacity constrained by low quotas. Current ceilings, they argue, do not adequately reflect production capacity, which

Riyadh is accused of hoarding since the 1991 Gulf war took capacity in Iraq and Kuwait out of the market.

Riyadh argues that it is the only country capable of ensuring stability in global oil markets. But the three others claim their own investment in production capacity has weakened the Kingdom's position as "swing producer". The time for redistribution is nigh, they say.

Algeria and Nigeria, and to a lesser extent Libya, would in any case be highly unlikely to stick closely to any agreed OPEC quota. Venezuela, looking to recoup lost oil income of around \$6bn after the crippling oil workers strike of earlier this year, appears an equally unlikely respecter of quota discipline.

Added to the mix is the prospect of revived Iraqi exports, perhaps to the tune of 2m b/d by year-end 2003. OPEC will be keeping a close eye on developments in Iraq, as US managers of the country's petroleum resources have already made noises about taking Iraq out of the cartel (*GSN 713/17*). Saudi opinion still appears divided over whether to respond to Iraq's return with an aggressive defence of its market share or by giving up some production capacity in order to keep prices high.

With annual crude demand growth expected at little more than 1m b/d, and most of this supply likely to be snapped up by non-OPEC producers, OPEC members acknowledge that high prices are undercutting their future growth prospects. An extended period of low prices would help boost long-term oil demand growth and help dampen competition to the cartel. Painful medicine perhaps, but cartel members are not averse to thinking the unthinkable when needs must.

Perspective: Three Years Ago

There was a perfect historical symmetry in George W Bush's consecration last week as Republican Party candidate for the USA's presidential elections in November. The Grand Old Party's Philadelphia convention came almost exactly ten years after the defining moment in the presidency of 'Dubya's' father, George HW Bush. It saw one of Bush senior's closest aides, Dick Cheney – defence secretary in August 1990 – confirmed as GOP vice presidential candidate.

General Colin Powell, the USA's Gulf War chief-of-staff, has been widely touted as Bush's secretary of state-in-waiting. Bush's foreign policy advisor, Condoleezza Rice, a 45-year-old senior fellow at Stanford University's Hoover Institute, in line to become National Security Council chair. Rice has argued that as well as opposing Iraq more robustly than the Clinton Administration has tended to do, the USA "has to rebuild some elements of the Gulf coalition."

Bush aides note that in economic and social policy Dubya's view of America is different from his father's. The Texas governor showed in his early sorties before the cameras as a presidential candidate that he is no foreign policy expert; his father was – and Dubya is tapping this expertise by reassembling key elements of Bush senior's

team. This includes relative youngsters like Rice, a senior NSC member during the Gulf conflict...

Former Kremlinologist Rice (whose CV includes a book on Czech/Soviet military relations) is an advocate of a powerful US, with that power projected against troublemakers – such as Iraq, "an outlaw state" as she called it in the *Financial Times*.

Despite scant evidence that the Iraqi National Council can mount a viable challenge to Saddam, both Bush and Gore have promised stronger support. Republicans believe the INC could be the focus for a possible rebellion—and insist that it should receive more money.

Rather fancifully, the Republican platform set out in Philadelphia said Bush would work to rebuild the Gulf War coalition, while maintaining sanctions against Iraq. It said that Bush would work to reverse Clinton's failure to persuade European allies to bolster their "lagging military defences", which became apparent in the NATO air campaign in Yugoslavia. Clinton had "squandered" opportunities to change the situation in Iraq, where "there is no coalition, no peace, and no effective inspection regime to prevent Saddam's development of weapons of mass destruction."

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EU Approaches Test Of Influence In Gulf

Coming months will put the European Union to the test in the Gulf, as it seeks to demonstrate to what extent it can operate as a counterweight to US influence there. In practice, the EU already has a stronger hand than the US in its dealings with Iran, and it has begun mobilising resources to take a more prominent role in Iraq. With a more flexible view of the region than US policy-makers and more willingness to engage, the EU has a very real opportunity to strengthen its hand in the region. But the region has had similar hopes dashed before. By autumn it should become apparent whether Europe's willingness is matched by enough diplomatic muscle to make a difference.

A preference for policy change rather than regime change marks an important divergence between the EU and the USA as regards Iran. Most European policy-makers do not share the US administration view that the theocratic regime in Tehran is either fragile or ripe for counter-revolution. The EU's greater level of engagement with the Islamic Republic gives it a closer view that will make it a valuable counterpart to the USA, but it also means the EU may be satisfied with slow but effective progress on policy issues, rather than the sudden wholesale shifts that US policy-makers seem to prefer.

The EU maintains a range of personal links and exchanges that afford it a current and sophisticated insight into Iranian motives and intentions. Reciprocal visits by *European Commission (EC)* and Iranian delegations in December and April contributed to a keen appreciation of what may be possible as regards Iran. This relatively clean view and free hand contrasts strongly with a US view of Iran that begins and ends within the Beltway, strains under the weight of historical baggage, is anchored to Israeli national security interests and is increasingly devoid of useful sticks or carrots.

MANAGING NUCLEAR AMBITIONS

A senior EC external relations official spoke to *GSN*, outlining the Commission's view on a range of Iran issues, including the country's nuclear ambitions. In stark contrast to Washington or Tel Aviv, EC decision-makers have made a significant mental transition towards accepting that Iran's capability to build nuclear weapons can no longer be interdicted by technology denial or preventive military action.

Though the 19-20 June EC summit at Thessaloniki stated for the first time that WMD proliferation could trigger an EU military response given a valid multilateral mandate, decision-makers in Brussels were "only putting down a marker for

future cases", according to the EC diplomat. Brussels has accepted that Iran's indigenous nuclear fuel cycle is too dispersed and multiply redundant to be militarily vulnerable. As a result, the EC has boiled down the range of policy options open to Europe, concentrating on modifying Iranian intentions rather than capabilities.

The minimum objective of EU policy is to keep Iran from crossing the nuclear threshold, whilst leaving the country in possession of a "virtual nuclear arsenal" that by necessity would include all the necessary components to produce nuclear weapons under emergency conditions. The challenge to Brussels is to recondition Iranian views on nuclear weapons, which are perceived to have been influenced by recent US policy in Iraq, North Korea and Pakistan. EC diplomats who were in Iran this year told *GSN* that Tehran observed that the "Axis of Evil" state without nuclear weapons "got clobbered," whilst the US invited North Korea to talks after Pyongyang signalled its possession of a virtual nuclear arsenal. Pakistan, meanwhile, "left its borders completely porous to *Al Qaeda*, leaked intelligence to terrorists, and tested a nuclear bomb, and were rewarded with the red carpet, a big embrace, and a fat trade package."

The current Iranian outlook views nuclear weapons as "an insurance policy that will force the world to accept them." As *Shahram Chubin* of the *Geneva Centre for Security Policy* noted in a recent article, Iranian pursuit of WMD is driven by the search for prestige, independence and equity, as well as deterrence. This complex mesh of motivations may well make it difficult for the EU to effect policy change of whatever pace in Tehran.

THE WRONG IRANIANS

The EC views the Iranian polity as broadly divided into three parts: the conservative establishment, the reformist establishment, and the Iranian street – described as "the strong and strong-willed grassroots youth movements" by senior French Foreign Ministry official *Gilles Andreani*.

Though the US government has increasingly disavowed support for either of the establishment factions and has sought to appeal directly to the Iranian street, the EC is highly sensitive to the risk of sparking a conservative crackdown. As one EU analyst told *GSN*, "Where the Americans see the Berlin Wall or the fall of Ceaucescu, we see Tiananmen Square."

As Andreani noted, "setting the state against the people is a risky game."

EC thinkers draw on relatively intimate knowledge of Iranian decision-making structures,

which has led to substantially more modest and pragmatic expectations of political reform. Identifying basic concepts around which to structure reforms is a major first step taken by the Commission.

The EC external relations team sent to Iran in December explored “checks and balances” as a potential theme, and discovered that different tiers of the power structure had radically different interpretations of the concept. A senior member of EC Deputy Commissioner for External Relations **Christian Leffler**’s team told *GSN* that President **Mohammed Khatami** displayed a sophisticated view of the issue, quoting from French political theorist **Montesquieu**. Head of the *Expediency Council* **Ali Akbar Rafsanjani** instead “displayed an innate cunning understanding of checks and balances as a means of dividing and ruling”. The conservative judiciary head **Mahmoud Shahroudi**, meanwhile, could not comprehend the concept of division of power.

According to the Commission diplomat, the EC’s demands on human rights and political reform “are well understood, but by the wrong Iranians”.

SEEKING MILESTONES IN CO-OPERATION

The EU’s principal mechanism for affecting Iranian policy has become the Trade and Co-operation Agreement now being negotiated with Tehran (*GSN* 713/11), and a relatively detailed set of milestones is being developed before the TCA can move to the next stage this autumn. These milestones were described by Christian Leffler as “clearly enunciated expectations” that include conditions in the fields of human rights, regional stability (including support of hard-line **Palestinian** groups), support of terrorism, and WMD issues.

The EC has a relatively good ability to monitor human rights and judge Iranian activities affecting the Middle East peace process. Support for terrorism is more opaque and assessment of Iran’s WMD activities will rely on the *International Atomic Energy Agency’s* (*IAEA*) reports throughout the summer, which the EU has promised to consider “carefully and critically”.

One wildcard here will be **Russia**. EC diplomats are candid that the EU has little ability to pressure Russia to cease the supply of nuclear reactors and nuclear fuels to Iran. A researcher from Moscow’s *Carnegie Centre* told *GSN* that the first Bushehr reactor would certainly be built, whilst Iran’s development of a nuclear fuel cycle would reduce the importance of Russian nuclear fuel deliveries, weakening the argument that Russian provision of fuel is potentially destabilising to the region.

Several EC diplomats were candid with *GSN* that the Commission “does not enjoy a particularly close or co-operative relationship with Russia” and have enjoyed “about the same level of success as the Americans in interdicting Russian nuclear assistance – that is to say, not much”.

According to Iranian *IAEA* representatives at a

recent conference in Geneva, the June *IAEA* meeting missed referring Iran’s case to the *UN Security Council* by only a single vote, the board members casting 17 votes in favour of referral and 18 against. Such a referral would have found the EU without a prepared position, and Europe will need to develop a joint position by the autumn on how to react to a potential Security Council referral. The current EU position on the TCA is robust: if Iran fails to sign up to the *IAEA* Additional Protocol (93+2) mandating increased transparency in the programme, or if the *IAEA* otherwise condemns Iran, progress in the TCA will halt. Progress on the other milestones is likely to be more malleable.

INFLUENCING IRAQ

The United States’ tight grip on military action in Iraq means Europe can play only a limited role in the continuing effort to stabilise and secure the country. Where the EC will have considerably more influence, though, will be in reconstruction efforts.

The EC will lever their strength as a funding body to influence a range of elements of Iraqi reconstruction in the run-up to October’s reconstruction conference. One senior EC diplomat told *GSN*, “The EU is not a statutory subcontractor to the CPA [Coalition Provisional Authority]. If the CPA wants to call the shots, they will have to pay for it themselves.”

The EU’s record of guiding political and economic reform with conditional aid in post-Communist Eastern Europe indicates that Europe has a strong chance of achieving a smaller-scale success in Iraq. The stabilisation and integration of Eastern Europe is seen in the EU as Europe’s greatest foreign policy success. The EU and especially its “New Europe” members thus considered themselves uniquely well-placed to assist in Iraq’s economic and political reconstruction, and were disappointed by their under-utilisation.

According to *Czech* Ambassador to **Kuwait** **Jana Hybaskova**, the “Bremer approach” (involving the wholesale replacement of existing security structures) reduced the applicability of Europe’s expertise in reforming – rather than tearing down and rebuilding – such institutions.

French diplomats expressed similar doubts to *GSN*, stating they had not expected full *de-Baathification*, and questioning the concept of tearing down such an established totalitarian structure so quickly, moving the country from one extreme to the other.

According to EC representatives canvassed by *GSN*, Europe favours reform over transformation. “We cannot have revolutions everywhere, thus there must be a strategy for an evolutionary downsizing of frustration,” one said.

An appetite is also building in Europe for an approach to democratisation and nation-building that is distinct from Washington’s. “The US brings a lot of [ideological] baggage to the reform process.

The EU would do well to bring its own words and approaches to democratisation,” one European diplomat said. These approaches are likely to surface in October at the reconstruction conference.

EUROPE'S OPPORTUNITY

Less useful in Iraq will be EU military aid. The issue of military action in Iraq not only caused a trans-Atlantic rift between the European continent and the US, but also exposed major intra-European and Anglo-European fault lines. But though Europe found itself somewhat divided over the Iraq war, the post-war period is leading EU countries to seek increased convergence – though this is not always proving an easy task.

EU nations such as the Czech Republic were by and large excluded from involvement in *Operation Iraqi Freedom*, when (as in *Afghanistan*) the US preferred to forge a coalition involving only those powers it deemed able to make a useful military contribution. EU nations unwilling or unable to play a major part in the war (such as **Italy, Poland, and Spain**) are now making major contributions.

But such bilateral contributions are complicating an EU position on the issue. *US Central Command (CENTCOM)* is not necessarily seen by Europeans as the natural command mechanism for international operations. *NATO* would be more acceptable. EU High Representative for the Common Foreign and Security Policy **Javier Solana** recently stated that “most of us would prefer to be called an ally or partner, rather than tools in the box”. Yet, as long as the US remains in war-fighting mode, multilateral command structures are highly unlikely to evolve, suggesting that the EU will not develop a major role in Iraq's stabilisation.

The period from July to October will see Europe further define its ability to counterbalance US influence in the Gulf, operating from a position of strength on Iran and recovering from a position of weakness in Iraq. Europe will seek to shake off the image of being “faint-hearted, soft-headed, and militarily and politically weak” as depicted by Javier Solana in a speech on EU-US relations. Solana observed that Europe and the US were often compared to Venus and Mars, and noted that the progeny of these deities was the goddess Harmonia. Yet Europe seems to be evolving some of the characteristics of Athena, the resolute goddess of wisdom, suggesting that friction, not harmony, may continue to characterise EU-US relations throughout the year.

US Seeks New Moves On Syria

With US neo-conservatives viewing Syria as an “Axis of Evil” associate and even some in Europe taking a harsher view, new sanctions pressure may soon be falling on President **Bashar Assad**,

especially if the **Bush** Administration can be persuaded to take a stronger stand for **Lebanese** self-determination.

Assad has recently sought to appease the US and other international critics. But appeasement is far from a resolution of the issues that concern Washington, which has accused Damascus of aiding the fallen Iraqi regime during the recent war. Further pressure, if it comes, could well take the form of sticks, not carrots.

Syria now faces an increasingly stiff challenge from the US legislature. Assad had been relieved after US Secretary of State **Colin Powell's** May trip to Damascus turned out to be a relatively mild affair, rather than the transformational confrontation it might have become. Opinion had been split in Washington, but lawmakers now seem to be coalescing around the idea of concrete action.

In mid-June, US senators completed a three-year process by giving majority backing to Senate bill S.982 – the Syria Accountability Act. The House of Representatives, meanwhile, is only 13 votes short of passing their equivalent bill, HR.1828.

The act would prohibit exporting to Syria any item on the US Munitions List or Commerce Control List of dual-use items. It would prohibit the provision of any US assistance to US businesses with investment or other activities in Syria, and would end any *Overseas Private Investment Corporation* and *Trade Development Agency* programmes there. Finally, it would suggest that the US president impose two or more additional sanctions, including export or business investment bans, downgrading US diplomatic representation, or travel restrictions on Syrian diplomats in the US.

GIANT STEPS

This would be a serious step. An arguably more serious one – and one that could be more effective – would be for the US to take a harder stand behind UN Resolution 520, which calls for “the strict respect for Lebanon's sovereignty, territorial integrity, unity and political independence under the sole and exclusive authority of the Lebanese Government through the Lebanese Army throughout Lebanon”.

With control over Lebanon considered by many to be Damascus' primary security concern, and with Assad considered to be strongly influenced by *Hizbollah* leader **Sheikh Nasrallah**, new impetus for UN censure over Resolution 520 is arguably the one lever that could rapidly bring Syria to heel.

Since **France** shocked Syria by raising the issue of Resolution 520 in April 2003, **Israeli** diplomats in Washington have pushed the issue with determination, if not much success. Should it take a firmer stand, the Bush administration might find it difficult to then step away in response to other concessions from Syria. It remains to be seen how big the stick is that Washington wants to shake in Damascus' direction.

Kuwait Vote Shifts Power Away From Parliament, But May Open Door To Reform

With the ailing Crown Prince Sheikh Saad Al-Abdullah Al-Salem Al-Sabah increasingly ill and unable to govern, Sheikh Sabah Al-Ahmed Al-Jaber Al-Sabah stands next in line for the premiership (*see box*), and has emerged the one clear winner from a Kuwaiti general election that struck a severe blow against the country's party political establishment.

With both the liberal bloc and the *Sunni Islamic Constitutional Movement* losing more than half their seats to the flurry of largely young new independents entering the National Assembly, the ruling family finds itself in a much strengthened position. By some calculations, the number of pro-government MPs – out of 50 elected members – has increased from 15 to around 30.

With unelected cabinet ministers also holding the right to vote in parliament, on an ex-officio basis, Sheikh Sabah has the chance to drive through important reforms and restore a sense of direction to a country where the weakness of leadership had become a perennial complaint.

But as he seeks to move forward, everything will depend on the make-up of Sheikh Sabah's new government and his choice of early measures to bring before MPs.

There is wide agreement among Kuwaitis that if the ruling Al-Sabah family continue to occupy half or more of cabinet posts, the leadership will have missed a chance to broaden the government's base of support and exploit the general post-election mood of goodwill.

On July 8, three days after the election, the Emir of Kuwait, **Sheikh Jaber Al-Ahmed Al-Sabah**, held "traditional consultations" with all former speakers, including **Jassem Al-Khorafi**, prime minister **Sheikh Saad**, and other leading figures, to discuss the formation of a new government. This round of private discussion follows all Kuwaiti elections.

Within the Al-Sabah family, however, another discussion has been going on, which could mean important changes in the structure of government in Kuwait. The issue of separating the roles of Crown Prince and Prime Minister – both posts currently held by Sheikh Saad – has been underway for some time. As *GSN* went to press, one Kuwait newspaper predicted deputy premier Sheikh Sabah could be appointed PM as early as 12 July. Sheikh Sabah has been *de facto* head of the government for the past three years, since Sheikh Saad became seriously ill.

The Crown Prince commands huge public affection. But many influential Kuwaitis feel that it no longer makes sense for him to continue as titular head of the government itself while he is so sick. The situation could bring about a government reform that would prove more lasting than any single regime.

Meanwhile, both liberals and Islamists say that now is the moment to bring forward important economic reforms that have the potential to win support across the political spectrum.

The government can expect to enjoy a honeymoon period of about six months while the new independent MPs find their feet, and Kuwait's quasi-parties lick their wounds. (Political parties are not permitted in Kuwait, but they exist in all but formal legal shape.)

THE RIGHT REFORMS

There is not universal agreement over the most politically astute "to do" list of political reforms. But it is clear that economic liberalisation would be high on the agenda.

That could mean some privatisation and the passage of a long-delayed bill to transform *Kuwait Airways* into a state-owned but commercially independent company. The government might even find a fair wind for its plan to bring big international companies into the \$7bn northern oil fields project. There is a widespread assumption that it will also make a fresh attempt to secure parliamentary approval for the granting women the right to vote and stand for office.

But having seen this reform blocked by the last assembly, even liberal die-hards caution that it might be wise to hold back for a while, until the government has had the chance to mobilise newly elected members in support. A rush to push through such a reform in the new session this autumn might produce a backlash, and turn MPs against the government on other issues.

SEEKING A CO-ORDINATED TEAM

All sides are agreed that the new parliament and government, working together, have to avoid sinking into the sort of confrontational stalemate that has paralysed the Kuwaiti political scene over much of the past four years and left the public disenchanted.

The government has paid the price in widespread popular disillusion – and members of the old assembly paid for it with their seats.

Kuwait has always had a high turnover of MPs. The fact that 48% of the members of the old parliament will not be returning to work in the new assembly is not a great surprise. But what shocked everyone was the voters' rejection of so many leading lights, particularly those from the main political groups.

The prominent liberals **Abdullah Naibari** and

Ahmed Al-Rubei were both kicked out, as was *Islamic Constitutional Movement* leader Mubarak Al-Duwailah; his Islamist colleague Nasser Al-Sane only just survived the cull. The populist Ahmed Al-Saadoun, a noisy critic of reformist ministers over the past four years, also had a narrow escape.

"Some got a yellow card. Some got a red card. It is a lesson to all of us as to what is really required," said Jassem Al-Khorafi, speaker in the outgoing parliament and the favourite to retain the presiding chair this time around.

"I feel that we are wasting a lot of time," he told GSN. "Laws are still taking a very long process.

Unless we do something about it, we will keep going in circles."

With so many novice independent members, Khorafi – himself comfortably re-elected in the middle class Shuwaikh constituency, just outside central Kuwait City – is set to play a key role as both peacemaker and facilitator, negotiating with Sheikh Sabah and mobilising parliamentary support in favour of government measures.

But he also believes it is not just MPs who have to sharpen up their act: "In the last parliament, government was not as co-ordinated as it should be, and individualism was seen, instead of a co-ordinated government."

Kuwait Election Setbacks Cloud Balance Of Power

Setbacks to both liberal and Islamist factions in Kuwait's parliament mean the country's ruling family will gain some power over a fragmented legislative body. And the fact that the two most cohesive blocs have now lost more than half their seats also makes it difficult to read just what voters do want, and how parliament might go about giving it to them.

Kuwaiti liberals are still struggling to come to terms with a crushing and unexpected setback in the 5 July general election, which saw them lose five of the eight seats they held in Kuwait's 50-seat national assembly. They had been widely expected to stand still, and supporters thought they might even pull off a gain of one or two seats.

Their die-hard rivals in the *Islamic Constitutional Movement* – the Kuwaiti equivalent of the *Muslim Brotherhood (Ihwan)* – suffered an equally painful knock-back, seeing their seats fall from five to just two.

Although elections in Kuwait are decided on the basis of complex personal and tribal allegiances more than they are by ideological considerations, their results do carry real consequences for policy and government. The semi-official party groups in parliament have clear policy positions, and their views shape votes, even in an assembly with an increased number of independents.

But with the shift in the distribution of seats, it remains to be seen what power blocs will form in the new parliament.

While the election slashed the number of liberals in parliament, and reduced the Islamic Constitutional Movement to just two seats, the "traditional" Sunni Islamist Salafis retained their two seats, while Walid Tabtabei of the deeply conservative *Salafi Movement* is now joined by two more colleagues. Shia Islamists – whose more liberal elements support reforms such as women's suffrage – also did well.

With the support of sympathetic independents, both Islamist and liberal blocs believe they can muster a lot more than their paper strength: Islamists put their head-count at 14, while Ahmed Bishara, secretary general of the liberal National Democratic Block, believes his camp can mobilise 18 votes.

VOTING FOR CHANGE, BUT LITTLE ELSE

Voters' motivation for rejecting so many prominent MPs may well have had little to do with their partisan stances.

The blockages and wrangling that characterised the last parliament inspired widespread public anger. Some key measures had been debated in parliament for years – foreign investment in the northern oil fields, for instance, and reform of *Kuwait Airways* status – without the body coming to any kind of firm decision on a course of action.

There is no doubt that Kuwaitis want change. And in a country where 70% of the population is under 30, many wanted to see a younger generation of legislators in the new assembly. The recent vote was for more effective government leadership and legislative action more than anything else.

But neither the pattern of voting nor the campaign that preceded it has shed much light on what Kuwaitis, in policy terms, want their leaders to do.

Despite the fact that Islamists have been as fierce as most other Kuwaitis in condemning both terrorism and Saddam Hussein, there had been some speculation that they would suffer a backlash in this first election since the 11 September 2001 attacks and the fall of the Iraqi dictator.

But many commentators remained convinced in the run-up to the election that the Islamist movement was still advancing, and thought it was the liberals who would come under pressure.

The results have shocked both camps. No one had quite expected to see either movement suffer such punishing defeats.

FINDING POLICY AMID THE PARTY

With a plethora of candidates, no official political parties, small constituencies and no reliable opinion polls, reading election results in Kuwait is always difficult, at best.

Tribal connections and MPs' capacity to help arrange jobs and services for their constituents count for much more than ideology and political labels, even among many middle class voters. Tribes select preferred candidates in unofficial primaries and, when it comes to the official election, the distribution of allegiances can be decisive – though liberal candidates generally stand little chance in deeply conservative tribal areas.

Patronage, tacit government support for certain candidates, family and local ties and even, in a few cases, corruption, are all factors too.

For candidates and constituencies alike, campaigns are a busy agenda of private visits and crowded public meetings where food and drink is generally provided in the evening as a reward for sitting through platform speeches.

A festive atmosphere prevails during campaign season, as Kuwaiti men, often accompanied by their sons, gather to sit outside in the heat of summer nights, to listen and pose questions. The streets are a riot of posters, and voting day itself becomes a social occasion, with large crowds gathering to chat and queue to enter and cast their ballots.

But for all the noise and activity, the election process is light on policy. Candidates promise to promote national unity and defend Kuwaiti citizens' lavish welfare rights. But rarely is there a serious or informed discussion of policy issues.

Who's in, Who's out – Kuwait Election Results, A Close Look

It was the liberal *National Democratic Movement* (NDM) whose losses captured the greatest attention the morning after Kuwait's 5 July election. One prominent casualty told GSN he had had no idea that defeat might be looming until the votes were actually counted.

Two of those who were defeated from the NDM – **Abdulla Naibari** and **Ahmed Al-Rubaei** – were among the most high profile members of the old assembly. The other casualties were **Meshari Al-Osaimi**, **Faisal Al-Shaye** and **Abdul Mohsen Al-Medej**.

Naibari's defeat, in the middle class Dahiyat Abdullah Al-Salem inner suburb (Constituency 2), was a big shock to many Kuwaitis. Each constituency has two members. The other Constituency 2 representative, another liberal, **Abdulwahab Al-Haroun**, narrowly survived.

Some commentators blamed NDM losses on the liberals' support for uncomfortable economic

reform ideas, such as reductions in housing subsidies. Yet it was Al-Haroun, from a merchant family and chairman of the old assembly's finance committee, who was the most associated with these proposals; Naibari, with a background in the Arab nationalist left, is sceptical about economic liberalisation.

However, Naibari does not have big merchant family clout behind him. The surprise new winner in Constituency 2, **Mohammed Al-Mtair**, is also a merchant, thought to be well connected in government. The result points to the continuing importance of patronage and personal factors in Kuwaiti elections.

Al-Shaye's defeat, in Rawda (Constituency 9) was the result of a split in local liberal ranks. **Salah Mudaf Ahmed Al-Mudaf** had stood aside to allow Al-Shaye an easy run four years ago – in return for a promise he could stand this time. But the NDM argued that local conditions had changed, and asked Al-Mudaf to withdraw again. But even three days before the vote, he ignored their final appeals; the few votes he got would have been enough to give Al-Shaye a victory over the prominent *Islamic Constitutional Movement (ICM)* MP **Nasser Al-Sane**, whose defeat was a prime liberal target.

NDM gains came in Qadsiya and Udailiya, with the elections of **Ali Al-Rashed** – who campaigned on labour issues – and **Bassel Al-Rashed**. Besides Al-Haroun, the group's survivors were **Mohammed Al-Saqr**, outgoing chairman of the foreign affairs committee, who was easily re-elected in Shuwaikh, and **Mishari Al-Anjari** (in Faiha).

The group also publicly supported some pro-reform non-members who did win: **Abdullah Al-Roomi**, **Mohammad Al-Faji** – who defeated ICM leader **Mubarak Al-Duwailah** in Omariyah – and **Ahmad Al-Mulaifi**. Al-Mulaifi triumphed in Hawally/Mishrif (where another liberal, **Saad Al-Ajmi**, made a brave showing but, as a non-local, ended up fifth).

The NDM also backed the moderate pro-reform Shia candidates **Saleh Ashour** and **Yousef Al-Zalzahleh**, and the Shia cleric **Hussein Al-Qallaf**. They, like the liberals, support women's political rights.

For Sunni Islamists, the poll brought mixed results. The ICM suffered badly, with Duwailah apparently sunk by a shift in tribal support, and **Mubarak Al-Sunaida** and **Abdullah Al-Arada** also defeated. The survivors were Al-Sane and **Muhammad Al-Busairi**.

The "traditional" Salafi Islamists saw former religious affairs minister **Ahmed Baqer** survive comfortably, but **Ahmed Diraj** was thrown out. This was offset with the gain of one seat by **Fahad Al-Khanna**.

The more austere *Salafi Movement* was strengthened. Its leader, **Waleed Tabtabei** will be joined in the new assembly by **Awad Barrad**, elected in Jahra, and **Abdullah Aqash**.

Soft Tones Follow Raised Tensions After US Border Attack Wounding Syrian Guards

The **US** and **Syria** came closer than either party hoped to direct conflict on 18 June when a US military strike on the remote border between **Iraq** and Syria wounded five Syrian border guards.

Though the guards have since been repatriated, their detention for two weeks after the incident strained relations between Washington and Damascus. The latter has been working to correct perceptions that it aided the fallen Iraqi regime during the recent conflict.

The raid was ostensibly directed at suspected **Baathist** leadership figures travelling in a convoy near the border with Syria. Besides the border guards, 17 of 20 Iraqis captured in the raid have been released, and no Baathist leadership figures were reported as captured or killed, leaving the impression that the raid mistakenly targeted a group of smugglers fitting the profile of Baathist figures escaping into Syria.

With three Syrians seriously injured, the incident came painfully close to presenting a major diplomatic quandary. This may have explained why US spokesmen downplayed the episode, whilst the uncommon restraint shown by Syria's Foreign Ministry in responding to the incident is an indication of the Syrian leadership's eagerness to appease the US.

The influential Foreign Ministry spokeswoman **Buthayna Shabaan** even sounded an apologetic note, stating that "we can't watch every metre of the border", while US diplomatic fallout from the incident was limited to a mild rebuke for **Theodore Kallouf**, US Ambassador to Damascus.

The attack followed soon after the capture of **Hamid Abid Mahmoud**, head of **Saddam Hussein's** Office of the Presidential Palace, who was considered by many Iraq-watchers to be the fourth or even the second most powerful figure in the Baathist hierarchy.

Intelligence from captured Baathist leaders was combined with communications intercepts to guide US forces to a convoy of vehicles stopped at a point on the Syrian border commonly used by smugglers. The attack was executed by the Task Force 20, the US special operations unit charged with hunting down senior Baathist leaders.

In the attack, Predator unmanned drones directed AC-130 gunships, AH-64 Apache attack helicopters, and US special forces to a compound near the Syrian border, where a number of suspect vehicles were destroyed, one Iraqi killed, five Syrian border guards wounded, and twenty Iraqi suspects detained.

Bahrain Reform Programme Clouded By Al-Wasat Case

Bahrain's High Criminal Court has adjourned until 20 September the case against **Mansoor Al-Jamri**, editor of the independent newspaper *Al-Wasat*, and *Al-Wasat* reporter **Hussein Khalaf**. Their prosecution, on charges of breaking official limits on the coverage of the release of detainees, threatens to seriously damage the country's public image.

In permitting last autumn's launch of *Al-Wasat* – backed by prominent Sunni and Shia investors – the government of **King Hamad Bin Isa Al-Khalifa** signalled its commitment to media freedom. Free speech and open access to information is of course a central element in the reform programme introduced by the monarch over the past four years.

However, the decision to bring a case against **Jamri** and **Khalaf** is seen as a demonstration of the entrenched strength of conservative information minister **Nabil Al-Hamer** (*GSN 709/7*).

Moreover, the case is attracting international publicity that is highly damaging to Bahrain's new reformist image. Both *Reporters Sans Frontieres* and the New York-based *Committee to Protect Journalists* have spoken out on the issue.

EU Extends Diplomatic Mission To GCC Via Riyadh

Chris Patten, the European Union's commissioner for external relations, has confirmed that the EU will open a permanent mission to the Gulf Co-operation Council countries. He was speaking at a joint press conference with **Abdurrahman Al-Attiyah**, who was making his first official visit to Brussels as GCC secretary general.

The EU and the Gulf countries are currently negotiating a free trade pact.

EU officials have said that the mission will be in Riyadh, seat of the GCC's secretariat, but accredited to all six member states. It should open by the end of this 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*.

Kuwait Looks For Early Ties With Post-Saddam Iraq

As the American-led coalition struggles with the rebuilding of Iraq's political, industrial and even social infrastructure, the country's neighbour to the south-east is taking early steps to forge ties that could help integrate the country into the broader region in the period following the fall of Saddam Hussein's isolated regime.

Kuwait, which has been keen to patch up relations with its neighbour (*GSN 709/11*), has established a task force of top officials and business leaders to map out a strategy for the country's dealings with Iraq and try to overcome barriers to the development of economic links.

Government leaders are acutely aware that the overthrow of Saddam Hussein has transformed the prospects for co-operation – and has also offered wealthy Kuwait a chance to regain lost goodwill in the Arab world by helping its battered northern neighbour.

The Kuwait-Iran task force is headed by **Sheikh Mohammed Sabah Al-Salem Al-Sabah**, foreign minister in the outgoing government. Its members include representatives of the *Kuwait Investment Authority (KIA)*, the *Kuwait Petroleum Corporation*, the government compensation agency, which handles claims relating to the Iraqi invasion, the *Kuwait Fund for Development* and the finance ministry's Higher Committee for Economic Development and Reform, which provides the secretariat. Private sector members represent industry, the financial sector and the chamber of commerce.

The task force hopes to develop a strategy for Kuwaiti trade and investment, and will look at practical issues such as border formalities, where an excess of red tape might hamper business flows. A first meeting of the group will take place by mid-July.

But the work of the new group will not be confined to trade matters. In the next few years, until oil revenues are much increased and the country is able to finance its own development programmes, Iraq will be heavily reliant on external aid – and the Kuwait Fund for Development expects to be a major donor.

"The key issue is that Iraq has the cash-flow to really improve human living standards over the next five or six years," a senior government source in Kuwait City told *GSN* (see box, page 12). Recouping Iraq's debt to Kuwait is not the government's first priority, the source said.

DEALING WITH THE DEBT

According to the official, Iraq owes its neighbour \$8.5bn in unpaid government loans, \$3bn in oil debt and more than \$26bn in compensation already awarded by the *United Nations* for the 1990-91 invasion and occupation. The \$11.5bn in debt alone makes Kuwait one of Iraq's largest creditors.

For the Kuwaitis, a stable and prosperous Iraq is the most important goal, and not necessarily for wholly altruistic reasons. For Kuwait's own security, this is far more important than the servicing of old financial obligations.

But it remains to be seen how quickly aid and ties to Iraq can be implemented. With Kuwait itself facing rising unemployment and corruption, and a recent election that fragmented parliament and appears to have handed more power to the ruling family, delaying recompense of debts in order to aid a neighbour is not a policy that will prove politically popular for long.

Eventually, the sensitive financial dossiers will be examined. These concern money lent by the Kuwaiti government to Iraq, compensation claims over the 1990-91 invasion, and the cost of oil exported on Baghdad's behalf to world markets by Kuwait during the Iran-Iraq war – when Iraq's own maritime export terminals were closed.

The value of the compensation awards is still rising – some \$1.5bn was recently awarded to the KIA by the United Nations Compensation Commission, and there are many claims that have still not been processed at all. But the Kuwaitis are happy to leave the UN to decide compensation issues and the proportion of Iraqi oil revenues that should be allocated to paying off compensation awards, one source said.

The question of commercial debt will be decided in the Paris Club of government creditors, where all creditor countries should end up with the same deal. But government sources in Kuwait City already point to the range of options on offer. These include both traditional rescheduling and the example set by recent massive debt cuts granted to least developed countries under the Heavily Indebted Poor Countries initiative.

Debt swaps, facilitating Kuwaiti investment in Iraq through the purchase of massively discounted receivables, are another possibility that will be examined. If handled well, such transactions, rather than being strictly fiscally oriented, could help knit the region closer together in a way that would benefit debtors and creditors both.

Poles Prepare For Iraq Adventure As NATO Provides Essential Support

The lynchpin of the “New Europe” lauded by everyone from Euro-federalists to US Defence Secretary **Donald Rumsfeld**, Poland has come through with its commitment to take over a “segment” of Iraq. It has assembled the 9,200-strong multinational stabilisation force it will command from 1 September in central and southern Iraq, in a belt of territory running from the **Iranian** to the **Saudi** borders, between the **UK**-led southern zone and the US-controlled north.

The zone’s commander-in-waiting, General **Andrzej Tyszkiewicz**, and nearly 250 Polish troops, left for the Gulf on 2 July. Poland will send 2,300 troops to work with some 1,300 **Spanish** troops. Officers from NATO in western Europe will take part, along with soldiers from **Ukraine**, **Bulgaria**, **Hungary**, **Romania**, **Slovakia** and the Baltic states. Also possible are troop commitments from the **Philippines**, **Thailand**, **Mongolia** and **Fiji**.

At a press conference before they left, Defence Minister **Jerzy Szmajdzinski** was asked about potential casualties – a hot issue in a country where public opinion showed as little enthusiasm for the war as other Europeans. “We are analysing each death of US and British troops and preparing our soldiers the best we can,” Szmajdzinski replied. According to senior NATO and member government officials, the Poles have confronted the problems associated with building up the force with refreshing frankness.

REACHING OUT

A reinvigorated NATO – with a broader mandate since its Prague conference last November – has been providing a range of back-up for the most high-profile military mission undertaken by a central or eastern European country for decades. NATO was approached for, and has provided, technical and logistical support for the Polish mission – which, along with the **International Security Assistance Force** mission to **Afghanistan**, represents the alliance’s first operations outside its traditional trans-Atlantic theatre of operations.

This was approved of by all of NATO’s 19 member states – including **Turkey**, as the chief of the US Mission to NATO’s Political Section **John Heffern** observed during a 1 July conference at the **Royal United Services Institute (RUSI)** in London. As NATO Secretary-general **Lord George Robertson** said at RUSI, NATO did not differ from wider society in enduring a debate of great “intensity” over Iraq. NATO emerged stronger, said Robertson, a British New Labour politician expected to leave NATO soon. The hot money suggests his successor will be Polish.

REACHING INTO THE TOOLBOX

In making their big commitment to Iraq, the Poles, who joined NATO only in 1999, “have turned around political goodwill, and now they need capabilities”, Heffern said. NATO has evolved the concept of providing a wide-ranging “toolbox” of capabilities to support such operations. The USA has been strongly supportive; some **European Union** states – what Rumsfeld might call “Old Europe” – have been less so.

Afghanistan will set a trend, with a NATO-flagged force taking over from the peacekeeping mission now led by **Germany** and the **Netherlands**. NATO sources said the Polish-led mission in Iraq would operate like the Dutch and Germans have in Afghanistan, with NATO providing behind-the-scenes back-up for now. Even so, the shape of the force suggests that NATO has finally arrived in the Gulf.

Some opinion-formers, including the UK **Conservative Party**’s shadow Defence Minister **Bernard Jenkin**, have considered the wisdom of taking that role even further – with NATO becoming the vehicle for a wide number of out-of-area operations such as peacekeeping in Congo, for instance. This has some logic, given that NATO after the 11 September 2001 attacks on the USA seems finally to have found its post-cold war *raison d’être*. This means NATO is an element of international politics that Gulf governments can no longer afford to ignore.

Don’t Forget “Old Europe”

It is not just the **Poles** who have found a new lease of life and arrived in the Gulf a decade after the Cold War expired.

Anglo-American efforts to broaden the multinational base of the forces occupying **Iraq** will take a major step forward over the next few weeks with the transfer of Dhi Qar and Al-Muthanna province from US control to a UK-led European force, including major contingents from **Italy** and the **Netherlands**.

The British-led troops will also continue to occupy the provinces of Basra and Maysan – the scene of the recent killing of six UK military police in the town of Majar Al-Kabir.

Some 1,100 Dutch troops will assume responsibility for Al-Muthanna – which stretches from the Euphrates valley around the town of Al-Samawah and across the desert down to the **Saudi** border. Meanwhile, a 3,500-strong mainly Italian force, with some **Romanian** and **Portuguese** detachments, will take over Dhi Qar province, including the politically important Shia city of Nassiriyah.

The Italians are particularly experienced in such delicate occupations, having played a major role in **Kosovo** and carried out an impressive stabilising intervention in post-communist **Albania**.

The British-led multinational force, with 15-16,000 troops in total, will also include **Danish** and **Norwegian** soldiers.

UK Spots Progress Among Continued Reconstruction Challenges

As British and American troops and coalition administrators in Iraq struggle with the task of rebuilding a country from top to bottom, slow progress is being made on a number of fronts. In early July, *GSN* spoke with Major General Peter Wall, commander of the British First Armoured Division – whose troops will soon be relieved in Iraq – about conditions both in the UK-controlled south and throughout the country, and about the areas where more efforts need to be made.

SECURITY

Security remains a prime concern for the UK, a point recently stressed both by Wall and by the UK's new Secretary of State for International Development, **Baroness Amos**.

Visiting Kuwait in early July, Wall conceded that even in the south – which is generally much calmer than the Sunni areas around Baghdad – violent gangs have continued to operate. These appear to include *Baathist* hard-liners, tribal elements and common criminals.

Some 5,000 Iraqi police are now back at work in Basra and Maysan. The British hope eventually to bolster police numbers to 8,000.

The courts are also back in operation, now that the British have interviewed all 56 judges working in Basra and Maysan. Seven judges belonging to the politically senior third and fourth tiers of **Saddam Hussein's** Baath party have been sacked.

EMPLOYMENT

Besides law and order, employment remains a major problem. Despite a recovery in local business activity, there remains a desperate shortage of private sector jobs.

In this atmosphere, the necessary import of expert foreign workers to carry out specialist reconstruction tasks has caused a fair degree of local resentment. But in many cases, suitably trained Iraqis are not available.

Local business prospects should improve once Umm Qasr port, Basra airport and the land border with Kuwait are open to routine traffic. This should be possible once proper customs and immigration controls are in place. Wall – whose troops are just completing their tour of duty and will be replaced by the infantry of the UK's First Division – said the British hope to achieve this within a few weeks.

He also pointed out that, thanks to the discovery of reserves in local offshoots of the central bank, the UK occupying administration has been able to pay public sector salaries in Maysan and Basra since mid-April, albeit not always on time.

GOVERNMENT

Local government in Basra is now gradually being transferred into the hands of an Iraqi interim committee, whose members have elected a chairman to act as a provisional governor.

Admittedly, the relatively positive official UK assessment of conditions in the south is not shared by all observers. A recent *Amnesty International* report states, "The climate of fear and insecurity is overwhelming in Basra."

But there is no doubt that progress towards peace and stability is much further advanced than in US-controlled central Iraq. There have been gains even there, however, with the holy city of Najaf having seated an elected city council.

At the national level, **Paul Bremer**, US head of the provisional administration, has been preparing to unveil a new transitional council. *UN* special envoy **Sergio Vieira de Mello** told *AFP* that Bremer had listened to *UN* advice and made some concessions: the national transitional council would now have some executive powers, rather than the purely consultative role first envisaged. European diplomats in Baghdad predict that Iraqi parties will eventually be allowed to choose their representatives on the 20-member body.

Humanitarian Assessment Remains Mixed

The UK's new Secretary of State for International Development, **Baroness Amos**, sounded almost like the inscrutable US Defence Secretary **Donald Rumsfeld** in assessing the humanitarian problems that remain widespread in post-**Saddam Iraq**.

"There is no doubt that some things have improved and some things have not," she said after visiting Basra and Baghdad for two days in late June.

While Baroness Amos described a recent *Unicef* report on malnutrition as "a touch alarmist," she agreed that, although the expected post-war humanitarian crisis had not materialised, subsequent progress had been mixed. Humanitarian problems remain widespread and the various international agencies, non-governmental organisations and occupying forces differ widely in their assessment of the extent of deprivation. In many places, though, humanitarian problems are contributing to coalition security concerns.

Water and power have now been restored to pre-war levels in the UK-controlled zone. But localised shortages of certain key items continue. Medical aid is a notable problem. While some hospitals are now able to operate at almost full capacity, others can manage only 30-40% of their normal workload. The UK is working to remedy a shortage of hospital oxygen. **Kuwaiti** businessmen have also donated oxygen equipment. Medical drugs are not generally in short supply, but there has been a necessary shift in the pattern of incoming consignments. Before the war, imports consisted largely of the drugs needed to treat so-called "diseases of affluence." The current priority is basic essential pharmaceuticals to deal with problems such as cholera – a major risk in the summer heat.

Iran Opens Bond Markets To Wary Parastatals

Iran's central government has decided against an early return to the Eurobond market, preferring instead to leave the field open for the country's two blue-chip parastatals, the *National Iranian Oil Company (NIOC)* and the *National Petrochemicals Company (NPC)* this fiscal year. The decision was motivated in part by an adequate supply of foreign currency, but more strategic considerations are at work as well.

Bank Markazi (Iran's central bank) and the finance ministry have decided against an early Iranian government return to the bond market, despite the success of last year's two issues, because no extra foreign currency funding is required for the time being. However, *GSN* has been told that the central bank would be pleased to see NPC and NIOC make their debut.

For the central bank, the entry of Iranian corporates into the international capital market would mark a step towards liberalisation and the state's withdrawal from supporting the production economy. It would also maintain Iran's profile among European and Middle Eastern investors.

The policy decision to allow NIOC and NPC, as key public sector corporate entities, to seek their own capital market funding, has already been taken, in principle. For Bank Markazi it is now simply a question of waiting to see whether the companies wish to try their luck, and whether they then come forward with bond issuance strategies that satisfy the central bank. This is a formal requirement of Iranian budget law, but it is unlikely to pose much of a problem, provided the company has a well planned proposal.

No guarantee will be provided by the state. Preparatory talks with ratings agency *Fitch* are on the agenda. (US sanctions preclude *Standard & Poor's* and *Moody's*, as American entities, from looking at Iran.)

BUT DOES IT ADD UP?

Though the doors are open, NPC managers still have to be persuaded that a bond issue can offer a competitive source of money. Their pick-and-choose attitude to fund-raising is born of the self-confidence accumulated over the past five years, as the company has steadily consolidated its standing in the financial markets.

Whatever the public relations attraction of a bond issue, it has to make sense in purely economic terms. The NPC group will only be tempted by interest rates that can compete with the cost of bank loans and export credit.

Management has been discussing possible market opportunities with financial institutions. But NPC International's managing director,

Mohammed Rahbari, told *GSN*, "So far we are not convinced about going to the bond market."

To make a bond issue attractive, Rahbari said, bond markets would have to beat the competitive financing terms his group already obtains from international banks and export credit agencies. Some €1.5bn in external financing capacity is available from these two sources already.

Britain's Export Credits Guarantee Department recently approved £100m in cover capacity for NPC as a corporate risk, and £150m for NIOC (*GSN 709/12*). **Hermes** of Germany has also agreed cover and **Italy's Sace** is expected to follow suit soon; promising signals are coming from **France's Coface** too. The overall western export credit capacity now available to NPC stands at €500m.

Meanwhile, commercial bank loans available to the company – from mainly European, **Japanese** and Middle Eastern institutions – total more than €1bn.

Those favourable terms have been hard won. NPC has been working since 1998 to step out from under the protective shadow of state support.

Rahbari believes a major contributor to this enhanced financial standing was the company's slow but steady improvement in productivity. In 1989, just after the Iran-Iraq war, NPC had an installed capacity of 5.8m tonnes, but actual output was only 2.4m tonnes (little more than 40%). Last year, installed capacity had climbed to 15.1m tonnes, while actual production was an impressive 13.1m (86%). Indeed, some units theoretically surpassed 100%, by operating at full pitch for more than the 330 planned working days each year.

Iran Floats Offshore Banking

Sparking international interest, **Bank Markazi** (Iran's central bank) is expected to grant early permission for foreign banking activities in the Kharg Island foreign trade zone, though it plans to make foreign banks wait several years before opening operational units on the Iranian mainland. A number of foreign banks, including both big international names and **Dubai-** and **Bahrain-**based institutions, have expressed interest in opening branches or joint ventures on Kharg. **Standard Chartered** has already announced a firm intention to do so. The Tehran market is alluring. But Iranian authorities want to give reforms of existing state banks time to take effect, and local private banks time to grow stronger, before they allow voracious foreign competitors into the country. Officials want to avoid a repeat of the situation in much of ex-Communist eastern Europe – where many of viable state-owned banks were swallowed up by big international groups. They believe three to five years will be needed before Iranian institutions are able to face up to an influx of foreign competition.

GSN Risk Grade – C+/2: Political squabbles are not affecting a positive investment climate

Political And Social Development

Overview: While King Hamad Bin Isa Al-Khalifa is making his presence felt on the international stage, opposition demands continue for constitutional change at home (partly in protest at sharing legislative functions with an appointed Shura Council) and concerns about press freedom have been raised. The Islamic National Wafaq Society, the political vehicle of the majority Shiite community, places the issue above most Islamist issues and has formed alliances with opposition groups.

Opposition: There are concerns about freedom of the press, with the editor of the independent newspaper Al-Wasat facing legal action from Information Minister Nabil Al-Hamer after refusing to adhere to a gagging order. Meanwhile, the editor-in-chief of the Arabic daily Akhbar Al Khaleej and six other individuals have been charged with criticising Sharia court judges. Both cases have been adjourned until September. Opposition groups boycotting the last parliamentary elections – Wafaq, NDAS, Islamic action and NDS (ex-Baathists) – have been joined by the Democratic Forum Society and Nationalist Islamist Society to stump for more representative democracy.

Security: The civil disturbances seen during the Iraq war have receded, but security services remain vigilant. A Bahraini man was jailed for five years in early July for planning terror attacks in the country; he was one of five men arrested in February for alleged terrorist plots. (Three of the men were acquitted. The other, a member of the Bahraini armed forces, is awaiting trial.) Saudi authorities say a Bahraini man is among those arrested in connection with the recent bombings in Riyadh.

External relations: Relations with the USA remain close, though Bahrain continues to push for the release of six nationals detained in Guantanamo. King Hamad participated at the recent Sharm El-Sheikh peace summit, but Bahrain has rejected the idea of more contact with Israel unless it will help bring peace with Palestine. Close dialogue is kept with GCC states; Saudi Arabia is routinely consulted on a variety of issues. There have been frequent high-level contacts with Iran in recent months; seven co-operation agreements were signed in May, including one for fighting terrorism and organised crime, while a joint bank is also planned. Bahrain is also the present chair of the Arab League.

Economic Outlook

Overview: The economy is expected to strengthen in the second half of the year, including a healthy foreign trade performance. The government has forecast 5% economic growth for 2003. Unemployment, however, remains a real concern at around 15% for nationals. The government has pledged to overhaul the work permits system by 2005, while infrastructure such as the Bahrain Financial Harbour, Durrat Al Bahrain resort and the new Formula One race track will help create new jobs. The oil industry is minimal; Bahrain pumps around 40,000 b/d from its own oil fields and 140,000 b/d from a shared offshore field with Saudi Arabia.

Financial sector: Bahrain is a regional leader and there are encouraging signs of further growth. Some banking sector concerns persist, however: Bahrain International Bank and BMB Investment Bank are in technical default. The Pension Fund Authority and General Organisation for Social Insurance (Gosi) also face problems. Gosi could be bankrupt by 2023 if the benefits regime continues. A debut five-year \$500m sovereign eurobond was launched in January. S&P provided an initial A- rating. The Bahrain Monetary Agency plans to issue Islamic bonds worth \$670m in 2003 to develop the market; a \$250m issue was listed on the local bourse in early July.

Budget: A BHD744.6m (\$1.946bn) combined budget deficit is forecast for 2003 and 2004 (BHD362m for 2003 and BHD383m for 2004). Total spending of BHD1.158bn is envisaged in 2003 (BHD1.189bn in 2004) with revenues forecast at BHD797m (BHD806m in 2004). BHD330m has been set aside for development projects in each year. The budget is based on an \$18/bbl oil price. Foreign investment will be required in order to meet targets.

Liberalisation: US officials held trade talks in June over a possible free trade agreement; formal talks are expected by year's end. Bahrain expects around \$700m FDI from privatisation sales in 2003. MTC Vodafone won the second GSM licence in mid-April. A new telecoms law is due 2004. A committee has been created to prepare a feasibility study to privatise the electricity and water sectors. Transport sell-offs could include management of Mina Salman and Khalifa Bin Salman ports. A 3% base rate income tax has been mooted.

Bahrain: Key Projects

HIDD POWER AND DESALINATION PLANT EXPANSION: France's Alstom has a \$300m contract to install 700MW; a steam turbine will be installed by mid-2004. Consultant to be appointed for third phase expansion.

ALUMINIUM BAHRAIN: Fifth potline for completion June 2005; Bechtel started construction mid-February. Five tranche \$1.05bn commercial bank facility secured; \$300m European export credit tranche also sought. Alstom has a 650MW power contract. USA's Alcoa is mulling a sixth potline to raise output to 1m t/yr.

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

FORMULA ONE MOTOR RACING TRACK: Scheduled to open in 2004, with long-term F-1 deal secured. Construction has already started. Government funding passed in late March after a parliamentary tussle.

BANGAS LPG: Debottlenecking and 20m-30m ft³/d expansion to existing 280m ft³/d processing plant. FEED award awaited; bidders include ABB Lummus Global, Costain Oil & Gas, Foster Wheeler and Stone & Webster. EPC tender expected Q1 04 for 2006 completion.

SITRA REFINERY: Bids expected in August from five companies for the EPC management contract to build a \$600m, 40,000 b/d low-sulphur diesel production unit at Bahrain Petroleum Company's 250,000 b/d refinery.

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.

Bahrain: Economic Indicators

(\$ million)	1998	1999	2000	2001	2002
GDP current prices	6,166	6,601.1	7,947.3	7,911.7 ^a	8,100 ^a
GDP growth (%)	-2.6	7.1	20.4	-0.5 ^a	0.5 ^a
Exports	3,260.7	4,350	6,176.3	5,562.1	5,354.6
of which: hydrocarbons	1,689.2	2,767.7	4,464.3	3,671.4	3,530.2
Imports	3,555.6	3,686.8	4,619.7	4,294.4	4,619.9
Trade balance	-294.9	663.2	1,556.6	1,267.6	734.7
CPI (percent)	-0.4	-1.3	-0.7	-1.8	0.5 ^a
Current account	-775.1	-339.7	112.7	182 ^a	-440.0 ^a
Foreign exchange reserves	1,290	1,369	1,564	—	—

^a Preliminary. ^b Estimate. GDP – Gross domestic product. CPI – Consumer price inflation.

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

GSN Risk Grade — E/3: Political heat rises. Economy resilient despite inflationary concerns

Political And Social Development

Overview: Real concerns about both the domestic and international political scene have prompted a one notch downgrade in the country's political outlook. Payments conditions remain unchanged. There have been some signs of compromise in the reformist/conservative power struggle but the increasing dissatisfaction of a youthful population with both sides has been made very apparent. There has also been a resurgence in student-led street protests against the regime (see box). US Secretary of State Colin Powell says the US will not seek to intervene in a 'family fight', but the US is applying significant pressure over Iran's nuclear ambitions.

Two key bills: In early June the conservative Guardian Council rejected two Khatami-supported bills that would reduce its power to veto electoral candidates and give the President greater power to rein-in the judiciary. Parliamentary sources have indicated that the GC may be prepared to compromise by surrendering its right to veto candidates for elected office (a central provision of, the first bill, Khatami's proposed new election law). There are also efforts to reach compromise on the other bill but CG approval may be exceptionally hard. One proposal suggests that the President be given the right to block judicial verdicts he considers unconstitutional and refer the final decision to a panel of judges who would determine whether there had been a violation of the defendant's rights. The fear of domestic instability in the face of external pressure from the US may force the two sides to reach a workable compromise.

The nuclear question: Iran is coming under intense international pressure to give assurances about its nuclear ambitions. The US appears ready to allow Iran to develop a nuclear power industry but has been lobbying potential partners hard, including Russia, which has been asked to limit Iran's freedom to modify Russian nuclear fuel supplies. The EU has also hardened its line by tying settlement of the nuclear issue to future technical and economic co-operation, as well as human rights issues. The US is seeking Iranian commitment to enhanced International Atomic Energy Agency safeguards and inspections and its abandonment of an indigenous fuel fabrication capability. The early July announcement of the successful Shahab-3 missile test (capable of hitting Israel) will intensify US pressure.

Economic Outlook

Overview: Iran continues to make significant economic progress without US investment. The IMF said recently that the prospects for 2003/04 look favourable but has warned about inflationary pressures. The government is forecasting 6% GDP growth for its 2003/2004 year, with inflation of around 15%. Progress is being made in the non-oil sector; real GDP growth was 7.9% in 2002/2003. Tax revenues (despite some encouraging recent figures) and private investment remain concerns. Iran says it is hoping to attract \$4bn-5bn in foreign investment over the next year. Serious structural problems also remain, including state domination and a weak banking system, while bureaucracy and corruption must be further addressed. Unemployment is officially 16%.

The IMF view: A recently concluded IMF mission highlighted the country's solid economic growth record over recent years but warned the authorities over inflationary pressures including expansionary spending of oil revenues. The IMF advised the government to curb an expansionist fiscal policy and reduce the forecast budget deficit for 2003/04 to 1.4% of GDP from a target of 2.2%.

Finances: New Bank Markazi (Central Bank) Governor Ebrahim Sheybani is expected to continue reforms started by previous governor Mohsen Nourbakhsh who died in March. The authorities have stated that they have no plans to tap the international debt markets again this year. Funds necessary for development projects will instead be drawn from the oil stabilisation fund. While credibility with foreign investors has grown, helped by a good repayments record, some analysts have raised concerns about money laundering.

Liberalisation: Talks are ongoing with the EU on a free trade agreement; detailed discussion are awaited; Brussels refuses to commit itself to a strict timetable. WTO membership is blocked by the US. A two-tier exchange rate was scrapped March 2002; import procedures have been streamlined but restrictive elements remain. Privatisation progress has been slow. Urgent reforms are required to labour and commercial laws, and to regulate securities. A revised investment law was passed in May 2002. The government has proposed lifting ceilings on oil sector buy-back contracts.

ANNIVERSARY PROTESTS: More student leaders were detained on the 9 July anniversary of bloody protests in Tehran. The activists were reportedly taken by plainclothes Islamic vigilantes known as basijis, loyal to Ayatollah Ali Khamenei. The capital erupted in protest that night. Earlier, IAEA head Mohamed El Baradei had visited to discuss a further opening of Iran's nuclear programme. Elements in government are said to be amenable to a deal, but internal rifts may mean no action is taken before an informal September deadline.

Iran: Key Data and Forecasts*

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

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

^p Preliminary. ^f Forecast.

Sources: IMF, Washington; Bank Markazi, Tehran.

Iran: Key Projects

SOUTH PARS GAS FIELD: Initial 12 phases; work underway on phases one and three to ten (phases two and three were commissioned earlier in 2003). Award of phases 11-12 awaited (BP, Eni, Petronas, Statoil and TotalFinaElf among revised bidders). Shell reportedly interested in 13 and 14. Around 20 companies have expressed interest in prequalifying for phases 15-16.

LNG: Four projects under discussion. BG and Agip have signed a partnership agreement with National Iranian Gas Export Company, a subsidiary of the state National Iranian Oil Company. NIGEC launched prequalification in June for the first of two 4.5m-5m t/yr trains. Contracts for TotalFinaElf-led (Pars LNG) and Shell-led (Persian LNG) projects awaited. BP and India's Reliance also studying a project (Iran LNG).

INDEPENDENT POWER PROJECTS: State Tavanir is selling 350MW Khoy gas/steam plant in Azerbaijan province; bids due mid-2003. Tavanir is also tendering six 500MW projects, award of Zanjan one and two is expected in August. A tender for Khoram Abad one and two will follow next, then tenders for plants in Mashad and Kashan.

HYDROPOWER: Bids for the 1,000MW Siah-Bisheh project are due in August. Contract award is expected by end-year.

REFINERY MODERNISATION: EOPC tenders for upgrade work at the Abadan and Arak refineries expected by end-year. Work on the Isfahan and Bandar Abbas refineries will follow.

MIDDLE EAST ENERGY

POLICY, RISK AND PROJECTS IN THE GULF AND LEVANT

IRAQ: Q4 pickup

The US Energy Department's statistical section has revised its projections for Iraq's oil production this year, now saying it will reach a key level of 1.5m b/d late in the fourth quarter – not the third quarter, as previously estimated. *De facto* Iraqi oil minister **Thamir Ghadhban** in June predicted that the country's crude production could reach 1.5m b/d by the end of that month. But Ghadhban's projection turned out to be "overly optimistic" because of looting, sabotage and attacks on oil pipelines, the Energy Information Administration said, in a monthly analysis of OPEC production published in early July. It estimated Iraq's current production at about 450,000 b/d.

SAUDI ARABIA: Core Ventures Still Kicking

Riyadh is keeping up the momentum this summer on its core gas ventures, and is understood to be preparing to present plans to international oil companies on 22 July for a restructured gas initiative. Insiders suggest the re-tendered project might comprise the upstream element of core venture 1 and possibly elements of core venture 2 in the Red Sea. The presentation is expected to be held in London, with the original CV consortium members invited to attend, plus others such as the Norwegian duo **Statoil** and **Norsk Hydro**, Spain's **Repsol YPF**, Italy's **Eni** and other companies.

IRAN: Moscow defies US

US pressure on **Japan** to halt an oil development in Iran may have paid off, but **Russia** is continuing with energy co-operation projects in the Islamic Republic. Russia's Energy Minister **Igor Yusufov** and Iranian official **Mohammad Forouzandeh** signed a protocol in Moscow on 7 July to work more closely in the energy sector. The two are reported to have discussed working together in areas such as repair and renovation of energy generating facilities, drilling for oil and gas, laying oil and gas pipelines and other issues related to power plant construction and operation.

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Doha Keeps A Heavy Foot On The Gas

Qatar's commitment to pushing gas expansion on all fronts is transforming the peninsula into the region's new Klondike. As the deals continue to roll in, gas-to-liquid projects and other new initiatives may hold the key to continued growth.

Qatar's prodigious run of gas sales deals shows little sign of abating, despite intensifying competition among LNG suppliers. Based on the exploitation of massive gas reserves in the North Field, **Qatar Petroleum (QP)** has been lining up a broad range of new gas projects. According to a survey by **Dubai-based consultants Connexions**, the total value of Qatari projects will exceed \$30bn in the 2003-2005 period – second only to **Saudi Arabia** in the region. Gas projects account for at least \$13bn of that figure, **Connexions** estimates.

Yet according to well-placed project financiers, suggestions that QP is at risk of "imperial overstretch", as one banker put it, are wide of the mark. "QP has built up an enviable track record in the past few years of focusing on a project and just getting on with it," said a banker participating in QP's Oryx gas-to-liquid (GTL) debt finance package. "The contrast with the way a number of other national oil companies operate is quite spectacular."

QP's recent achievements are notable. In early July, the joint QP/**ExxonMobil**-owned **Ras Laffan LNG Company (RasGas)** secured an \$8.7bn LNG deal to supply 1.7m

tonnes/year (t/y) to **Taiwan's** state-owned **Taiwan Power Company** utility from 2008. QP beat off stiff competition from A-list international oil companies **Royal Dutch/Shell**, **BP** and **Total**, to win the project, which will be executed in association with Taiwan's **Chinese Petroleum Corporation (CPC)**.

A final decision on the size of the plant at Ras Laffan has yet to be made, but project sponsors are said to have mooted a design capacity of 3-4m t/y. Taiwan Power said the gas would be supplied to its power plant in northern Taiwan at around \$0.17/m³, some one-third cheaper than it now pays for gas feedstock.

Based on this deal, it seems QP is prepared to take a short-term hit on prices in order to win access to critical new markets in the Asia-Pacific region. CPC said the Qatari gas deal would replace a 1.5m t/y Indonesian contract set to expire in 2008.

NEW DIRECTIONS BEST?

Long-term gas contracts in place will see Qatar's LNG exports almost double from the current 13m t/y capacity by 2005, as new trains come on stream at RasGas II and debottlenecking is completed at Qatargas trains 1-3. Two 7.5m t/y megatrains are planned through the **Qatargas/ExxonMobil** expansion, on which

the front-end engineering and design work is now underway. Deliveries are earmarked for the gas-hungry UK market.

The 3.2bn ft³/d Dolphin gas pipeline to the UAE and the planned 1bn ft³/d Qatar-Kuwait pipeline, as well as a raft of GTL projects on the drawing board, all underline QP's aggressive market push

Some bankers see GTL as a better bet for Qatar than LNG, despite its noted ability to notch up lucrative LNG deals with creditworthy offtakers.

"The gas is there, the rationale is there and GTL is the right way to go for gas producers," the banker on the Oryx deal told GSN. "It's actually easier than LNG because they don't have to worry where it goes. With LNG, global current capacity is only about 115m tonnes, so another 3-4m tonne plant is significant, particularly when there's lots of people scrambling around trying to find good offtakers."

This point is backed up by other experts. "Qatar does suffer from a slight disadvantage in terms of LNG as it's the most distant potential source of gas from every market," said Nick White, a director at consultants *Arthur D Little*. "Any time a Qatar LNG project becomes economically viable, you know any sizeable gas reserve anywhere between Qatar and its destination market is going to be even more attractive to do. It's the last pick, in that sense."

The GTL advances now threaten to eclipse the impressive strides QP has made in the LNG market over the past five years. The company is planning GTL production of more than 900,000 t/y through seven separate projects, in association with credible international partners. In late June it signed an initial agreement with *Marathon Oil Company* of the US for a study on a new 120,000 b/d plant at Ras Laffan, expected to be commissioned in 2008.

A 34,000 b/d plant to be built in collaboration with South Africa's *Sasol* is the most advanced GTL scheme on the books. Syndication of the \$700m debt facility closed in early June, with *Norddeutsche Landesbank* and *ANZ Investment Bank* joining four local and regional banks in the \$119m transaction.

A total of 15 lead arranging banks were appointed late last year for the 14-year facility, a sign of banks' eagerness to dip their toes in the novice GTL market. The plant – the world's first commercial GTL project – is due to be completed in 2005.

Sasol, which developed its GTL expertise during the apartheid years, will play the lead role in marketing the middle distillates produced from the plant, primarily in Europe and the Far East. Feedstock gas will come from *Al-Khaleej Gas Company's* enhanced gas utilisation project.

QP is also exploiting the gap left by Iraq's oil exports since war began in March. Crude production averaged 740,000 b/d in the first

quarter of 2003, up by at least 100,000 b/d on the average output level registered in 2002. Energy & Industry Minister *Abdullah Bin Hamad Al-Attiyah* will be anxious to protect Qatar's market share gains at the forthcoming *OPEC* ministerial meeting, given Iraqi production's longer-than-anticipated absence from the global market.

IQ TEST

The government's more urgent focus is on economic reform, which is primarily designed to expand the role of the private sector. This has direct implications for QP, as it has now transferred its majority interest in three industrial companies – *Qatar Petrochemical Company*, *Qatar Fertilisers Company*, and *Qatar Fuel Additives Company* – to a newly established holding company, *Industries Qatar (IQ)*.

In May, 15% of IQ's share capital was floated on the Doha Securities Market in the country's biggest public offering for four years. QP will retain an 85% interest in IQ and provide ongoing assistance, nominating a seven-member board to head the company.

The move is tangible evidence that the reform-minded *Al-Thani*s are ready to push change, even if it touches on the hallowed national oil company – a clear break from traditional Gulf practice, where privatisation of oil assets remains taboo.

But selling down state assets in petrochemicals, fertilisers and steel does not presage a break-up of the state oil company.

What it does indicate is a willingness to back up stated commitments to privatisation with firm action, even when coffers are flush and the pressure for reform is less insistent than elsewhere. The ripples from the IQ sale will undoubtedly be felt at QP, whose remit is now explicitly focused on oil and gas.

The IPO raised some \$330m, but the government sees the sale less as a cash-raising measure than as a convenient way of revitalising the stock market. With full coffers and projected GDP growth of 8% in 2003, Qatar has little need for loose change. *Qatar National Bank* estimates 2002 GDP at \$17.5bn, producing a per capita income of \$28,000 – more than three times Saudi Arabia's. This has set the benchmark high for the fewer than 200,000 Qatari nationals.

The authorities are betting on the expansion of the gas sector and a revitalisation of the domestic private sector as the twin motors of future growth. If it can repeat the marketing success shown in notching up major gas deals like the recent Taiwan agreement, QP looks set to continue to play the lead role in realising these ambitions.

Market Forces Seen Benefiting Iraq Oil

A new survey of industry and government players in the international oil sector indicates strong support for the adoption of market mechanisms in the redevelopment of Iraq's petroleum resources. But any push for privatisation would lead to tensions over Iraq's continued OPEC membership. Though the experts – mostly UK and US consultants and diplomats – feel the question of OPEC membership should ultimately be left to a legitimate new government in Baghdad, international pressure and American plans may make that tension unavoidable.

A new report by *Deutsche Bank's* global oil and gas team – which established strong research credentials ahead of the conflict with its *Baghdad Bazaar* report on the prospects for post-Saddam Iraqi oil – found many correspondents agreed that critical questions were best left to an eventual legitimate Iraqi government.

Questions of OPEC membership, of whether to encourage rapid and massive foreign investment, of whether to privatise state-owned oil assets and of whether to establish a development fund or oil profits distribution policy – all these would be best decided by whatever post-Saddam, post-occupation government is eventually put in place.

But Deutsche Bank's study, released in early July, also found little doubt that sentiment is biased towards market mechanisms. Privatisation is seen as a way to decrease the power of the central government and enhance the prospects for new Iraqi oil companies to jump-start the economy.

Paul Bremer, director of the coalition provisional authority, has stuck to the line that OPEC membership is a question for the Iraqi people. But Bremer has stronger views about the need to inject market forces into Iraq's oil sector. "Capital allocation was made on political and bureaucratic bases, not in response to market forces," Bremer was quoted as saying in a recent Department of Defence news transcript. "Because these state-owned enterprises did not face market discipline, they destroyed value rather than created it."

THE POLITICS OF MARKETS

But even a decision to adopt more market-based mechanisms may ultimately be politically motivated.

Many experts canvassed by the bank felt Iraq should stay in OPEC. But according to a Middle East-based UK diplomat quoted in the report, there is little economic advantage in staying in OPEC, where in time Iraq would have to set production ceilings. With its vast reserves and an oil sector that was once well developed, Iraq would probably benefit more from being outside OPEC – like the UK and Norway – in case the cartel sets production

caps to try to maintain oil prices.

Thus a decision to remain in the cartel might be seen as a political act, "perhaps a first gesture of defiance to the Americans", the diplomat said.

One US energy consultant put in that the influence of neo-conservatives in Washington will wane over time, and cautioned that the interim administrators of Iraq may well steer clear of forcing major decisions on the government, in order to avoid just such gestures of defiance.

The obvious incompatibility of OPEC membership with a move for privatisation could in itself decide the issue. But if privatisation should come, it was frequently pointed out by respondents that poor privatisation strategies – as in Russia, for instance – would eliminate any benefits.

As the UK diplomat put it, privatisation could become a recipe for letting corrupt or irresponsible actors into the sector, if assets are sold off before they are made attractive to more solid investors.

"It is hard to see the Western oil majors investing heavily in Iraq until there is a stable Iraqi government likely to endure well after any American departure," the diplomat said. "The risk of nationalisation and renegeing would be far too high. In a well-ordered and secure oil sector, they might come in on technical service agreements, as a way of getting a foot in the door for when investment becomes a safer bet."

Partial privatisation may hold another solution. One US oil company executive said state-owned oil assets should be privatised, even if only to the extent that foreign firms can partner with the national oil company. "I think they will be semi-privatised, in the interest of attracting FDI. That would be difficult otherwise," he said.

Another executive pointed out that privatisation was probably still some way off. "We won't know if the experiment can be successful for five to 10 years," he said.

Dim Saudi View of Iraq Prospects

Iraq will not reach the 6-8m b/d production capacity some interim Iraqi leaders have predicted by 2010, according to an article published in *Saudi Aramco's Alqafalah* magazine. The declaration sheds a ray of light on possible Saudi thinking on its neighbour's prospects. The article, written by Professor A F Alhaji of *Ohio State University*, claims that Iraq would be unable to finance on its own the increase of its production capacity to 8m b/d. Capacity expansion would require tens of billions of dollars to develop Iraqi oilfields and build infrastructure. The lack of financial resources will force the Iraqi government to finance capacity expansion either through borrowing from international lenders or by sharing the oilfields with international oil companies. Both methods are problematic. Furthermore, historical data from various oil-producing countries indicates that oil production has declined after every episode of political turmoil or change in these countries' leadership.

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