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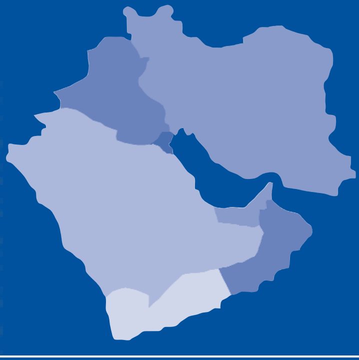

GSN

Companies & People

Bahrain Benefits From The Syrian Security Connection

US security officials are bemoaning the breakdown of intelligence co-operation with Syria, which began after 11 September 2001 as President **Bashar Al-Assad** saw an opportunity for a new start with Washington and ended as both sides polarised in the run-up to the **Iraq** war and hawks in the Pentagon took against Syria's support for ***Hizbollah***. But some fruits of this co-operation – and of Syria's deep security relationship with several Gulf states – may still be working their way through. Few details emerged when on 6 July, Bahrain citizen **Jamal Al-Balooshi** was sentenced to five years in jail by a Manama court for planning "terror acts". Balooshi and four other Bahrainis were arrested in February *(GSN704/7)*. Three of the five were subsequently acquitted; Balooshi admitted only to possessing weapons for personal use and the fifth man still faces charges. The group were arrested after Syrian intelligence passed on details of an ***Al-Qaeda*** plot to attack the US Fifth Fleet, which is headquartered in Bahrain.

GSN 717

GSN will take a short summer break. Issue number 717 will be published on 5 September 2003.

Across The Region

GSN's Analysis

MIDDLE EAST ENERGY

GSN View

Anecdotal and estate agents' evidence suggests that Gulf Arabs are spending less time in their old summer haunts, such as London's Knightsbridge or even the south of France. Indeed, work is on the agenda for more senior officials than usual during this long, hot summer. This August, many princes, politicians and businessmen are hard at work at home instead of seeking refuge in more temperate climes. Viewed from outside, the political and economic moves that will result from that effort may seem insubstantial, but the right moves now could lay the groundwork for more formidable results in the autumn, with major ramifications next year. As *GSN* heads into its summer break, a number of issues now being resolved will impact on political and economic developments going forwards.

Most obviously, steps taken to control the security situation in Iraq will make a huge difference. Attacks on Coalition troops could well wane this summer, but their sophistication could grow at the same time. While the Governing Council and various US and multilateral advisors get down to drafting the central banking and investment laws that will bring Iraq back into the international economy – the IMF plans a donor conference for the autumn – authorities are laying the groundwork for elections that could take place in 2004. After that, the bulk of US forces could be only steps away from withdrawing, even if this leaves a huge question mark hanging over the security situation.

The question of Iran's nuclear programme will give no one a rest. Whether or not it is seeking nuclear weapons capabilities, Iran could well soon agree to the International Atomic Energy Agency's additional inspection protocols, but the timing will be crucial. Iran would save face by agreeing a new inspections regime very soon (before they are seen to have been pressured) or very late (just before the IAEA meets in mid-September, when it will discuss the situation) when the move would most disrupt the IAEA's plans.

The crackdown on so-called terrorist elements in Saudi Arabia will likely continue, with the same uncertain results for domestic politics and relations with the USA *(see page 4)*. With economic reforms taking priority over social ones, the Kingdom will be strained by conflicting trends: moves towards a tighter grip on security could conflict with calls for more social and economic freedom.

Political developments in Qatar – where Sheikh Tamim Bin Hamad Al-Thani has just replaced his older brother Sheikh Jassim as Crown Prince *(see page 6)* – could also have a bigger impact further down the line. A new heir apparent may well serve to strengthen the political scene, and with the approval of a draft constitution in April and new moves to liberalise and attract investments, much could be in the offing as Qatar spends its huge new gas revenues on everything from energy infrastructure in third countries to the services of ageing Argentine soccer idol Gabriel Batistuta.

Abu Dhabi Crown Prince Sheikh Khalifa is also using the summer to consolidate his position in the UAE *(see page 7)*. Kuwait will prepare for its new National Assembly, with the authorities pushing for a breakthrough in oil investment *(see page 18)*. Oman's 500-plus candidates for its October Majlis Al-Shura elections will be busy laying the groundwork for their campaigns. In business and finance, new hydrocarbons deals and offers in Saudi Arabia, Kuwait and Qatar could see the pace of investment and resource development gradually build speed over the summer, culminating in a more robust round of deal-making. Substantial reforms will take more time – this will be a theme that will be addressed in Dubai, when the IMF/World Bank Annual Meetings are held in late September, a first for the region. The seminar programmes are heavily weighted toward Gulf and Middle East issues, but by the time such meetings roll around, almost all the deals have already been done. Until then, it's worth keeping an ear to the ground.

Perspective: One Year Ago

Saudi irritation at Al-Jazeera Satellite Channel, Arab resentment at its continued contacts with Ariel Sharon's administration in Israel, and its deepening strategic collaboration with the USA have combined to put Qatar in the diplomatic doghouse. An Al-Jazeera documentary examining the role of Saudi Arabia's founder, King Abdelaziz Ibn Saud, produced more than the usual annoyance from Riyadh *(GSN 685/8)*. Foreign Minister Prince Saud Al-Faisal omitted Doha from a tour of Gulf Co-operation Council capitals, while Saudi media launched a personal assault on Foreign Minister Sheikh Hamad Bin Jassim Bin Jabr Al-Thani.

This is more than a storm in a diplomatic coffee cup. It highlights underlying Saudi unease at the manner in which Qatar is carving out a role as a key US ally, hosting the strategic and fast-expanding Al-Udeid airbase, while presenting itself as a bridge between the Gulf mainstream and the Arab/Islamic world's odd men out, notably Iraq, and maintaining contacts with Israel… There is considerable concern in the region at the extent to which Doha is developing a close military relationship with Washington. Al-Udeid, whose existence had barely been noticed even a year ago, has emerged as a major strategic base *(GSN 684/4)*…

Well-informed observers in Doha believe the decision to accord US forces such large-scale use of Al-Udeid is to some extent an insurance policy – not against attack from Iraq, or even from Iran, with whom the Qataris share one of the world's largest offshore gas deposits, but against the possibility of a strong-arm attempt by Saudi Arabia to influence events or policy in Doha. It is not forgotten that in 1996, the year after Sheikh Hamad took power, Saudi hardliners supported a failed comeback putsch by the ex-Emir.

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USA Still Needs Subtle Hand After Tactical Successes In Iraq

Guarded optimism over the security situation in Iraq has surfaced in Washington for the first time since May, with some signs of improvement seen after the killing of **Uday** and **Qusay Hussein**. The discovery and death of **Saddam Hussein**'s sons was seen as the crowning achievement in a series of steady tactical victories and innovative counter-insurgency operations, prompting influential US correspondents to make cautiously optimistic predictions about the evolving security environment in Iraq.

But a more comprehensive solution to the ongoing security problem may require greater strategic and political co-ordination on the part of the Coalition Provisional Authority (CPA). Tactical successes will not put to rest the root causes of resistance in the so-called "Sunni triangle". While Coalition forces can expect fewer local grievances and spontaneous outbursts of violence, the ripples resulting from the loss of Sunni entitlement since the fall of the ***Baath*** regime will continue to be felt for some time.

The Sunni question

US counter-insurgency and de-Baathification policies have reduced fear of Baathist resurgence and dismantled the security and political infrastructure of the Hussein regime, but they have not tackled the broader grievances motivating resistance in the Sunni triangle.

Feelings of humiliation, loss of entitlement, and fear of future marginalisation will continue to fuel some spontaneous local violence and organised guerrilla activity led by local criminal elements, Baathist or Arab nationalist resistance leaders, or radical Islamic currents in the Sunni community.

The ethnic and geographical make-up of the Governing Council reinforces such fears, particularly since none of the five Sunnis on the 25-member council have familiar or recent ties to communities or tribes from the Sunni triangle *(GSN 715/3)*. Until more representatives from the region are visible on the Governing Council or are seen to be contributing to the development of a new constitution, grievances and related violence will continue.

Though local hearts-and-minds successes will reduce the numbers of attacks, they will not impact the nucleus of ex-Baathists, who have displayed tactical sophistication and adaptability since Iraqi *fedayeen* first engaged US forces in March. Such forces have recently moved towards so-called "stand-off" tactics – involving means of attack that do not expose their forces to US firepower, including indirect mortar fire and roadside bombs.

The next step may be to begin targeting less well-protected elements of the Coalition presence, or even to target the Governing Council and other Iraqi elements of the US-led provisional government. Such attacks had already begun by late June, when a senior Iraqi reconstruction official was killed and two Iraqi electrical engineers were killed by a roadside bomb in a separate incident.

Unless the Governing Council's tribal and ethnic make-up is tweaked to include elements from the Sunni triangle, such attacks may become focused on the coalescing Iraqi executive body, as well as the coalition occupation forces.

Local Problems, Local Solutions

On the military level, US counter-insurgency approaches have not yet graduated from the local level to an integrated nation-wide approach.

Each US divisional commander has approached the challenge of resistance in a different manner in his individual fiefdom, and the Baghdad-bound CPA has remained a distant and faint voice in security matters.

In the 3rd Infantry Division's zone, encompassing Fallujah – the area most hostile to coalition forces in Iraq – the USA has employed a light touch. Relations have remained fraught since 15 Iraqi protesters were killed and over three dozen wounded on 28 April. US forces subsequently withdrew from many forward positions, and struck deals with local leadership concerning the conditions under which women would be searched and armoured vehicles would enter the town, as well as other invasive elements of the occupation.

The 3rd Infantry has also paid blood money to the families of civilians killed by the USA, set at $1,500 per death and $500 per person injured.

The USA has facilitated the development of a range of militias in the area, including a 75-member militia under the control of the town mayor, 400 US-backed police, and 200 armed guards to protect critical infrastructure.

In the neighbouring US 4th Infantry Division zone, covering much of the Sunni triangle north of Baghdad, a very different approach has prevailed. A proactive series of offensive operations is seen to have resulted in a decline in the overall number of attacks on coalition troops in the area since May. Operations in this zone most resemble the sort of counter-insurgency operations carried out in **Vietnam** and other classic anti-guerrilla campaigns, with a balanced use of intelligence-gathering and high-intensity combat forces.

Few military tools have been excluded from use in the area. For example, the 4th Infantry has fired more than 60 rounds of artillery ammunition at areas where it has detected mortar launches, a risky strategy in semi-urban locales. In operations such as *Peninsula Strike* and *Desert Scorpion*, Baathist leaders were identified, located, and pursued in 56 simultaneous raids.

The division's intelligence officer recently explained that successes had come from both "walk-in intelligence" from informants, and from less savoury methods including the detention of family members of Baathist suspects until the fugitives handed themselves in.

The result has been the detention of over 1,000 suspects and the deaths of 300 guerrilla fighters.

Financing Hearts And Minds In Iraq

Alongside its counter-insurgency operations, the **USA** has engaged in extensive small-scale infrastructural funding it characterises as part of its hearts-and-minds efforts. Each brigade commander is supplied with an Emergency Repair Fund that is stocked with $200,000 and kept replenished to this level, to be used to pay for infrastructure repairs in regions through which US forces have moved. So far, forces have distributed $13m worth of funding across Iraq, including $2m in Fallujah alone. Troops undertaking counter-insurgency operations supply funding to immediately repair road degradation and other architectural damage, and to restore water or cooking gas supplies as they move through various regions.

Media wars bring television embarassment

Critics say overall funding for hearts and minds is still far from enough. With the Pentagon and CPA angsting about negative publicity, the gulf between theory and practise in the media war became apparent when ***Iraq Media Network*** head **Ahmed Al-Rikabi** resigned. Employed by the US-funded ***Radio Free Iraq***, Rikabi was recruited by the Americans in February to remake Iraq's broadcast media *(GSN 710/11)*. He won fame for reporting **Saddam Hussein**'s downfall but left complaining the CPA had no idea of media management, and not understanding television had badly under-resourced his operation. IMN journalists received only $120/month, compared to a minimum $500/month on other Arab stations, Rikabi said. The channel lacked funds to buy everything from enough cameras and news footage to presenters' suits.

Rikabi complained in London on 6-7 August that IMN was persistently trounced by broadcasters based outside Iraq, most notably ***Al-Jazeera Satellite Channel*** and newcomer ***Al-Arabiya Satellite News***, owned by the majority **Saudi**-owned, **Dubai**-based **Middle East News**, also proprietor of ***Middle East Broadcasting Center (MBC)***. Both channels have been recipients of recent **Saddam Hussein** videos and their film crews have complained at intimidation by Coailition forces in Iraq. Rikabi's complaint was that his small team did not even have the resources to get out and compete with these new global media players.

Of the 55 most wanted Iraqis identified by the USA, 37 are now either in custody or dead.

Spreading the news

The Pentagon is intent on communicating news of these tactical successes as broadly as it can, but still lacks an effective means of communicating with the Iraqi people.

In a report sponsored by the Pentagon, the Washington-based ***Centre for Strategic and International Studies (CSIS)*** recently highlighted the lack of US media operations in Iraq as the key deficit in winning hearts and minds at a national level *(see box)*.

GSN has learned that Pentagon Office of Special Plans Senior Advisor **Abe Shulsky** has been investigating ways in which sympathetic journalists can be encouraged to raise the profile of Coalition successes in the domestic US media. The result is likely to be increased provision of military escorts for journalists to visit perceived success-stories such as the US- and **UK**-supported local leaderships in Kut and Amarah.

SAUDI ARABIA: Saudi-US Relations Suffer Over Report

Saudi Foreign Minister **Prince Saud Al-Faisal**'s public anger at US President **George W Bush** over the recent Congressional report on the 11 September 2001 terrorist attacks underlined the recent low ebb in US/Saudi relations *(GSN 715/5; 712/4)*. The foreign minister is unhappy at Bush's refusal to declassify 28 pages of the report. The Saudis think Bush's move implies they are guilty of connivance in the 9/11 attacks, without giving them the right to respond.

As was expected, the report suggested that at least two well-connected Saudi citizens implicated in the attacks had developed a complex web of financial relationships with various parties, allegedly including Saudi government officials. In the 28 pages cut from the public reports but widely leaked to the press it was suggested that **Omar Al-Bayoumi** and **Osama Bassnan** were probably Saudi intelligence agents and may have reported to Saudi government officials. An unclassified part of the report said that one of the ***FBI***'s best sources in San Diego informed the FBI that he thought that Al-Bayoumi must be an intelligence officer. The report observed: "Despite the fact that he was a student, Al-Bayoumi had access to seemingly unlimited funding from Saudi Arabia."

In this highly charged atmosphere, the Saudis have let in a senior US delegation, led by State Department counterterrorism co-ordinator **Cofer Black**, to further investigate allegations of terrorist funding.

UK Foreign Office Reaches Out For Arab Reform

CONCERNED ABOUT BRITAIN'S IMAGE in the Arab world and hoping to retain a hand in the course of Arab reform, the Foreign and Commonwealth Office (FCO) is setting up a special unit to monitor Arab reform issues and develop UK thinking on how to deal with it. This autumn will see the assignment of dedicated specialist staff to **Bahrain** and Cairo, backed up from a central office in London. Ministers signed off on a strategy paper laying the basis for the new unit in late July.

The new unit will have the job of developing ideas on how the UK should work with the process of reform now gaining ground in a number of Arab countries, particularly in the Gulf. It will also be asked to work out ideas for improving the UK's battered image in the region. The FCO is concerned that **Tony Blair**'s Britain is widely perceived as being a Christian country that regards Muslims with wariness, according to an official of the new unit.

The role of the new Arab Reform team will largely be to listen and to evolve ideas for circulation within the Foreign Office itself, but not to engage in the active promotion of any particular political model. The FCO is firmly convinced that the process of reform has to be driven from within the Arab world itself and that it cannot be fostered by active Western advocacy of a specific agenda.

If asked by Arab governments, the new unit will be available to suggest ways in which the UK might help, through expertise, contacts or visits. But the British government is keen to avoid being seen as an active proponent of reform policies. The new unit will not proselytise or tell Arab governments what the UK thinks they should do. London believes it is important to avoid pushing for rushed reforms that might destabilise a country or fail to take root because they were hurried in response to external pressure, the official said.

Much of the new team's work will be concerned with the development of initiatives that the British government itself could take up, to encourage dialogue with Arab countries, break down stereotypes and enhance Middle Eastern understanding of the UK and British understanding of the Arab world.

From the other direction, the FCO wants to achieve better Arab understanding of the essentially non-religious character of today's Britain – where, in a multi-cultural society, people are defined by their job or official position and not by their religious allegiance (if they happen to have one).

New speed of reform

Underlying the decision to create the new unit is the FCO's recognition that Arab reform is emerging as an important new phenomenon, for which the UK has yet to develop a clear strategy. Indeed, the new team are to a large extent being invited to develop this strategy and to work out what their own role as a unit should be. This is not a short-term initiative to cope with the immediate regional aftermath of the war in **Iraq**, according to the FCO, but is envisaged as a permanent addition to its capacity.

In contrast to many other foreign policy areas – such as human rights or relations with African, Caribbean and Pacific countries, on which co-ordinated **European Union** action has become a major tool of diplomatic strategy – the task of developing a strategy towards Arab reform is seen as essentially a bilateral challenge for now, rather than something to be negotiated among EU member states.

That, to some extent, may reflect the fact that in parts of the region, such as the smaller Arab Gulf states, it is primarily the UK, and to a lesser extent, **France**, who are the significant foreign policy players. The creation of the FCO Arab Reform unit will leave the UK well-placed at the centre of the stage in shaping common EU approaches, where these do eventually evolve.

Ears to the ground

The new team will be practical and low-key in style. Experienced Arabist diplomats of first secretary rank will be appointed to Bahrain and Cairo – where they will be based in British embassies but not part of the normal embassy staff handling bilateral relations. They will be supported by local staff and have substantial travel budgets, so they can get out around the region, making contacts and keeping an ear to the ground.

Back in London there will be a central team at the FCO, managed by a second secretary. In staffing terms, this will represent about six new posts, a considerable investment in FCO terms. The Bahrain- and Cairo-based diplomats will be encouraged to develop their own ideas of what the team should do. But they are likely to attend conferences, develop a wide range of contacts, speak at events, and work on ideas for developing Arab-UK dialogue and "public diplomacy" to enhance Britain's image in the Arab world.

Global Opportunities Fund initiative

If they want to arrange visits and conference invitations, academic exchanges and so on, they will be able to tap into the FCO's new Global Opportunities Fund, which has been set up to finance UK foreign policy work, contacts and diplomacy in five key priority areas. One of the Fund's five action themes is engagement with the Islamic world.

The FCO has been interested by the "dialogue of civilisations" theme put forward by Iran's President **Mohammad Khatami** and subsequently developed into an important ***United Nations*** document, which many countries have supported. Some £2m from the new fund has been allocated for engagement with Islamic countries in 2003. The initial focus will be on the Middle East and North Africa. But next year the budget will rise to £8m, and it should continue to increase after that, as the initiative widens out to encompass countries all around the world with substantial Muslim populations.

Changes At The FCO

The FCO has a new Director General, Political – **John Sawers**, newly returned from **Iraq**, where Prime Minister Tony Blair sent him (from **Egypt**, where he was ambassador) as **L Paul Bremer III** took over as **US** Administrator. In the FCO pecking order, he is only one step down from Permanent Under-secretary and Head of the Diplomatic Service **Sir Michael Jay**. Four departmental directors report to Sawers, including Middle East and North Africa Director **Edward Chaplin** – who himself has a new Deputy, **Jolyon Welsh**.

Sawers – widely seen as a very ***New Labour*** diplomat – won high official approval and media recognition for his performance in Baghdad. He has been replaced as Special Envoy to Iraq by another star performer, former British Ambassador to the ***United Nations*** **Sir Jeremy Greenstock**, who was to retire but has stayed on to perform a job which will tax to the full his experience as a diplomat and Arabist with a very positive profile in the USA.

Switch Of Princes Rebalances Power In Qatar

Far from spelling turmoil for the monarchy, the unexpected shift of princes in Qatar on 5 August will more likely lead to more robust government on the peninsula, and could strengthen the position of **Emir Sheikh Hamad Bin Khalifa Al-Thani** and his family *(GSN 708/10)*.

Sheikh Hamad broke off a holiday in **France** to fly home and appoint the new Crown Prince, **Sheikh Tamim Bin Hamad Al-Thani**. Sheikh Tamim, 24, replaces his older brother, the 25-year-old **Sheikh Jassim Bin Hamad**, who had recently been rumoured to be on the way out – and who said on his exit that he had never wanted the job anyway *(see box)*. Sheikh Tamim, long a more enthusiastic student of politics than his sibling, had been shadowing Jassim and other top officials for some months. But the timing of the move came as a something of a surprise, even to well-connected observers of Qatari dynastic affairs.

Sheikh Hamad had found broad support for the move in recent days among members of the Al-Thani family and other leading Qataris. At a time of intense diplomatic activity, and with important domestic reforms under way, Sheikh Hamad seems finally to have concluded that he could no longer retain Sheikh Jassim – laid back in style and always a reluctant apprentice in government – as his official stand-in and designated successor.

Sheikh Tamim is known as a hard worker, a talented sportsman and a committed soldier who has served in Qatar's Commando Special Forces. He is popular with ordinary Qataris and is respected for his ability to handle responsibility; he is leading preparations to host the 2006 Asian Games, a hefty planning challenge. The hot summer months will provide Sheikh Tamim with a gentle introduction to his new task. As the new Crown Prince, he should at least inject a new sense of forward motion into the government as he is groomed for a role to which he seems well suited – or at least much better suited than his brother..

The Emir had been away from Doha for five weeks on a rare long holiday break when he made the surprise move. According to one former diplomat close to the family, Hamad became concerned at the management of state affairs during his absence, which prompted the move.

Sheikh Hamad had been travelling a great deal in recent months, and Jassim does not seem to have enjoyed the daily grind of serving as his proxy in government, chairing ministerial committees, reading state papers, and hosting the visits of the endless trail of diplomatic big guns.

Jassim and Tamim are sons of **Sheikha Mouza Bint Nasser Al-Misnad**, the most high-profile and ambitious of Sheikh Hamad's wives. A vigorous campaigner for a better educated Gulf élite, she is said to have been concerned at the contrast between Jassim and some of his counterparts, such as **Bahrain**'s **Crown Prince Sheikh Salman Bin Hamad Al-Khalifa** *(GSN 696/1)*.

Both Jassim and Tamim attended the English School in Doha, while pursuing Arabic and Islamic studies with a **Moroccan** tutor at home. They were then sent to England to attend ***Sherborne International School***, loosely connected with the well-known private boarding school ***Sherborne***. But Jassim completed only one year before moving on to the ***Royal Military Academy Sandhurst***'s one-year officer's course. Tamim spent two years at Sherborne International and then a year at ***Harrow School*** before following his brother to Sandhurst, where he did particularly well; back home, spared the sporting injuries that have troubled his brother, he became a good amateur tennis player and had the physical and mental fortitude to join the Special Forces.

Spinning The Qatar Succession Switch

Not the least striking aspect of the way the 5 August switch in Qatari crown princes was handled is the way the personalities themselves presented the matter to local media. **Sheikh Jassim Bin Hamad** himself appeared on television to address Qataris, making no secret of the extent to which he had felt uncomfortable in the role of crown prince – though he had soldiered on until **Sheikh Tamim Bin Hamad** was ready to take over. He revealed that Tamim had been studying and working in preparation for the job for the past two years. In reporting the event, the official ***Qatar News Agency (QNA)*** was even more direct: "With thousands of people glued to television screens and with speculative reports doing the rounds in a section of the foreign media, Sheikh Jassim, the Emir's third son, very plainly said he never wanted to be the Heir Apparent in the first place," it reported.

Emir Sheikh Hamad also made an announcement, regretting Jassim's decision to quit. His insistence that he had repeatedly tried to persuade Jassim to stay on may appear a touch too diplomatic. He wasted no time moving on to stress Tamim's qualities of "competence, goodness and sincerity".

The polite grace with which Jassim's resignation was handled represents a conscious attempt to buff the rough edges of what was inevitably an awkward moment, particularly for the outgoing crown prince himself. But the relative openness of the whole process represented something of an innovation in regional political culture. Indeed, the co-ordination of the various statements and the release of the text of Jassim's official resignation letter was reminiscent of the public relations touches that characterise reshuffles in European governments. In this way, at least, Qatar can point to progress in political reform.

Jassim is known around Doha for his great charm and lively circle of friends. He is widely liked, but it is Tamim who stands out as capable, tough and diligent. Insiders say Tamim will have the strength to stand up to the other powerful Al-Thanis, such as Foreign Minister **Sheikh Hamad Bin Jassim**, who has good relations with both young men and remains hugely influential. "He'll be a power behind any throne," the ex-diplomat said of Hamad Bin Jassim.

TOWARDS A SMOOTHER SUCCESSION?

When Sheikh Hamad seized the throne from his father in 1995, he told his children that it might be ten years before he chose an heir. They would have to show what they could do and compete for the post. But the Emir learnt soon after that he was seriously ill and would have to travel to the **USA** for a kidney transplant. He had already survived one failed putsch that had sought to restore his father, **Sheikh Khalifa Bin Hamad**, and was worried about further plotting by the old man's supporters in **Saudi Arabia** and the **UAE**. Feeling he could not leave the country without naming one of his own sons as official successor, Sheikh Hamad appointed Jassim in October 1996, hoping to minimise the risk of further rivalries.

Two older brothers by Sheikh Hamad's first wife were not deemed suitable. One appeared to lack any interest in government, while the other had Islamist sympathies. Jassim assumed the job only reluctantly, out of a sense of duty, sources say. He later asked to be relieved, but was asked to stay on while the new heir completed his preparation.

Surrendering the prestige of the Crown Prince's role cannot have been easy for Jassim, even if he never really wanted the job. It seems likely that Sheikh Hamad will seek to find him an alternative role with prestige attached; one possible avenue could be to focus on the environment, a subject about which he cares strongly.

For Sheikh Hamad, the succession decision was also difficult. But he has often been ready to take a tough line with his children. To widespread astonishment, he once agreed to the expulsion of one of his sons from the prestigious Qatar Academy, set up by Sheikha Mooza herself. The boy had been accused of bullying classmates.

Abu Dhabi's Khalifa Steps Out But Treads Carefully At Home

With the UAE's President convalescing from a hernia operation in **Switzerland**, the summer will provide **Crown Prince Sheikh Khalifa Bin Zayed Al-Nahayan** of **Abu Dhabi** the chance to establish his leadership credentials with the public at home and with foreign partners. The presumptive heir to the UAE presidency, Sheikh Khalifa has been steadily raising his international profile as *de facto* head of the federal government for some time now. But he will have to step carefully if he is to show a strong enough hand abroad and at the same time build support at home, where his father, **Sheikh Zayed Bin Sultan Al-Nahayan**, enjoys a reverential following.

But there are signs that the balance of power may be shifting. The Crown Prince has long been responsible for many day-to-day decisions at the federal level, especially on the economic front. Abu Dhabi insiders have known for years that his is generally the crucial opinion that must be won over. But on purely political matters and on issues of foreign policy, Sheikh Khalifa's weight has been significant only behind closed doors, with the outward appearance of power remaining with Sheikh Zayed.

That may now be changing. In recent months, Sheikh Khalifa has presented himself as increasingly ready to take the lead in international affairs, rather than playing the role of adjutant to Sheikh Zayed. But as he begins the process of eclipsing his ailing father, the Crown Prince will need to tread carefully so as not to lose the support of any part of the Emirati political spectrum as he quietly consolidates power against the day when the presidency will be his.

The developing tone of Sheikh Khalifa's role was most overtly demonstrated by his visit to **France** and the **UK** in June. At the heart of his agenda were the big foreign policy issues: **Iraq**, **Iran**, the Gulf region, the Middle East and terrorism. The Crown Prince held talks with French President **Jacques Chirac** and UK Prime Minister **Tony Blair**

Sheikh Khalifa's European Agenda

For the man who makes the **UAE**'s big defence procurement decisions, industrial and military expertise is a key theme in the European relations volume of his encyclopaedia, titled *Systematic Foundation and Construction*. Sheikh Khalifa's meetings with **Spain**'s Chief of Staff and Defence Minister are noted in the encyclopaedia's second volume, and military issues inevitably occupy a slot in the coverage of relations with **France**, which has always been a major supplier. Relations with **Germany**, **Italy**, **the Netherlands** and **Belgium** also get a mention.

But in the ***Zayed Centre***'s promotion of the book, it is Spain that is singled out for special attention. Partly, it seems, because of Madrid's long-standing concern for the **Palestinians**, the UAE has asked the Spaniards to convince fellow members of the ***European Union*** "to adopt more realistic attitudes with regard to Arab affairs, and to focus on the positive action that would lead to secure peace and security in the Middle East and the Gulf area." Spain is seen as a reliable ally in maintaining Europe's strong focus on Palestinian rights. The UAE may also be hoping Spain might persuade other European governments to ease up on the political aspect of EU talks with the ***Gulf Co-operation Council***.

UAE's Policy Doubts, Business Ambitions In Iraq

With their ports and trading capabilities, the Emirates expect to play a major role as a supply hub and entrepôt for the reviving Iraqi economy and a logistics base for some of the reconstruction effort. Corporate clients have entered the UAE real estate market leasing accommodation for the families of employees deployed to Iraqi reconstruction projects.

Politically, the UAE is clearly ill at ease with Iraq's occupied status. It is keen to see the country normalised as part of the Arab world. **Crown Prince Sheikh Khalifa** said as much in an interview with *Asharq Al-Awsat* in June: the war was still casting heavy shadows in the Middle East, creating a state of imbalance that would only end when Baghdad returned to the Arab, regional and international fold, he said.

On the prospect of Iraqi entry to the ***Gulf Co-operation Council***, the **Abu Dhabi** Crown Prince made positive noises without actually committing the UAE to a firm view. Clearly, adjusting Iraq to the GCC's common defence strategy, emergent open trading zone and proposed single currency would pose big challenges. But for the smaller members, Iraq's membership could prove a useful counterweight to the dominance of **Saudi Arabia**.

and accorded a major interview to the London-based Arab daily *Asharq Al-Awsat*.

The Paris/London trip and the manner in which it was promoted attracted a measure of media attention *(GSN 712/20)*. But a clue to Khalifa's growing international ambitions had slipped out a few months before, when the ***Zayed International Centre for Co-ordination and Follow-Up***, a government-backed think-tank, published the second volume of *Systematic Foundation and Construction*, his "encyclopaedia". Its theme was the development of relations with Europe.

Volume One, published in 2001, set out Sheikh Khalifa's general philosophy and career. Last December, the Centre published *Determination and Strength*, in which he set out his strategy for economic development and employment training – issues at the heart of his longstanding role as *de facto* keeper of the UAE's purse-strings.

The encyclopaedia's second volume, with European relations as its subject, seems to have been designed to prepare the ground for the Prince's subsequent visits to London and Paris. The book and the trip represent a modest step towards establishing Khalifa as a foreign policy player in his own right.

New Face Abroad, Same Foreign Policies

Sheikh Zayed continues to play an active public role. But it is, these days, largely a ceremonial one – meeting and greeting visitors, keeping in touch with the emirati public and casting an eye on pet projects such as afforestation.

Sheikh Zayed's 10 July hernia operation in Geneva was at least the third major surgical procedure the President has undergone in recent years. He is thought to be 85 years old. In September 1996 doctors operated on his neck and in 2000 he underwent a kidney transplant – after which he staged an impressive recovery. His discharge from hospital on 24 July, after the hernia treatment, led to open celebrations in Abu Dhabi.

While Zayed remains the figurehead, it is Khalifa who is increasingly the public face as well as the engineer of government – for international affairs now as well as the domestic agenda, handling many of the routine diplomatic calls, such as a recent chat with **US** Ambassador **Marcelle Wahba** in Abu Dhabi.

In policy terms, Sheikh Khalifa's enhanced role is not bringing a dramatic change. **Palestine** remains a major concern, while the UAE continues to support the "war on terror". Having kept its public distance from the US/UK invasion – to pragmatically adapt to the new Iraq *(see box)*.

At the same time, Khalifa has taken steps to avoid pushing Iran back into isolation and strengthen the hand of hard-line conservative nationalists in Tehran. He studiously avoided deploying angry language over the Iranian occupation of the disputed islands of Abu Musa, and the Greater and Lesser Tunbs. Iran's President **Mohammad Khatami** has accepted an invitation to visit the UAE and has been in telephone contact with Sheikh Zayed.

The Domestic Challenge

Within the UAE, Sheikh Khalifa seems happy to be seen as a moderate conservative, but faces greater challenges in emerging from his father's shadow.

On economics and procurement, where Abu Dhabi's spending clout holds sway, the Crown Prince enjoys relative freedom to set the course, and on foreign policy he is beginning to mark out his personal role. But when it comes to domestic constitutional and political issues, Sheikh Khalifa is not yet in a position to lead from the front.

Because of the unique personal prestige that has cushioned Sheikh Zayed, the Crown Prince must cautiously build consensus on domestic issues to overcome other Emirates' potential resentment at his growing pre-eminence, and balance potential domestic rivals such as the influential sons of Abu Dhabi's 'First Lady' **Sheikha Fatima Bint Mubarak** *(GSN 698/7)*. Sheikh Khalifa is well aware that he must take care to alienate neither modernisers nor conservatives, and to quietly build the base of national connections and support that will enhance his ability to lead in future.

Pressed to comment on reforms to the Federal National Council, he pointed to a broad agenda for possible change, ranging from the way members are chosen and the question of women's membership to the powers of the assembly itself. But he was careful not to commit himself on anything, instead stressing the value of what already exists: "We shall avoid anything that might lead to what could be called a 'political show' at the expense of a cohesive political structure built by a prudent, far-sighted leadership," he said.

Centrepiece: Turkey's Role In Iraq

Ankara Reaches Out To The EU Via Washington

Turkish Foreign Minister **Abdallah Gul**'s late July mission to the **USA** brought high expectations for restored intimacy in Ankara's relationship with Washington. But sources tell *GSN* that although Gul was well received, the first visit by a senior Turkish official since before the Iraq war uncovered little on which the two countries could reach substantive agreement.

But while US requests for troop contributions have met only ambiguous responses – including one badly misjudged request for Turkish units to serve under the **British** in Basra – Turkey is beginning to show signs of withdrawing its military presence from northern **Iraq**. And Ankara's strong desire for ***European Union*** membership may lead it towards greater co-operation with the US-led reconstruction effort.

While the USA and Turkey had much to discuss concerning Iraq, US decision-makers were clearly not in the mood to make small talk during Gul's visit, and the Turkish official had little latitude to immediately respond to US requests for troops in Iraq. This relegated the trip to the status of a public relations exercise aimed primarily at restoring relations with the USA, while allowing Gul to air the views of the ***Justice and Development Party (AKP)*** and trumpet Turkey's ambitions to join the EU.

Gul met his US counterpart, Secretary of State **Colin Powell**. This was regarded by the Turks as an important step, after US/Turkish communications were snarled in the spring by a clamour of poorly co-ordinated voices that included unofficial intermediaries and officials of different levels.

Gul was well accommodated at the White House, which granted his requests to meet with senior figures such as Vice President **Richard Cheney** and National Security Advisor **Condoleezza Rice**. This provided the kind of high-level interface the AKP had sought to sell the visit as a success at home.

Also meeting with Gul were senior leaders at the Pentagon – consistently the most pro-Turkish arm of the US government – including Secretary of Defence **Donald Rumsfeld**. As their visits to Washington coincided, the Pentagon arranged for Gul to meet Coalition Provisional Authority (CPA) Administrator **L Paul Bremer III** as well.

Gul was ideally suited for the mission. Among an AKP leadership not known for its extensive foreign affairs experience or wealth of multi-lingual, well-travelled ministers, Gul is foreign-educated – at ***Exeter*** and ***London Universities*** – and worked at the Jeddah-based ***Islamic Development Bank*** in 1983-91. As Prime Minister during the Iraq war, Gul had great insight into the sequence of events that led to the 1 March parliamentary rejection of US basing in Turkey.

"They Will Be Gone"

Though Gul stuck to an unyielding line on Turkish operations in northern Iraq, recent moves have shown a greater willingness on Ankara's part to eventually wind down its military operations in the region.

US/Turkish military co-operation has been strained since the 4 July detention of 11 Turkish special forces operators in Sulaymaniyah – though both sides have written the incident off as the result of local officers' actions rather than government policy. At a closed-door speaking session, Gul took pains to underline the seriousness of the arrests, which were reportedly undertaken to prevent a Turkish special forces cell from assassinating a Kirkuk politician.

But one Turkish analyst with close connections to the Turkish General Staff told *GSN* that the cell was instead involved in providing arms and training to Turkmen activists in northern Iraq. "These special forces were not in Iraq to target **Kurdish** leaders," the analyst said. "The US found no written orders or planning materials in the safes. The Turkish military are very bureaucratic and would have issued orders that could have been held up as proof."

Nor was the US operation the result of an intelligence breakthrough concerning Turkish presence in the region. Kurdish leaders have long given tacit permission for the Turkish military to operate in their midst. The location and numbers of the special forces cell operating from the Sulaymaniyah safe-house was long known to the US, according to Gul. Although the Turkish government sought a pledge from the USA concerning the Iraqi Turkmen's political status, Gul is not thought to have won any special concessions for the minority.

In Washington, however, Gul communicated to the Pentagon what could be the first step in the process of Turkish military disengagement from northern Iraq. Following the 4 July incident, Turkey's civilian government convinced the General Staff to hand over control of Turkmen issues in northern Iraq to the Foreign Ministry and the ***Milli Istihbarat Teskilati (MIT)*** intelligence service. With safe-houses and cells of its own throughout the ***Kurdistan Regional Government*** zone, MIT is well-placed to provide the Foreign

Turkish Aid Flows More Easily On The Ground

Turkish Foreign Minister **Abdallah Gul** had a hard act to follow on his late-July visit to the **USA**. He had been preceded in mid-June by Turkey's Foreign Affairs Under-secretary **Ugur Ziyal** in a visit to the State Department. Where Gul's visit was largely symbolic and focused on confidence- and relationship-building measures, Ziyal arrived in Washington armed with a ten-page proposal underlining practical measures Turkey could take to assist the reconstruction of **Iraq,** including military aid such as logistical support and civilian overflight support for US forces in Iraq. Other proposals included infrastructure, hospitals, development assistance and the facilitation of civilian flights. Ankara offered specialist assistance in areas of Turkish expertise, such as the rapid establishment of cell-phone and computer networks.

Ziyal was warmly received, and the State Department at least felt that the Turkish offers were useful options for the possible further development by the Coalition Provisional Authority (CPA). Gul said Turkey had already begun facilitating the trans-shipment of 12m tonnes of supplies to the CPA, was involved in possible sustained supply operations to support US forces and was assisting with humanitarian aid. The political atmosphere in Turkey may make broader measures difficult or impossible to implement, but the logistical aid that Turkey is able to deliver could be a good indication of willingness as discussion of other arrangements moves forward.

Ministry with local intelligence.

In the face of growing military concern about Turkmen issues, time will tell whether the military follows through with its commitment. Convincing the military to leave the policing of northern Iraq to the **USA** – and to the federal Iraqi authorities, one day – will be an uphill struggle.

Turkish special forces have been operating in the north without internal oversight or Iraqi government interference for over a decade. One Turkish political-military analyst described them to *GSN* as "semi-autonomous".

While Gul would not be drawn into discussing operations in support of the Turkmen population, he did state that Turkish military presence in northern Iraq was linked to ongoing concerns about ***Kurdistan Workers Party (PKK)*** fighters operating from Iraq. On this issue, there are signs of movement that could see an end to all overt Turkish military presence in Iraqi Kurdistan. In June, new legislation passed by the AKP gave Turkish Kurds new freedoms to launch Kurdish-language television and radio stations and give their children Kurdish names. On 30 July, the AKP followed up these reforms by passing limited amnesty legislation for PKK returnees, reducing prison sentences and granting outright amnesty and right of return to some classes of returnee.

In return for such concessions, the Pentagon announced that US and Turkish special forces would co-operate on border security. US State Department Under-secretary **Marc Grossman** noted that any PKK cells not taking advantage of the amnesty would be pursued by US forces. In Grossman's blunt outlook, "they will be gone."

Out Of Step On Troops

Although the USA and Turkey made some progress on issues in northern Iraq, an unexpected result of Gul's visit was to cast the spotlight on US requests for Turkish troop contributions in the southern and central portions of the country

Before the war, Turkey had simply been one of dozens of countries to receive and return a questionnaire stating their capacity to provide peacekeeping forces in post-war Iraq. This non-binding outline of possible contributions has been replaced by a formal US request for troops, first issued by the new head of US Central Command (Centcom), Lieutenant General **John Abizaid**, in his 21 July visit to Turkey.

Turkey is one of the few countries capable of providing a large contingent – likely to be around 12,000-strong – without overtaxing its armed forces. **India**, another such country, declined to contribute until a new ***UN*** Resolution is passed to bolster the CPA's legitimacy.

Turkish forces would need to enjoy a degree of autonomy, possibly including a direct line of communication with Bremer. Sources in the Turkish policy community suggest that highly traditional Turkish officers would not take kindly to being subordinate to or at the same level as former Communist bloc commanders, particularly **Romanians**.

The US attitude to Turkish provision of troops is reminiscent of its ham-fisted approach to securing Turkish bases before the war. Abizaid's request came less than two weeks from the closure of Parliament in Turkey, and Washington decision-makers communicated to Gul that force contributions should be made as soon as possible. This left the AKP with the unpalatable choice of risking a hastily convened debate just before the closure of parliament, or calling an extraordinary session in the summer recess, which would greatly raise the profile of the debate. Either option is fraught with the potential for another parliamentary rejection of the US, while a debate during the new session of parliament in October may come too late.

As a result, the timing of Gul's visit places the AKP in a difficult position. Though it was partly meant to prepare the ground for a visit by Prime Minister **Recep Tayyip Erdogan** later this year, this is now unlikely to occur until the AKP government can formulate an answer for Washington on the issue of troops. This is a blow to the government, as it has come under intense criticism at home for its handling of pre-war relations with the USA.

To add salt to the wound, the US press and even the White House continue to intimate that Turkey is seeking payment for force contributions. The editorial board of the *Washington Post* met with Gul for breakfast on 25 July, after which the paper reported that the Foreign Minister had stressed the need to link commercial awards and economic benefits to the issue of troop contributions. Gul angrily denied the comments had been made, and Turkish delegation insiders told *GSN* that the mix-up resulted from Gul's imperfect grasp of English.

According to a source close to the AKP delegation in Washington, Condoleezza Rice was blunt with Gul, asking Turkey to either offer troops or decline, but warning the AKP to refrain from attempting to "bargain" on the issue. The ingrained characterisation of Turkish motivations as mercenary will be one of the hardest elements of US/Turkish relations to fix.

The Real Prize

Far from accentuating the importance of US/Turkish relations, Gul's visit instead highlighted Turkey's real foreign policy goal – securing EU membership. Gul used the US visit as a platform to underline the AKP's wide-ranging legislative programme and its characterisation as a reformist movement.

AKP representative on EU affairs **Murat Singar** recently stated: "We have crossed that threshold of the military blocking Turkey's pursuit of EU membership." Gul echoed these remarks, stating: "Our mind is very clear: we don't just want to join the EU, we want to speed up the process. Even if there was no EU, it would still be our duty to carry out reforms for the people."

"We own the reform process because of our absolute majority in parliament," Gul concluded.

This has been evident in the speedy passage of Kurdish reforms, PKK amnesty deals, and in the 31 July reform package, which reduced the powers of the military National Security Council, created new transparency in military spending and granted greater freedoms of speech and assembly.

The Turkish "deep state" – the military and intelligence establishment – has not interfered in these decisions. In some cases they may even have removed obstacles to US/Turkish relations. But as Ankara draws closer to Washington, it draws closer yet to Brussels – the real prize coveted by the AKP.

Finance And Policy

IMF Nudges GCC Currency Union Away From Dollar

Senior officials at the International Monetary Fund have begun gently encouraging Gulf Co-operation Council governments to look to a more flexible and broadly based exchange rate strategy, saying their current dollar-pegged currency regimes may eventually damp prospects for non-oil growth and slow the diversification crucial for sustainable development.

Moving away from a dollar peg would be a natural support to the Gulf states' long-term drive to reduce their dependence on oil markets by diversifying exports and broadening their employment base, say Middle East experts at the IMF. Through informal discussion and working documents, the Fund has been drawing attention to the possible benefits of a joint dollar/euro link, or a wider valuation basket, for the GCC single currency, planned to be in place by 2010.

The fund has not yet adopted an official policy stance on the issue – which has not yet been discussed at Executive Board level. But the IMF has made no secret of its enthusiasm for the proposed Gulf monetary union plan in general, and the issue of the future currency peg is moving centre stage as **Dubai** gets set to host the IMF/***World Bank*** Annual Meetings in September.

George Abed, outgoing head of the IMF's soon-to-be-reorganised Middle East department *(see box)*, has already set out his stall. In a recent *Working Paper*, he and two colleagues assessed options for future Gulf currency regimes. They concluded that the dollar link continues to serve GCC states well as an anchor for monetary stability, because of the region's heavy dependence on oil exports priced in dollars. They also pointed out that much of the GCC's non-oil trade and investment asset base was dollar-denominated, and reminded readers that the dollar peg had the virtue of familiarity for the region's policy-makers.

However, they warned that reliance on a pure dollar peg could undermine the competitiveness of the non-oil export sector – which is still relatively small but is crucial to hopes of diversification and job creation. It might thus make sense to bring the euro, gradually emerging as a major alternative international currency, into the exchange regime.

"As the share of non-oil exports and diversification into non-dollar assets increase over time, it may be desirable for the GCC currency union to move to a more flexible exchange rate regime," Abed stated in the paper. "Pegging to a dollar-euro basket may serve as an interim arrangement towards a more flexible exchange rate policy in the future."

But the paper cautioned that more time may be needed for the euro to prove itself as a competitive intervention and reserve currency. It suggested that a basket including, but not limited to, the dollar and euro "might serve as a cautious transitional strategy towards an even more flexible

IMF Reorganises Middle East

To better reflect the changing needs of its constituency – ie the World – the International Monetary Fund will reorganise its Middle East Department by 1 November, according to IMF Managing Director **Horst Kôhler**. With the countries of the Former Soviet Union rapidly being integrated into the global economy (and the ***European Union***), the IMF will dissolve its European II Department, placing seven of its 15 countries in European I (Western Europe), and the remainder in an expanded and renamed Middle East and Central Asia Department.

Middle East Department head **George Abed**, a **Jordanian**, will oversee the new department, but only until his retirement in December. Abed's replacement will be a **Pakistani**, **Mohsin Khan**, who will leave his post as Drector of the ***IMF Institute***.

exchange rate policy, as warranted by the speed and degree of diversification within the GCC zone". It pointed out that many countries, including some oil producers that have already managed to achieve a more diverse economic base – such as **Iran**, **Nigeria** and **Venezuela** – have moved to a floating exchange rate. But it suggested that GCC strategy should retain a strong dollar component.

Time Enough?

The currency peg issue was touched on when Abed and IMF Managing Director **Horst Kôhler** met GCC finance ministers and central bank governors in Doha in June, Fund insiders say – although it did not dominate the meeting. GCC governments have set 2005 as the deadline for adopting the criteria by which they will judge progress towards economic policy convergence.

In last December's edition of the IMF magazine *Finance & Development*, Assistant Director of the Fund's Middle East Department **Zubair Iqbal** and Deputy Division Chief **Ugo Fasano** set out a detailed agenda for GCC reform. They suggested the euro-zone could offer the Gulf states a useful model, when it comes to establishing a central bank or monetary authority.

They pointed to a host of technical differences between governments – on issues such as monetary instruments and bank regulation, commercial agency laws, industrial licensing, bankruptcy regulation and public sector procurement procedures. They noted that, outside **Saudi Arabia**, equity markets were "relatively small and undeveloped", while private securities markets had yet to develop and the evolution of government bond markets was hobbled.

"The GCC countries will need to make fundamental choices in designing an effective monetary union," Iqbal and Fasano warned, setting out a list of the key areas for decision – criteria for fiscal convergence, determining the common exchange rate policy, establishing a common central bank and monetary policy instruments, and shared data standards – together with the structural reforms needed to complement the new monetary union.

With such a crowded agenda to complete, the six and a half years remaining before the targeted launch date of the single currency looks no more than an adequate lead-time.

Achieving fiscal convergence should command the "highest priority", said the IMF staffers. Nor was this just a question of agreeing standard indicators, such as ceilings on government debts and deficits (including non-oil targets, to show underlying trends, outside of oil market volatility).

Because oil and gas are finite resources, governments would need to agree on a sensible balance between spending now and reserving assets for future generations. They would have to agree what fiscal action to take if faced by the "external shock" of a slump in oil sales or prices.

When it came to structural reforms, Iqbal and Fasano noted that, as Europe had found, a single currency does not in itself guarantee the integration of financial markets, without the completion of other harmonisation measures.

They also gently hinted that Gulf governments should not become over-reliant on employment quota targets for nationals as a way of getting them off the dole queue: "To increase job opportunities for nationals in the private sector, the GCC authorities should rely mainly on improving education and training." The politically sensitive unspoken message was that using quotas to impose recruitment of nationals would undermine efficiency and competitiveness.

Background Co-operation, Foreground Variation

Iqbal and Fasano said the planned monetary union would help GCC states in their efforts to reduce reliance on oil revenue and stimulate more diverse investment and activity. It would be likely to promote policy co-ordination, cut transaction costs and increase the transparency of pricing within the region. There might be only small direct gains from monetary union, such as a rise in trade. But indirect benefits could be more important, while the downside of union would be limited.

"The introduction of a common currency is likely to enhance growth prospects by contributing to the unification and development of the region's bond and equity markets and by improving the efficiency of financial services," argued Iqbal and Fasano. "The costs of monetary union to individual countries – such as giving up the ability to set an independent monetary policy and adjust the nominal exchange rate – should not be high because GCC countries have not relied on these tools for quite some time under their pegged exchange rate regimes." Moreover, trading regimes have been harmonised, with an open regional market and last January's adoption of a common external tariff.

But despite this background of co-operation, Gulf countries still exhibit big variations in policy and performance. Over the five years to 2001, average GDP growth ranged from less than 1% in

Kuwait to 10% in **Qatar**, while inflation ranged from negative 0.5% in **Oman** and Saudi Arabia to more than 2.5% in Qatar. The Qataris averaged a fiscal deficit of almost 5% of GDP, while Kuwait notched up 20% surpluses. If oil revenue is excluded, everyone was heavily in the red, but there were still substantial variations.

On the external account, Kuwait and the UAE were far more comfortably placed in surplus than their neighbours, while Saudi Arabia's government debt, at more than 90% of GDP, was much more burdensome than that of the smaller Gulf states.

SAUDI ARABIA: Corporates Set To Tap Funds After Sovereign Rating

Saudi Arabia's brand new sovereign debt rating from ***Standard & Poor's*** Middle East and Africa department could open the door for corporates to tap capital markets in coming months or years, providing an important new source of cash as the Kingdom seeks to continue the diversification of its economy and provide much-needed jobs for its growing population of unemployed. And rather than go to the capital markets itself, Saudi Arabia's high debt/GDP ratio could drop substantially by end-2003.

The mid-July rating, the Kingdom's first from S&P, grants the highest rating possible to short-term sovereign debt, and rates long-term debt at the lower end of the top of the scale. Long- and short-term local currency debt was rated A+/A-1, while long- and short-term foreign currency debt was rated A/A-1.

Though it is not Saudi Arabia's first debt rating – ***Moody's Investors Service*** gave the Kingdom's foreign currency debt a Baa2 ceiling, slightly lower than the S&P rating, but still investment grade – having the probing eyes of S&P monitoring the debt should reassure international investors, and may precede corporate ratings that could make private-sector issuance more attractive.

"The expectation of the Kingdom is that with the government having received a credit rating, there are other entities in both the public and private sectors that are interested in the global capital markets," S&P's managing director for sovereign ratings and international public finance **David Beers** said in an interview with *GSN*. Though he would not say what S&P was now looking into in the Kingdom, Beers added: "We would expect to see some of those entities getting rated by us in the future."

The sovereign burden

Although Saudi corporates could well go to the markets in the near future, the rating will probably have no impact on sovereign debt. The Kingdom now carries a whopping 95% debt/GDP ratio, but there is no external debt, and about 80% of government paper is held by pension funds and other government entities in medium- and long-term instruments, giving the country a "favourable" debt profile, along with substantial foreign exchange reserves and the government's sizeable domestic investments, according to S&P's report.

For these reasons, according to Beers, "there's no intention of the government engaging in any cross-border borrowing anytime soon." In fact, regional economists say Saudi debt levels could well drop. ***Citigroup***-managed ***Saudi American Bank***'s chief economist **Brad Bourland** sees Saudi sovereign debt falling to 80% of GDP by end-2003, thanks to strong growth and a possible decline in gross debt levels. "They'll need to stay on the course of fiscal adjustment and a bit of austerity for many years to get debt down to levels that are more prudent," Bourland told *GSN*.

S&P's report noted that low levels of non-oil sector private sector growth and the slow pace of political reform had constrained the Kingdom's rating somewhat. But S&P was happy with the direction of economic reforms already under way – though how quickly these are implemented remains to be seen. Saudi Arabia's rapidly growing workforce will be a key impetus for further economic reform. Although S&P sees Saudi GDP continuing to grow at 2-3%/yr in 2004-05, per capita income and real GDP is set to shrink over the next two years. This could add to the government's financing needs, depending on how the Kingdom addresses the heavy social burden that a growing population and rising unemployment would entail.

Opening For Business

Recent events have had government's attention focused elsewhere. Since the 12 May bombings, the Kingdom has been consumed with a security crackdown – but that has yet to hamper the pace of economic change. A new capital markets law was approved in June establishing a ***Saudi Securities and Exchange Commission*** that will license brokers and authorise securities offerings to the public, and set up a private sector ***Saudi Arabian Stock Exchange (SASE)*** to incorporate the Kingdom's long-standing securities depository and regulate the market.

That could boost foreign direct investment (FDI). Saudi Arabia enjoys the highest average foreign FDI flows and total FDI stock of any Arab country, but net flows were negative in 1999 and 2000, and have averaged only around $1bn/yr recently, despite the flight of Saudi capital from the **USA** post-9/11. Net flows to the Kingdom peaked at around $11.1bn in 1981.

The SASE will facilitate capital-raising at home and the process of privatisation. Total Saudi market capitalisation stands at about SAR477bn ($125bn) in 65 listed companies.

Risk Management Report — Oman

GSN Risk Grade — B/2-: Non-oil growth boosts economic outlook ahead of elections

Political And Social Developments

Overview: Oman remains stable ahead of elections planned for October with fewer of the security problems apparent in other Gulf states, leading *GSN* to hold Oman's political risk grade at B. While Sultan Qaboos Bin Saeed retains a tight grip on policy and security, he has proved one of the Gulf's more enlightened rulers and is happy to chart a course of gradual democratisation and promote the active role of women within Omani society. For this election, suffrage has been extended to all citizens over the age of 21.

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

Women's rights: Oman is a conservative Sultanate that has nevertheless promoted women's rights. In March, Sheikha Aisha Bint Khalfan Bin Jumiel Al-Siyabiah became the first female cabinet minister in the GCC when she was named president of the new National Authority for Industrial Craftsmanship. There are two women in the Majlis Al-Shura, with this level of representation expected to increase in October.

Security: Despite criticism of the government's pro-Western stance, and some sympathy for pan-Arab and pan-Islamic ideas, Oman has a deep-rooted tradition of tolerance and religious pluralism. The authorities allowed peaceful demonstrations during the war in Iraq. Job creation could become an issue if not continually addressed; an estimated 67,000 young Omanis will enter the workforce in 2003. Omanisation is seriously addressing this problem, if with some impact on competivity.

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

Economic Outlook

Overview: The economy is expected to shake off first-half blues and post GDP growth of 3-4.4% for 2003, prompting *GSN* to raise Oman's economic risk grade to 2-. The budget is based on oil at $20/bbl, but OPEC expects prices to hold through 2003. Omani crude averaged $24.29/bbl in 2002. The non-oil sector grew by 3.6% over 2002 and further growth is targeted – in tourism, fishing and natural gas-based industries. Declining oil production is a concern but investment is being encouraged to reverse a dip in output.

Finance: The 2003 budget envisages a OMR400m ($1.04bn) deficit, based on $20/bbl oil, with OMR2.6bn revenue and OMR3bn expenditure. Fiscal and current account surpluses were posted in 2002. Borrowing of OMR150m is expected in 2003, with a five-year Eurobond mooted in H2 by Central Bank of Oman. An OMR80m five-year government bond launched in early May was 25% over-subscribed, a further OMR80m issue was launched in July. The funds will be used for development projects. Bank consolidation is under way but structural weaknesses remain.

Liberalisation: Oman Telecommunications Company is to be split into three separate companies (land line service, mobiles, and internet), with 30% sold through an IPO by end-2003. The launch of a second GSM licence is being reviewed. Reforms planned to the 1994 Foreign Capital Investment Law would allow 100% foreign investment in banking and insurance, IT services and securities, up from 70% now, with 100% in economic development projects. Three power generation companies will be created for sale in 2003-04, plus one transmission and three distribution companies. Privatisation of the national grid is expected by 2004 with sector reform completed by 2005.

Oil production: Production including condensate is around 900,000 b/d. Main producer Petroleum Development Oman plans to invest $1.5bn to 2007 to boost output to 724,000 b/d by 2005 and 800,000 b/d by 2007. New enhanced recovery schemes are scheduled from 2004, starting with Harweel and Mukhaizna fields; this could push production costs to $8/bbl from $4 currently. Bidding for a three-block offshore licensing round closed 15 July. Awards are expected by end-2003.

OMAN: Key Projects

Oman LNG expansion: Japan's Chiyoda Corporation and Foster Wheeler were awarded the third LNG train construction contract for LNG shipments from 2006. A new shareholder structure has been put in place train three. Qalhat LNG includes Oman LNG, the government and Union Fenosa Gas. Two more trains are expected later. A $300m contract was signed in July for two new LNG vessels.

Salalah Free Trade Zone: Government technical committee and consultants working on implementation after project promoter pulled out.

Sohar refinery: JGC Corporation/Chiyoda $879m contract to complete a 125,000 b/d plant by Q2 06. Sohar Refinery Company has lined up ten prospective lead arrangers for $1.2bn 14-year financing, to include a $647m loan with standby, and two $261m tranches from Nippon Export & Investment Insurance and The Japan Bank for International Co-operation.

Sohar financings: Financings expected during 2003 include Sohar refinery, Sohar fertiliser plant (estimated $600m debt including German export credit) and Oman Polypropylene's planned $200m-250m plant.

Salalah port expansion: Bidding expected H2 03 for $150m project. Work includes expanding two deep-water berth and the existing breakwater.

Sohar IWPP: Tender expected in September for a 480-550MW, 30m g/d desalination plant. Advisory team includes Denton Wilde Sapte, Bank Muscat, Société Générale and Fichtner.

GSN Risk Grades

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

OMAN: Key Data and Forecasts

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

* Jan-Sep; ** Jan-Nov.
Source: Ministry of Finance, Muscat.

Qatar — Risk Management Report

GSN Risk Grade — B/2+: New Crown Prince strengthens government; econ prospects good

Political And Social Development

Overview: The early August announcement of a new Crown Prince and heir apparent caused a stir but does not suggest a wider power struggle within government *(see page 6)* and thus leads *GSN* to maintain Qatar's political risk grade at B. A draft constitution was approved by referendum in April. Elections are not expected until early 2004. Qatar appointed its first female cabinet minister in early May when Sheikha Bint Ahmed Al-Mahmoud became Education Minister.

Succession: Emir Sheikh Hamad bin Khalifa Al-Thani named his fourth son Sheikh Tamim as Crown Prince and heir apparent in early August after third son Sheikh Jassim announced his decision to stand down. Sheikh Jassim, who was appointed in 1996 shortly after a failed coup attempt, had never wanted the position and had taken the responsibility on only because of the sensitive circumstances. His replacement, Sheikh Tamim, is a year younger than his brother at 24 and like Sheikh Jassim and his father is Sandhurst educated. He has been shadowing the duties of the Emir and other top officials for the last couple of years and has also served as chairman of the Qatar National Olympic Committee.

Constitution: Draft constitution envisages a 45-member Shura Council two-thirds elected by universal suffrage of Qatari nationals aged 18 and over, with the remaining one-third appointed by the Emir. All bills must be passed by a two-thirds majority and endorsed by the Emir to become law. Although a significant move towards pluralism, it also enshrines power in Al-Thani hands. Political parties are not allowed. Expatriates do not have the right to vote but will benefit from equality before the law. A flood of women into politics may still be some way off. A Qatari woman made history by winning a seat in the Central Municipal Council elections in April.

External factors: As chair of the GCC and Organisation of Islamic Conference, Qatar continues to make its voice heard and maintains high-level contacts with the permanent UN Security Council members. The Al-Thani-sponsored Al-Jazeera Satellite Channel is a source of irritation to both Arab and Western governments. The station has come under heavy criticism from the US both during and after the war in Iraq, but this has not had a negative impact on Qatari/US relations.

Economic Outlook

Overview: The economic prospects look good, with strong fiscal and current account surpluses fuelled by a buoyant hydrocarbons sector and related infrastructure, leading *GSN* to maintain its risk grade of 2+. Ratings agency Standard & Poor's upgraded the country's long-term ratings to A+ in July. GDP forecasts vary but are positive. The Arab Monetary Fund has forecast growth of 5.8% in 2003, while the Central Bank of Qatar is predicting 8% growth. Inflation is expected to rise slightly from the 1% recorded in 2002. Total debt was around $16bn at end-2002.

Finances: In July, S&P upgraded Qatar's long-term sovereign credit and senior unsecured debt ratings to A+ and affirmed its A1 short-term currency ratings. S&P cited declining debt and debt service burdens, prudent fiscal policy and substantial external liquidity as supporting the ratings, but added that public sector external debt was still high. The 2003/04 budget has a $474m deficit, 4.8% down from 2002/03, based on a cautious $17/bbl average oil price. Part of any surplus will go to the Oil Stabilisation Fund. The budget envisages $5.9bn revenue and $6.4bn spending, with $1.69bn set aside for major projects. The government has made a significant allocation for the 2006 Asian Games. Doha Securities Market is performing well, rising 41.5% over the first seven months of the year.

Hydrocarbons: By 2007 Qatar aims to attract $4.7bn investment for the North Field gas development, $2.5bn for petrochemicals, $4.1bn to enlarge refineries and $825m for natural gas liquids. Ongoing downstream projects are estimated to account for only 27% of the North Field's more than 900tcf of gas reserves.

Liberalisation: Industries Qatar's IPO – from the merged state assets of Qatar Petrochemical Company, Qatar Fertiliser Company, Qatar Fuel Additives Company and Qatar Steel Company – was completed in early August. Although only open to local investors, demand was such that the IPO was increased to 30% of equity from 15%. Further IPOs can be expected, while 100% private ownership in the agriculture, and tourism sectors is mooted. Land ownership by foreigners will be permitted with the development of the planned West Bay man-made island project.

PALESTINE: Qatar could yet play an important role as a broker in the Middle East peace process. The Emir and Foreign Minister Sheikh Hamad bin Jassim keep a close dialogue with Palestinian Prime Minister Mahmoud Abbas; they recently met after Abbas's talks with US President George W Bush. Controversially for an Arab state, Qatar also maintains informal but not always secretive diplomatic contacts with Israel. In early May, high-profile talks between the Qatari and Israeli foreign ministers were held in Paris.

QATAR: Selected Economic Indicators
($ million)

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

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

Source: Central Bank of Qatar

QATAR: Key Projects

LNG: ConocoPhillips signed a preliminary agreement with Qatar Petroleum (QP) in July for a 7.5m t/yr Qatargas III project to supply the US market. A 15m t/yr Qatargas II LNG project is also being studied by QP and ExxonMobil, for first deliveries in 2007. At Ras Laffan, LNG capacity will reach 10m t/yr with RasGas' fourth train, for 2005 completion.

Petrochemical projects: FEED work on the $1.1bn Q-Chem II project is underway, with an EPC award expected mid-2004. The $1.62bn Q-Chem I project was inaugurated January 2003. Q-Chem II anticipates a 2007 start-up as does a planned $550m Qatofin low-density polyethylene project (partners QPC, France's Atofina and QP), and a $470m 1.3m t/y Ras Laffan ethane cracker, for which an EPC award is expected first half 2004.

GTL plants: Qatar says it hopes to become "the capital of gas-to-liquids". Six plants are envisaged for Ras Laffan. The most advanced, led by Sasol, closed a $700m financing in January 2003. Marathon Oil announced in June plans for a detailed study of a proposed 120,000 b/d plant. A FEED contract is expected this year for an ExxonMobil-led plant, while Shell is undertaking a feasibility study and ConocoPhilips and Sasol/Chevron are also looking at plants. Ivanhoe Energy has shelved its plans for a plant.

2006 Asian games: This major event implies massive infrastructure requirements, including a $233m sports complex in Doha, a $30m shooting range, and redevelopment of Doha's stadiums. Work has been accelerated. Consolidated Contractors International Company has a letter of intent for a $140m sports hall package.

MIDDLE EAST ENERGY

POLICY, RISK AND PROJECTS IN THE GULF AND LEVANT

OIL: Price Collapse?

Suggestions that **Iran** and **Saudi Arabia** might welcome an oil price collapse were given added credence in early August by Iranian Oil Minister **Bijan Namdar Zanganeh**. He said that if ***OPEC*** didn't obtain co-operation once **Iraqi** exports reached "significant" levels, "production increases by non-OPEC countries and a failure by OPEC to cut output while Iraqi oil returns to the market will see prices collapsing." Some analysts argue that Riyadh and Tehran now see mileage in a price collapse, as it would wipe out much of the non-OPEC market share gains achieved in the past two years. OPEC President **Qatar**'s **Abdallah Bin Hamad Al-Attiyah** said on 3 August that excess crude supplies in Q4 03 could lead the cartel to cut output at its 24 September meeting.

IRAQ: Indians Are Coming

India's ***ONGC GROUP*** is to drill an exploration well in the next few months. "We are waiting for a few clearances from the Iraqi administration. We hope to start drilling very soon," ***ONGC Videsh*** head **Atul Chandra**, said in early August. ONGC was awarded rights for Block 8 by the **Saddam Hussein** regime. ONGC officials who have visited Iraq said the Coalition Provisional Authority was likely to honour that contract.

IRAQ: Roll Out The Barrels

Upbeat news on revived crude production has been tempered by continuing sabotage to Iraqi oil infrastructure. A fire broke out on a pipeline to the Baiji refinery on 31 July and was only extinguished two days later. Residents reported seeing people tampering with the pipeline. The incident stoked fears about the reliability of restored output, which has been talked up by **US** and Iraq officials. Administrator **L Paul Bremer III** reported in early August that output had reached 1.2m b/d, of which 700,000-800,000 b/d would be available for export. *De facto* Oil Minister **Thamir Ghadhban** said production now at a sustained 1.5m b/d; he expected 300,000 b/d of Kirkuk crude to be available for export by end-August through the Kirkuk-Ceyhan pipeline.

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Summer Sun Holds Promise For GCC Power Projects

Independent power projects around the Gulf are seeing renewed interest this summer as exemplary successes in UAE and elsewhere spark new activity.

Taking a leaf from the book of regional private power pioneer **Abu Dhabi**, Gulf states are engaged in a frenzy of activity this summer to reinvigorate faltering independent power project (IPP) initiatives. From the leader that is ***Abu Dhabi Water and Electricity Authority (Adwea)*** to the relative laggards in **Kuwait** and, until recently, **Saudi Arabia**, new schemes on the drawing board attest to a revitalised confidence in the Gulf project market. Rather than let the dust gather this summer, governments have injected a welcome sense of dash into plans to plug the region's burgeoning electricity demand-supply gap.

Undaunted by tepid developer interest encountered on the $1.8bn Umm Al-Nar independent water and power project (IWPP) last autumn, Adwea on 2 July announced financial close on the scheme, breathlessly following it with an invitation of interest for the addition of 600-700MW of new generating capacity on its fifth planned IWPP at Mirfa, by a tight 21 August deadline.

Industry sources tell *MEE* that another major IWPP may soon be announced in the Emirate.

Adwea has set the benchmark high for other GCC authorities looking to play catch up.

But its four-and-counting IPP success rate is now regarded as the template to follow.

Saudi Arabia: Pressing Ahead

Saudi Arabia, after years of self-imposed paralysis, has torn up the form book with an aggressive summer play of its own. The signing of the Saudi gas initiative in June – which stripped out the labyrinthine downstream power and water components – has proved the catalyst to ratchet up the pace of electricity sector reform *(GSN 715/13)*.

Saudi Electricity Corporation (SEC) and partner ***Saline Water Conversion Corporation (SWCC)*** have now been able to put forward their own four-pronged IWPP scheme.

The newly formed ***Saudi Electricity and Water Company (SEWC)***, an offtake joint venture of SEC and SWCC, announced initial steps on 23 July for the privatisation of two electricity/desalination projects, at Shuaiba and Shaqiq. The Saudis are even looking to go further than Adwea in offering a bigger slice of the cake to foreign partners: the successful bidder is to take a 60% interest in the new project company, which is to execute the planned 700MW/176m g/d Shuaiba IWPP on a build-own-operate basis. Adwea has offered only a 40% stake in its four IWPPs.

The Shaqiq plant, also on the Red Sea coast, has a 700MW design capacity with 24m g/d of desal capacity. Expressions of interest were invited by 5 August – another sign that senior Saudis will be busy at home rather than in their traditional summer haunts of Knightsbridge and the Costa del Sol this year.

Riyadh's burst of activity was kicked off by the completion, after years of delay, of the 240MW IPP at Jubail. ***Siemens*** was nominated in mid-July to carry out the engineering, procurement and construction contract on the $170m scheme for ***Saudi Petrochemical Company (Sadaf)***. The project company is a joint venture of local private sector group ***National Power Company*** – backed by the powerful ***Al-Zamil Group*** – and **US** developer ***CMS Energy***. Although a "captive" plant – the offtaker is Sadaf alone – the conclusion of contract negotiations breaks a significant psychological barrier for the Kingdom. The Saudis are now in a position to boast their first true IPP.

Sadaf is not the only Saudi corporate pushing the IPP button. State oil company ***Saudi Aramco*** received bids at the end of June from two international developer consortium groups to execute four IPPs at Ras Tanura, Juaimah, Uthmaniah and Shedgum. The project calls for a total of 800MW of power to be installed, with proposed plants ranging from 140MW to 240MW. Leading the chase are the **UK**'s ***International Power (IP)*** – which sealed the Umm Al-Nar contract last year – and **Japan**'s ***Mitsubishi Corporation*** *(GSN 708/20)*.

Unlike major US developers ***AES***, CMS and ***PSEG Global***, IP kept its hat in the ring during the years of retreat and rationalisation since 2001. As IP's regional director **Ranald Spiers** told *MEE*, those who withdrew hoping for a smooth return to the Gulf in better times may face a rude awakening.

But there are signs – albeit tentative – of a slow return of blue-chip developers to the region. **Belgium**-based ***Tractebel***, which hastily pulled out of the Umm Al-Nar bidding last year, is said to have renewed appetite for Gulf project risk. And with the ***Islamic Development Bank*** now holding a one-third stake in AES' regional affiliate, even they may be back on the project trail soon.

Oman: Cross-pollination a possibility

Oman – which begat the Gulf's first IPP in the mid-1990s – is also back after a three-year hiatus. Abstinence has made Muscat's heart grow fonder with the Economy Ministry now moving ahead with a new IWPP at Sohar. The prequalification process got under way in earnest during July, with 20 firms responding to a solicitation of interest in the 480-550MW/30m g/d IWPP, due onstream from 2006.

Intriguingly, the Sultanate's Sohar industrial development has attracted Adwea's interest, raising the prospect of cross-pollination in Gulf power schemes. Adwea chiefs signed a memorandum of understanding with ***Oman Oil Company*** last year to invest jointly in two special purpose companies that will execute the project, comprising a 1,100MW captive power plant and a 500,000 t/yr aluminium smelter. The power plant – distinct from the new Sohar IWPP mooted by the government – might also supply the Omani grid, and eventually Abu Dhabi itself. Adwea officials are staying mum on further regional forays, but if the Omani venture reaps rewards, its transformation into a regional developer could be on the cards.

More ambitious plans to divest generating, transmission and distribution assets await progress on the regulatory front. Oman's attempts to push the wholesale privatisation of its unbundled electricity assets are contingent on the publication of the long-awaited sector law, which has yet to materialise.

Likewise, Abu Dhabi's attempts to lure private investors into the sector need a UAE-wide national grid to be in place before it has a realistic chance of success. But neither of these obstacles will prevent the relevant authorities from sponsoring their own IPP programmes.

Progress or pipe dreams from Bahrain to UAE?

The private power bug has also spread further north in the littoral, with **Bahrain** mulling private finance options for its power generation needs. A team of consultants led by ***Ernst & Young*** has been selected to advise on the electricity restructuring, along with technical consultants ***Lahmeyer International*** and US legal advisers. The team, appointed in early June, will review the sector and outline options for liberalisation, the establishment of an independent regulator and a new sector plan.

With power demand surging by 6%/yr, Bahrain's Ministry of Electricity & Water sees little alternative to bringing in private sector operators to expand capacity. Previously, Manama had given short shift to private development of electricity. But given the way the wind is turning, even the sceptics are being turned on to the BOT model.

There are always exceptions. Kuwait – where political battles have scarred previous government efforts at economic reform – has yet to unveil any serious plans at private participation. There have been mutterings that the planned 2,500MW Al-Zour plant might be structured as an IPP, but necessary regulatory reform looks a distant prospect at this juncture.

Dubai also remains firmly wedded to its state-led dirigism, despite neighbour Abu Dhabi's successful private-sector experimentation. This may change, however, if plans for a UAE national grid are realised. With bids due in August for the project to interconnect the five UAE power utilities, this may come sooner rather than later.

Qatar is another law unto itself, having largely accomplished the transfer of its state-held assets to the joint-stock ***Qatar Electricity & Water Company***. Unlike other Gulf states, its power generation needs also look largely sated; hence less need to pull in foreign developers. The focus of ***Qatar General Electricity & Water Corporation (Kahramaa)*** has therefore shifted to the possible sale of transmission and distribution assets. A study is looking at the sale of both electricity and water networks, the final link in the country's sector restructuring.

Another private operator got off the starting blocks this year, ***Ras Laffan Power Company***, in which US developer AES has the majority stake. Full plant commissioning of its 750MW and 40m g/d desal facility is slated for 2004.

Across the water, **Iran** has failed to match up to ambitious expectations talked up in recent years. Some ten IPPs remain on the table, but financial close looks some way off and the political risk involved is hardly persuasive to the dwindling band of international developers still on the prowl.

But project sources say Iran IPPs will happen, given time. European contractors are already participating in a project backed by ***Iran Power Plants Project Management Company*** for four power plants that would add more than 3,000MW to installed capacity, for a tidy $750m.

If a stable regulatory and legal framework can be worked up, IPPs may no longer appear the pipe dream of yore in Iran.

IOCs Show Renewed Interest In Project Kuwait

Within days of **Saudi Arabia**'s landmark upstream gas deal, signed with ***Royal Dutch/Shell*** and ***Total***, Kuwait got in on the act with a positive response from six international oil companies (IOCs) to the proposed Project Kuwait opening up its northern oilfields. The line-up comprises familiar faces: ***Kuwait Petroleum Corporation (KPC)*** drew responses from Shell and Total, ***BP*** and heavy-hitting **US** trio ***ExxonMobil***, ***ChevronTexaco*** and ***ConocoPhillips***.

The estimated $7bn Project Kuwait is designed to harness IOC investment to double oil production at the five northern fields – Rawdhatain, Sabriyah, Bahra, Abdali and Raqta – to 900,000 b/d over four years. KPC issued a draft in June of the proposed 20-year operating services agreement to be signed with the successful bidding groups.

The IOCs have been invited to form a three-member group from among the 17 companies pre-qualified for the position of non-operator. Bidding consortiums are to include an IOC as designated operator alongside the non-operators. At least four bidding consortiums – led by BP, ChevronTexaco, ***Shell*** and Exxon – are due to submit bids. Tipped to line up alongside ChevronTexaco will be Total, ***PetroCanada***, **Russia**'s ***Sibneft*** and **China**'s ***Sinopec***. BP's consortium is to comprise ***Occidental*** and ***ONGC*** of **India**.

The positive response followed a mid-July meeting convened by KPC in London, where KPC officials are understood to have detailed the operating process and the likely fiscal model.

The IOCs have been asked to proffer changes to the proposed service agreements by 18 August – like the Saudis, Kuwait is using the summer period to press ahead with its upstream opening. For Kuwait, this was prompted by the National Assembly's recess, which allows the government greater leeway to steamroller through Project Kuwait. This will be followed by submission of development plans by a 1 September deadline.

Opposition from the National Assembly, which has stymied progress on Project Kuwait over the past few years, will be less prominent given the greater numbers of pro-regime MPs in the newly elected chamber *(GSN 715/5)*. In any case, the Kuwaiti authorities have used the summer recess to put themselves in a position to present a final draft of the operating service agreement to the Parliament's Finance Committee.

But the government is not putting the cart before the horse. The final draft will still need to be sanctioned by the Committee before deals are inked with successful bidding consortia.

The twin Saudi and Kuwait upstream opening drives this summer – along with heightened **Iranian** activity at Bangestan and Azedegan – have injected a new sense of momentum into Middle East hydrocarbons investment prospects. The two governments' accelerated efforts are not coincidental. Both are capitalising on a shift in the political landscape – particularly apparent in Kuwait – to push the economic reform button.

Rivalry is another element in the mix, although Project Kuwait is a somewhat different beast to the Saudi gas deals. But neither opening is about to allow IOCs ownership of crude oil assets: in the Saudi Kingdom this was never on the cards, while in Kuwait a service contract model emerged, rather than an equity oil arrangement.

Gulf Currency Box

	$	£	€
Bahrain	0.3770	0.6020	0.4269
Iran	8230.0	12,968.2	8984.61
Iraq	0.3110	0.4998	0.3559
Jordan	0.7090	1.1393	0.8113
Kuwait	0.2998	0.4818	0.3431
Oman	0.3850	0.6188	0.4243
Qatar	3.6400	5.8491	4.1654
Saudi Arabia	3.7502	6.0262	4.2915
Syria	46.000	73.9174	52.6378
UAE	3.6730	5.9021	4.2032
Yemen	178.005	286.036	203.691

Source: Financial Times.

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Friendship Is One Thing, Business Another For The British In Oman

MUSCAT/LONDON—Sultan Qaboos Bin Saeed's extended visit to the UK this summer underlined enduring ties. The Sultan was on a private visit but still got in an impressive number of meetings with members of the British royal family, government and the private sector. Even so, there is much to do if the British are to retain their historic influence in Oman. Indeed, UK Ambassador **Stuart Laing** and senior Omani officials – including influential Commerce and Industry Minister **Maqbool Bin Ali Sultan**, a ***City University*** graduate – have felt it necessary to make a simple request to London, to send a British trade minister to Muscat. None has visited since 1994, despite the traditionally intimate commercial and strategic relationship. Maqbool made this point to Foreign Office Minister **Baroness Liz Symons**. An *Oman British Friendship Week*, postponed from April because of the Iraq war, is to be held on 4-10 October, providing a forum for business as well as social and cultural exchanges. So far the week's highlights are a planned Muscat Proms and a rare sporting event, the Oman Highland Games, which boast a Web site at *www.omanhighlandgames.com*.

On the military front, the UK has been visited by Oman's army, naval and air force commanders. Following Qaboos' early July reshuffle of senior officers, new Chief of Staff General **Ahmed Bin Hareth Bin Nasser Al-Nabhani** is expected to visit soon. Nabhani replaced **Khamis Bin Hamid Bin Salem Al-Kalbani**, who was killed in a 21 June car crash. At the same time, Qaboos named Brigadier General **Saeed Bin Nasser Al-Salemi** as Armed Forces Commander, with the rank of general. The British Embassy in Muscat now boasts a First Secretary for Defence Equipment Co-operation, seconded from the ***Defence Export Services Organisation***.

When the **US** Air Force quickly pulled out of Massira and Thumrait air bases in the two months after the Iraq war, it seemed symbolic that UK operatives took over prefabricated buildings vacated by the Americans in Seeb International Airport's military zone. The British remain, but US planners know they can quickly mobilise for modern warfare in the Sultanate – a point reinforced when Chairman of the Joint Chiefs of Staff General **Richard Myers** arrived in Oman on 30 July, following visits to **Afghanistan** and **Pakistan**. Oman's order for F16 jets pointed to a historic shift in the pattern of its procurement. However, British officials say that although the market has become "more competitive", there is "everything to play for". The Omanis have asked the Royal Air Force to provide trainers with F16 experience.

British contractors have been lining up for increased work from ***Royal Dutch/Shell***-led ***Petroleum Development Oman***, which has significantly increased its capital spending after severe reservoir management problems emerged in 2002, following several years of under-investment. UK firms also see big prospects in the water sector challenged by increasing demand, competition for resources with agriculture representing 91% of consumption, pollution, massive evaporation and saline intrusion. A Water Resources Master Plan, advised by ***Black & Veatch***, has been under development since the late 1990s. At present, only 27% of Omanis are served by waste and wastewater systems; the plan envisages that by 2020 around 97% will have access.

Banks with a big British profile, including ***HSBC*** and ***Standard Chartered Bank*** retain a significant position in an Omani banking sector only now emerging from a turbulent period. HSBC is understood to have suffered some internal problems at the Muscat branch it acquired in its ***British Bank of the Middle East*** takeover. But unlike Omani banks it has been able to make up losses from the collapse of **Ali Redha Darwish Al-Lawati**'s business empire *(GSN 698/18; 694/14)*. HSBC was able to seize and sell a London property belonging to the disgraced trader to cover its losses.

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