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Facing extremists, Saudi Arabia seeks middle ground

Squeezed between liberal critics and threats from the Islamist underground, the Kingdom is attempting to re-brand itself as a moderate state.

The announcement of local elections in Saudi Arabia *(GSN 720/6)* marks a break with past strategy for the Kingdom, and signals a new attempt by the country to position itself as a more moderate presence in the Middle East and Gulf region. But coming as it does in the midst of a spate of new terrorist threats and crackdowns, the move has perhaps not engendered the kind of plaudits and sympathy the Al-Sauds would have liked.

The latest development has been a new **UK** travel advisory suggesting that Britons not visit Saudi Arabia except for "essential business". Within hours of its issuance, travellers were changing their plans. The 24 October advisory came after British officials said they had received information that a terrorist attack was possibly "imminent" in the Kingdom. As the holy month of Ramadan approached, the **US** and **Australia** also warned that terrorist groups might strike again. According to a 25 October US advisory, "The Embassy continues to receive information that terrorist groups within the Kingdom are still active and planning future operations." American citizens were urged to be "particularly vigilant". But the US stopped short of echoing the UK's warning not to travel.

The UK advisory was preceded by reports that members of underground groups had been rounded up, having possessed a terrifying list of weapons and explosives, including around 50 explosive "suicide belts", which security officials said pointed to an *Al-Qaeda* link. Despite the new face that the Kingdom would like the world to see – and despite the crackdown orchestrated by Saudi Interior Minister **Prince Nayef Bin Abdelaziz** – the reports show just how real the threat remains, and just how much more needs to be done.

The costs of reform

The new round of crackdowns and terrorism warnings also followed unprecedented protests that shook the Kingdom in the week before the advisories were issued. Saudi liberals and officials were shocked that London-based Islamist dissident **Saad Al-Fagih** had developed significant reach via his London-based *Movement for Islamic Reform in Arabia (MIRA)* Web site and *Al-Islah* radio station and TV channel – mobilising around 500 people to demonstrate in Riyadh on 14 October *(GSN 720/6)*. Some 271 people were arrested at that demonstration, prompting a complaint from *Amnesty International*. The Interior Ministry said 83 of those arrested, including three women, were being investigated for staging the protest.

Prince Nayef and Higher Judiciary Council head **Sheikh Saleh Bin Mohammed Al- Luhaidan** have criticised the "demagogic" demonstrations, which Luhaidan said "amount to calls for strife, and to an attempt to spread vice and undermine security". But demonstrations are likely to continue, posing a significant challenge to Nayef's security forces and to **Crown Prince Abdallah Bin Abdelaziz**'s repositioning of Saudi Arabia as a more inclusive government.

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MIRA reported arrests around the Kingdom, including Dammam and Hail, and Fagih complained that the government jammed his radio station to stop a call for demonstrations in Riyadh, Jeddah and seven other cities on 23 October. Fagih is seen as a very canny media player, whose eloquence covers a tough Islamist agenda but who is tapping into much wider popular discontent and demands for change.

The stakes are high: ***Reuters*** quoted a senior State Department official as saying that if the US turned its back on the Kingdom, Saudi Arabia "could well see a ***Taliban***-type regime that would be full of conservative extremist elements". To avoid that end, the US would have to stick with Riyadh, but Saudi Arabia would also have to speed up social and legal reforms, and broader public participation in government to retain popular legitimacy.

Sidestepping a backlash

The authorities have announced local elections that liberal sources told *GSN* would be more far-reaching than was first suggested, including an opening to a partially elected Majlis Al-Shura (consultative council). According to this version of events, Crown Prince Abdallah and his team played down the elections' significance so as not to alienate conservatives. Potential opponents, most notably Second Deputy Prime Minister, Defence and Aviation Minister **Prince Sultan Bin Abdelaziz**, were diplomatically brought into the reform process *(GSN 719/7, 715/5, 713/10)*.

But liberals still fear a conservative backlash from within Al-Saud circles, as well as from hardcore Wahhabis and disaffected groups. The sympathies of such key players as Prince Nayef remain unknown, and it is Nayef's ministry that controls computer lists and the other state machinery essential to the success of elections.

Meanwhile US/Saudi relations will remain in the spotlight. Chairman of the ***National Commission on Terrorist Attacks Upon the United States***, former Republican governor of New Jersey **Thomas H Kean**, has suggested he could soon subpoena the White House and other executive agencies for intelligence documents linked to investigations of 11 September 2001. Some of these are believed to be compromising for Riyadh.

Image management

It was small wonder that Ambassador to London **Prince Turki Al-Faisal** was quick to express his frustration that the Saudi authorities had not been informed of British plans to issue the advisory. It came during a week when Turki had led an orchestrated effort to show that the Kingdom was serious about tackling terrorism and its support networks.

On 22 October, he took a big delegation to Whitehall for a conference, *Countering Terrorism: The Experience of the Kingdom of Saudi Arabia*, at the ***Royal United Services Institute (RUSI)***. An audience packed with London-based media, security and regional specialists heard new data on the Saudi crackdown: 600 arrested since May, mainly in the 15-25 age group; of these, 70-90 were set for trial, around 190 had been released and the rest were still being interrogated; some 3,500 preachers had been "re-educated" and some sacked from official mosques *(GSN 718/3)*.

The intention was to reverse negative perceptions, which have undermined Saudi/Western relationships. The Washington-based ***Centre for Strategic & International Studies***' **Anthony Cordesman** told the conference that there had been considerable improvement since the 12 May Riyadh bombings, and "much of the tension [in US relations] would never have existed if Saudi Arabia had not initially been in denial."

A statement from Prince Nayef said Saudi counter-terrorism measures were "crystal clear and cannot be denied by anyone except the cynical". Turki's delegation had a clear message to impart, and a passage from the Koran to support it. Prince Turki quoted the Prophet's assertion that members of the Islamic community were "people of the middle" – a source of moderation, not

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Big questions remain as Iraq donors step up commitments

Madrid has delivered–but delivered what? With more than $13bn pledged at the Iraq donor's conference in Spain, it remains to be seen whether the mechanisms are in place to put even this limited funding to use..

Donor countries in Madrid on 23-24 October pledged $13-$18bn in grants and loans for Iraq's reconstruction. With the $20bn already pledged by the **USA**, this should be at least enough money to allow major programmes to go ahead in 2004, provided the security situation allows.

However, key issues remain to be settled. How the money will be spent and by whom is a question fraught with potential conflict, and which would affect Iraq's development and its access to the further billions it will need for rebuilding.

Building on *United Nations* Security Council resolution 1511, passed the previous week, the Madrid conference effectively confirmed the legitimacy of the Interim Governing Council (IGC) as the interim embodiement of Iraq's sovereignty. A crucial signal came in UN Secretary-general **Kofi Annan**'s call for donor generosity. Over the summer Annan had made no secret of his concerns about political arrangements for Iraq. Setting those concerns aside has opened the door for multilateral agencies such as the ***World Bank*** and ***International Monetary Fund (IMF)*** to come in with commitments.

The World Bank is offering $3bn-5bn in funds, while the IMF can provide $850m in emergency assistance, followed by $850m-1.7bn/yr in 2004-05 under its regular facilities – a combined total of $2.5bn-4.25bn.

Gulf Arab states will also be substantial contributors – although nowhere near as big as Washington and the IGC would like. **Saudi Arabia** is putting up $500m in *Saudi Fund for Development* support and $500m in export credit – an interesting concept given the newness of Saudi export credit schemes and the limited scope for non-hydrocarbons exports.

Kuwait, which made clear it had already spent $1bn on humanitarian relief, is contributing an extra $500m. The **UAE** has offered $215m, while **Qatar** is providing $100m.

Offering an apparent olive branch to Washington, **Iran** is providing up to $300m in buyer and supplier credit, and offering electricity and gas supplies and the use of its oil export terminals for Iraqi crude – or a 350,000 b/d swap contract. The Islamic Republic wants to link its rail and road networks to those in Iraq and is willing to arrange for 100,000 religious tourists a year to visit the Shia holy sites, boosting the local economy in Najaf and Kerbala.

The *European Commission* has promised $235m. The biggest *EU* member bilateral contributors are key US allies: the **UK** ($496m), **Spain** ($300m) and **Italy** ($236m).

France and **Germany** did not pledge in Madrid, but have told the *United Nations Development Programme* – under the politically astute leadership of **Mark Malloch-Brown** – they will offer money later.

After the USA, **Japan** is the single biggest bilateral donor, with a $1.5bn grant for 2004 and $3.5bn in soft loans over 2005-07. **Canada**, though fiercely critical of past US policy, is nonetheless giving $300m. **South Korea** is contributing $200m. Many smaller or poorer countries, particularly in eastern Europe, are providing small sums, peacekeeping troops, training support or technical expertise. **Latvia**, for example, is offering archeological support from a team working on the Karnak temples in **Egypt**. **Vietnam** is offering technical personnel if other donors can pay for their accommodation.

Contracts ban for Saddam's business cronies

Individuals or companies indicted for illegal profiteering during the Saddam Hussein era will be barred from bidding for government contacts in the new Iraq, IGC Trade Minister **Ali Allawi** has announced. This could compromise some of the local firms who have already aligned themselves with **US** and other partners in the reconstruction effort.

"These are criminal activities that have led to the pauperisation of the country and the transfer of billions of dollars abroad," Allawi said during his visit to the Madrid donor's conference. He added that the Baghdad authorities already had a considerable "paper trail" of evidence showing how favoured groups and individuals had been involved in the looting of state assets.

Particularly during its latter years, the Hussein regime cemented the loyalty of key business players by according them privileged rights to handle smuggled goods or operate hugely profitable quasi-monopolies, which drained hard currency out of the economy. Allawi estimates that $3bn-5bn was lost through smuggling deals and other such illicit business operations. This figure is quite apart from the massive sums the minister believes to have been transferred abroad by the Hussein family over the past two decades. Allawi suggested this was in the area of $10bn-12bn.

Allawi insisted that the IGC would stick to strictly legal means in its efforts to recover money from abroad and pursue those involved. But once charges had been brought, those indicted would immediately be excluded from public sector procurement until the final verdict was known. "Where sufficient evidence exists to bring a case against these groups, we will do so, and we will expect the state not to deal with these groups until the courts decide," he said. "We will not allow the Iraqi economy to be turned over to semi-criminal gangs."

Allawi dismissed suggestions that the business purge would affect large numbers of people. Only a select band of major business "criminals" will be targeted. "They are small in number but large in intent," he told *GSN*. This decision to focus on a few top figures closely implicated in the regime is in line with the interim authorities' wider strategy. Ministers and governing council members canvassed by *GSN* indicated that there is no intention to penalise the vast majority of Iraqis–who had no choice but to make some compromises with the old system just to survive.

Structuring the funds

Most bilateral donor money will be paid into two trust funds, one run by the UNDP, for rapid disbursement of smallish sums for priority purposes, and one by the World Bank, for larger, long-term projects.

Iraqi oil money is channelled through the Development Fund for Iraq (DFI), which finances the interim government's current budget. The ***Arab Fund for Economic and Social Development***, IMF, UN and World Bank have now set up the long-awaited International Advisory and Monitoring Board, whose job it is to oversee the DFI's operation – which has effectively been under the control of the US-led Coalition Provisional Authority so far. The CPA also has its own budget.

Over coming weeks, a co-ordination committee bringing together Iraqis, the USA and the international organisations will finalise decisions over which funding channel will finance which projects and programmes. These will not be operational in time for the first EC disbursement, expected within weeks. So Brussels will pay this into an existing trust fund for post-conflict countries, which now has an Iraq window.

Contracts financed from the trust funds will be awarded under standard international competitive bidding rules – which accord some preference to Iraqi firms, but are otherwise neutral. The USA says it will not pay its $20bn into the trust funds. But it insists that its new Project Management Office will enforce transparent procurement procedures.

Saudi sabre-rattling jeopardises defence relations with the USA

A war of words involving Saudi Arabia and Israel has broken out over aircraft basing issues. It could spell further trouble for US/Saudi relations.

Military decision-makers in Riyadh appear to be enjoying the independence that has come from downgrading military relations with the Pentagon after Washington's decision in April to withdraw most US forces from the Kingdom and re-base them in **Qatar** *(GSN 709/3)*.

Contravening a long-standing agreement with the USA, Saudi Arabia in March deployed a number of advanced US-built F-15S aircraft at the north-western base at Tabuk, some 150km from Israel's southern port of Eilat – much to the **Israeli** General Staff's consternation.

Israel's subsequent request for the withdrawal of the aircraft – passed through US military channels to Riyadh – was summarily rebuffed. The Saudis followed up by going ahead with a long-planned series of combined arms exercises in the Red Sea, bordering the Gulf of Aqaba. The moves highlight Riyadh's new freedom, but the aftermath may well do further damage to Saudi Arabia's relations with the US Congress, jeopardising ongoing scheduled arms transfers, and making major new ones even less likely than they had been before.

Shrewd manoeuvring

Although the F-15S deployment only recently made the headlines, the issue began last March, when Saudi defence chiefs pulled a shrewd manoeuvre on their US Central Command (Centcom) counterparts. The ***Royal Saudi Air Force (RSAF)*** was at the time providing low-profile basing access to US special forces operating in **Iraq**'s western desert. Suggesting that the RSAF would provide local air cover for the US effort, the Saudis managed to get Centcom chiefs to acquiesce to a breach of a long-standing agreement that the Kingdom would refrain from basing F-15s at the King Faisal airbase in Tabuk.

One Centcom liaison to the Saudis told *GSN*: "We couldn't come up with a good reason to say no, and we needed the Saudi bases in a bad way." When the USA asked Riyadh to re-deploy the aircraft following the war, RSAF headquarters in Riyadh diplomatically ignored the requests.

Subsequent Israeli pressure on the USA has been intense. Israel Defence Force chief of staff, Lieutenant-General **Moshe Yaalon**, entered into an unofficial war of words with Saudi Deputy Defence Minister **Prince Khalid Bin Sultan** through the international press and US military intermediaries. General Yaalon outlined eye-catching Israeli concerns that a Saudi pilot or an ***Al-Qaeda*** terrorist might fly an F-15 into Israel and crash it into a building in a 9/11-style attack.

Israeli Ministry of Defence director-general Major General **Amos Yaron**, brought up the issue with US Deputy Secretary of Defence **Paul Wolfowitz** at a recent meeting.

The issue of Saudi basing is also likely to get some play during the late October session of the Joint US-Israel Political Military Group being held in Tel Aviv.

Significantly, this group is where Israel reviews US plans to transfer arms to Arab states and attempts to extract concessions from Washington – either in the form of military aid for Israel or reductions in the quality and quantity of arms transfers to the Arab world. The group influenced then-Secretary of Defence Harold Brown to make Saudi Arabia commit to basing the aircraft in the centre and east of the country in 1978, as part of the conditions leading to the original sale of 91 F-15C/D aircraft in 1981.

Sacrificing support

The effects of the deployment will likely be minimal in military terms. Israeli director of planning Major General **Giora Eliand** recently noted that the RSAF had little chance of penetrating

Israeli airspace. But fallout from the episode could have serious effects on US support sales to the Saudi F-15 fleet, and could affect other defence-related items as well.

The Saudi decision to keep the F-15S aircraft in Tabuk is a purely political gesture entailing reclamation of sovereign territory and an expression of independence. But the aircraft cannot remain at Tabuk indefinitely. Although the airbase has excellent wartime facilities, Tabuk is not a dedicated F-15 base in terms of hardened aircraft shelters, hangers, and other support infrastructure, and remains one of the least hospitable and most remote basing locations in Saudi Arabia.

The RSAF has preferred to use Saudi Arabia's geography to protect its valuable F-15 fleet from Israeli pre-emptive strikes. As a result, RSAF personnel and F-15 aircraft will likely move back to their main operating bases at Dharan, Khamis Mushayt, Riyadh and Taif as soon as political attention over the issue recedes. That could be too late. Following the US-Israeli military group meeting, the US Congress Joint International Relations Committee is likely to debate Saudi Arabia's violation of the conditions attached to the 1981 F-15 sale. The committee could decide to limit future arms sales or even curtail US support to the existing RSAF F-15 fleet.

Over 1,000 ***Boeing*** contractors working in partnership with a Boeing joint venture, ***Al-Salam Aircraft Company***, are required to support the F-15 fleet; over $2.6 billion has been spent on the fleet's maintenance in the last ten years. Without US support, the high-maintenance fleet would quickly fall into disrepair – as the RSAF found out in 2001 when it sharply reduced its spending on contractor support.

With Saudi Arabia currently mulling US avionics upgrades on the F-15C/D fleet, Riyadh may not have long to wait before finding out the price it will pay for the rare privilege of thumbing its nose at Israel.

UAE/IRAN

RAK shuffle pegged to Tunbs

The recent shuffle of princes in Ras Al-Khaimah (RAK) may have had more to do with the UAE's claims to the Tunb islands – long disputed with Iran – than with rebalancing the emirate's mix of business and politics, emirati sources now tell *GSN*. The June 14 removal of RAK's crown prince of 40 years, **Sheikh Khalid Bin Sakr Al-Qasimi**, in favour of his half-brother, **Sheikh Saud**, was at the time seen as an affirmation of Sheikh Saud's emphasis on business concerns over Sheikh Khalid's more reformist stance on social and political issues *(GSN 713/8, 707/11)*. But sources now say that domestic and international tensions over RAK's long-standing claim to the Greater and Lesser Tunb islands may have been what led RAK's 86-year-old ruler, **Sheikh Sakr Bin Mohammed Al-Qasimi**, to name Sheikh Saud crown prince. Sheikh Saud was reportedly able to persuade UAE President **Sheikh Zayed Bin Sultan Al-Nahayan** to sign off on the switch by pointing to Sheikh Khalid's increasingly inconvenient stance on the Tunbs, which have been occupied by Iranian forces since the 1970s, along with the island of Abu Musa.

According to this version of events, Sheikh Khalid had become convinced there were substantial oil reserves in the area of the islands, and had declined to sanction a number of economic development projects in favor of awaiting the revenues that Tunb oil would eventually bring, once the islands passed back into UAE and RAK hands.

Among the projects that got short shrift from Sheikh Khalid were tourism developments along the RAK coast that are now being promoted more vigorously by the entrepreneurial Sheikh Saud – who, not coincidentally, owns Al-Hamra Fort Hotel & Beach Resort and other foreigner-friendly locations.

In this context, Sheikh Khalid had become something of an embarrassment to **Abu Dhabi**: he had even refused the federal government's allocation of free electricity, preferring to pay RAK's way in order to make faster action on the islands more of a priority. Such moves made Abu Dhabi prepared to sanction Sheikh Saud's bid – not an action the conservative al-Nahayan leadership would take lightly.

Sheikh Saud now intends to focus RAK on business, and especially tourism. Expect more projects, more Dubai-style promotions – and possibly less heated rhetoric about the islands. Among those watching carefully will be naval suppliers: the UAE has lately sought to purchase warships and other equipment that could be useful should the Emirates try to retake the islands by force *(GSN 712/6, 679/6)*.

Sheikh Zayed returns to hospital

UAE president and **Abu Dhabi** ruler **Sheikh Zayed Bin Sultan Al-Nahayan** was flown to London for medical treatment in mid-October, suffering from a gall bladder complaint, according to official reports. Medical sources said an operation to remove some stones was successful.

This is at least the second hospitalisation of the year for Zayed. In July, it was reported he underwent a hernia operation, performed within hours of the octogenarian UAE leader's arrival in **Switzerland.** The Royal Court described it as "a complete success". Zayed visits Geneva most years to escape the UAE's intense summer heat. The president only returned home on 21 September.

Zayed spent a long period of time receiving medical treatment in 2001, bringing a huge entourage to the ***Mayo Clinic*** in Cleveland, Ohio. Besides pointing to a pattern of increasingly ill health, this slowed down government business as Al-Nahayan ministers, other key officials and notables effectively moved to the US for the duration.

Such episodes usually lead to resumed speculation about succession – which is widely expected to pass relatively seamlessly to **Crown Prince Sheikh Khalifa Bin Zayed** *(GSN 712/20)*.

When this will happen remains a great unknown. Sheikh Zayed tends to confound those who meet with him by displaying an energy that can put younger men to shame. Those who expect to see a sick man often leave reporting just how spry he remains, adding to the Zayed legend.

Iran's nuclear deal sends debate back to Bushehr

Striking Iran's nuclear deal was an important occasion for European diplomacy and a big step forward in tackling a major proliferation problem, but it has not definitively solved the question of Iran's nuclear ambitions. In Washington, hawks are re-assessing their options.

The agreement secured on 21 October by the big three European foreign ministers to suspend Iran's uranium enrichment reduces pressure on Tehran, but it only marks the end of the beginning for the nuclear crisis *(see page 16)*.

Iran's commitment to suspend its uranium enrichment programme – which was only uncovered by ***International Atomic Energy Agency (IAEA)*** inspectors in February – was a tactical sacrifice that has opened the potential for Iran to make significant gains on other issues *(GSN 719/5, 717/3)*. As **UK** Foreign Secretary **Jack Straw**, one of the triumvirate who brokered the deal, has pointed out, the European powers will now press Iran to make more concrete commitments.

With a majority of Iranians still apparently backing the Islamic Republic's nuclear programme, Tehran is expected to employ delaying tactics and Washington is expected to shift attention back to other proliferation concerns: the Bushehr nuclear reactor will again come under scrutiny *(see box)*, and the possibility of an Israeli air strike against the facility can still not be excluded.

Nevertheless, some things have changed with the 21 October accord, with Iran committing to "temporarily" and "voluntarily" suspend its uranium enrichment programme and agreeing – in principle but not in detail – to more intrusive IAEA inspections and to provide the international body with documents that trace the development of Iran's nuclear programme.

Hammering out details

The three strands of the agreement still require the development of detailed implementation programmes.

Iran has neither agreed to demolish the facilities at Natanz, nor to destroy enrichment centrifuges, effectively leaving the programme in a state of hibernation. Pinning down exactly what "suspension" will mean in practice is likely to be a lengthy process; if it is tightly defined, any efforts to covertly undertake enrichment activities will become a very dangerous move on Tehran's part. The vaguely worded agreement now needs to be followed by a detailed implementation schedule that discusses Iranian signing and ratification of the *Non-Proliferation Treaty Additional Protocol* (known as 93+2).

Signing up to 93+2 could take some time – perhaps two years to ratify – and Iran will be most likely to use this period to stall progress. The conservative Guardian Council may stymie the Majlis's (Parliament's) ratification of an agreement, even if President **Mohammed Khatami**'s government is ready to go ahead. This is particularly likely if the inspections threaten to open up sensitive regime security facilities in the way that *United Nations* inspections did in **Iraq**.

Perhaps most significantly in the near-term, Iran's agreement to provide an account of its nuclear programmes is a can of worms that Tehran may well wish it had not opened. On 23 October, Iran handed over documents pertaining to the nuclear programme, but the IAEA will undoubtedly prepare a list of deficiencies in this submittal, requiring further depositions. The IAEA will also wish to interview scientists.

The key effect of these steps will be to make further covert development of enrichment facilities or other weapons-related projects much harder. UN inspections in Iraq were highly effective at identifying gaps in the accounts provided by the Baathist state. Failure to account for missing scientists, programmes and funds is likely to be held up as evidence that Iran is continuing to develop covert weapons programmes.

Act Two beckons at Bushehr

If implemented, meaningful suspension of the uranium enrichment route represents a useful means of delaying Iranian nuclear breakout. The key benefit will be to once again make Iran dependent on international assistance in its overt nuclear industry. Using the enrichment route, Iran had full control of its nuclear fuel cycle with few safeguards – from mining the uranium ore, to milling and converting it to UF6 gas, to enriching and fabricating it into nuclear fuels or weapons cores.

The European deal could interdict this route, but only at the cost of accepting, and perhaps accelerating, the alternate route, that of reactor-based plutonium reprocessing. And with the uranium enrichment route apparently interdicted, all eyes will once again fall on plans to install **Russian**-built nuclear reactors at Bushehr. In an alarming development for Washington, the European trio signalled that Iranian suspension of enrichment could be rewarded by legitimising Iran's other nuclear programmes at Bushehr and by offering technical assistance, summoning up the spectre of a European/Russian axis supporting the development of Iranian nuclear reactors.

Russia had temporarily become a secondary actor in the Iranian nuclear drama: Tehran's closed nuclear fuel cycle meant that Russian completion of reactors at Bushehr and delivery of nuclear fuel no longer represented the critical proliferation risk.

As Act Two beckons, and if enrichment is halted, the reactors at Bushehr are again the key issue – their spent fuel will likely have to cool in Iran for 12-18 months after use, creating an opportunity for diversion into rudimentary clandestine reprocessing plants that can be quickly and covertly established.

Although light-water reactors such as the Bushehr models are not ideal for making weapons-grade plutonium, US research has shown that during their start-up cycle there exists a window of opportunity when uniquely high levels of plutonium-rich spent fuel are present. According to these calculations, after 12-15 months of operation, and a further 12-16 months of reprocessing, Iran could develop 50-75 small devices using its initial fuel load at Bushehr.

Thus far, Russian President **Vladimir Putin** has stuck to the commitment he made to the G-8, promising to negotiate tough restrictions on Iranian access to spent fuel. Since Washington has focused its attention on Iran, even Russian nuclear industry enthusiasts and ***Ministry of Atomic Energy (Minatom)*** lobbyists have relented from pressuring Putin about the near-term continuation of nuclear projects, accepting that delivery of nuclear fuels and Bushehr's completion will be delayed considerably until the diplomatic situation becomes clearer.

While nuclear co-operation is no longer viewed as the unblemished good that it was when Russo-Iranian nuclear ties reached their zenith in July 2002, there are signs that European support and the fracturing of global consensus on Iran's nuclear programmes could reactivate Minatom and Russian government interest in Bushehr. There would then be particularly strong pressure on Russia to provide nuclear assistance if European vendors were allowed to offer Iran the same.

Washington's options

The US response will become evident after the IAEA meets on 20 November, when it will evaluate whether Iranian disclosures leading up to the 31 October deadline had been satisfactory or require further depositions – the latter being almost certainly the case. At this point, the US may again seek to persuade IAEA members to recommend the Iranian case to the UN Security Council.

It is less clear what the US will do if, as nearly happened earlier this year, the IAEA takes this step. According to Washington counter-proliferation experts, Under-secretary of State for Arms Control John Bolton's office has given little thought to formulating a detailed US objective in such a scenario.

"US decision-makers have developed a process, but now they need an objective and an endgame," Henry Sokolski, executive director of the Nonproliferation Policy Education Center in Washington, told GSN.

Yet, there is no inter-agency consensus on what degree of Iranian disarmament will satisfy the US, short of tearing down all nuclear facilities, placing all new construction on hold, and implementing an intrusive inspections regime. Washington is also unclear about how to interact with the European triumvirate that negotiated the deal. The most likely measure Washington would take in the UN Security Council is to seek a resolution that invokes a new country-neutral amendment to the Non-Proliferation Treaty (NPT). This would revoke a country's right to withdraw from the NPT (and thus legally develop nuclear weapons) if they were in breach of the treaty. The IAEA could declare that Iran is now in this situation. This would not require the IAEA to bring the issue to the UN and would further constrict Iran's (and North Korea's) ability to reactivate its uranium enrichment or divert spent nuclear fuel to reprocessing without international censure.

Such a move would also free up the US to develop more overt military threats towards the Iranian programme, setting aside current concerns that any military threat could trigger Iran's perfectly legal withdrawal from the NPT on the permissible grounds that the US has threatened Iranian national security. In fact, Washington's next move could have as much of an impact on regional security as Iran's future compliance with the NPT and the 21 October deal.

US options at a glance: How Washington could seek to move the Iranian nuclear question forward

- **MULTILATERAL DIPLOMACY:** This track would see Washington driving the Europeans to designate tough implementation milestones for the vague 21 October statement of principles. Meanwhile, the USA would seek to persuade the ***IAEA*** to declare **Iran** in breach of the NPT and recommend the issue to the ***UN***. In what might be a separate UN resolution, the US could seek to change NPT rules to disallow legal withdrawal from the NPT if a country is in violation. The US would increase pressure on **Russia** to delay or cancel Bushehr's completion – or at least to press for very tight restrictions and delayed delivery of nuclear fuels.
- **MILITARY ACTION:** If Bushehr again becomes the key proliferation risk, military options in the US (and **Israel**) suddenly become a lot more feasible due to the reactor's known location and lack of effective defences. However, the counter-effect of strikes on Bushehr would still be devastating, including the potential for Iranian withdrawal from the NPT, and direct or indirect Iranian retaliation. Other military actions, such as interception of Russian nuclear technology and fuels, could also be attempted.
- **ACCELERATE REGIME CHANGE:** This option is attractive to many in the US Office of the Secretary of Defence who consider Iran ripe for political change. If nuclear progress can be delayed and regime change accelerated, the US could be left with either a democratic Iran (willing to disarm) or a nuclear Iran willing to normalise relations with the US and even Israel. Even US hawks recognise that, having failed to covertly support Iranian social groups and media since the Islamic Revolution, the US is poorly placed to foment a so-called velvet revolution – which in any case would doubtless turn very bloody. Instead, according to *GSN*'s observations at closed-door Washington meetings, US hawks are pinning their hopes on encouraging firmer US rhetorical support for regime change in Iran, and consider anything that might stir the body politic to be a bonus – including US military action against Iran's nuclear facilities.
- **GRAND BARGAIN:** The option of a package deal remains as remote as ever. The European package deal linked to a Trade and Co-operation Agreement calls for movement on four themes: nuclear programmes, human rights, terrorism and Middle East peace. But a US grand deal involving sanctions relief would require tougher milestones on the latter two, and would be viewed as a betrayal of Iranian reformers if it did not include calls for political reform. As the ***National Defence University***'s **Ray Takeyh** noted, "The Iranians have shown that they are willing to deal with the US case-by-case on individual issues, but with the US, it has to be all or nothing."

After elections, Oman faces challenge of reform

Sultan Qaboos Bin Saeed inaugurated the third session of Oman's joint majlis on 21 October with talk of the country's "enterprise in the field of democratic action", but although recent steps toward political reform in the Sultanate have looked good on paper, they have yet to satisfy a populace that would like more of a voice in the country's affairs.

Oman has long been known as a peaceable garden spot in a region given to big ambitions and occasional strife, but real reforms both political and economic will be needed before long if the sultanate is to avoid the kind of social and economic strains that have beset other Gulf monarchies.

The 4 October elections for the Majlis Al-Shura (consultative council) – the first conducted with universal suffrage for Omanis 21 and over – saw less than impressive voter turnout. Of the approximately 800,000 Omanis eligible to vote, some 262,000 registered, and less than 200,000 actually voted.

Sultan Qaboos was clearly hoping for more. Private sector employees were given a day's holiday if they could demonstrate they had voted, and the government mounted a huge get-out-and-vote campaign prior to the election *(GSN 719/4)* – though this was perhaps too little, too late.

Local critics also questioned the ban on campaigning in the media, which made it difficult for the 500-plus candidates to reach more people than they could shake hands with. Ultimately, though, the problem was lack of voter engagement, especially in the more liberal and educated precincts in and around Muscat. Though Omanis were pleased to get the vote – previous electorates have consisted of a small number of voters hand-picked by regional administrators – widespread scepticism about the council's effectiveness kept many away from the polls.

Small steps forward

The result is a council that should prove less pro-active than its predecessor, according to local political correspondents and Western diplomatic sources in Oman, a development that calls into question the efficacy of Sultan Qaboos's reforms.

Turnout was reportedly higher in the interior, where voters tend to support whoever the local leaders – themselves appointed by the government in Muscat – tell them to. Incumbents were forced out of many seats by term limits, and more than half the 83-member council consists of new faces. The two female incumbents held their seats *(GSN 720/4)*, though none of the 13 other women standing won their races.

Sultan Qaboos is seemingly more progressive than his citizens in this regard. He has said he would like more female Majlis members, has installed a number of women in senior government posts and earlier in 2003 appointed **Sheikha Aisha Bint Khalfan Bin Jameel Al-Sayabiyah** minister of the National Authority for Industrial Craftsmanship, the first female minister in any of the six *Gulf Co-operation Council* states.

Universal suffrage increases the Majlis's mandate, but the low turnout calls it into question. Other changes may give members more latitude: term limits have been lifted, and the term has been increased to four years, from three.

The idea that the Majlis Al-Shura might punch more weight because of its broadened mandate does not seem to have caught on among Majlis members, however. Sultan Qaboos also sounded a note of caution in his remarks, calling on the council to keep in mind the unity of the nation and the "responsible endeavour" they are charged with.

Two steps back?

One US-based Gulf analyst cast Oman as the one state in the region that is actually moving backward in terms of reform.

Economically, this is certainly the danger. Like the rest of the region, Oman struggles to find jobs for its growing population, though it does not have the same high levels of foreign workers as the **UAE**. Sultan Qaboos's "Omanisation" policy, however, has no strong direction, and the search for alternatives to oil revenues has been slow to get off the ground.

A major challenge will be *World Trade Organisation (WTO)* accession. As more and more sectors are opened to international competition, Gulf states will need to adopt more robust policies to keep domestic businesses healthy and competitive.

Oman's robust banking sector could be hit by accession should foreign banks – unfettered by the poor loan portfolios that have plagued some institutions in recent years *(see page 10)* – make a rapid entry. Of more immediate concern are the country's big trading concerns, which will find themselves competing with foreign dealers who are not constrained by family ties and other inefficient business practices.

One Western security analyst noted that while autocratic rule prevails throughout the Gulf, Oman – which has traditionally relied on a close relationship with the **UK** for what little military muscle it flexes – may not be as well placed to deal with much unrest as some other Gulf states. With at least some token movement toward reform already taken, Sultan Qaboos now has the chance to do much more. Which way Oman's future lies could depend on whether he takes it.

Omani boy, the pipes are calling

The close relations Oman enjoys with the **UK** were in evidence just after the opening of the Majlis, when UK Defence Secretary **Geoff Hoon** paid a cursory visit to Muscat on a late-October tour of the Gulf. He will be followed by **Prince Charles**, who will stop in Oman on 5-9 November, on his way back to England from **India**.

The UK views Oman as its toe-hold in the Gulf. The military relationship goes back to 1798, when the first treaty was signed providing British protection for the Sultanate. In fact, the Omani military is so Anglo-centric that its musical ensemble is the ***Royal Omani Mounted Police Camel Pipe Band***, led by **John Bruce**, the only Scot in a band of Omani pipers. Sultan Qaboos recently ordered a Scottish tartan for his army, according to *The Times* of London. The ***Scottish Tartans Authority*** is currently approving the design.

Spain looks for more influence in Middle East

Shrewd steps by the government have positioned Spain to try for a more substantial role in Middle East politics.

Prime Minister **José Maria Aznar** took the occasion of the 23-24 October **Iraq** donor's conference to set out an expanded role for his country, sending the message that Spain would henceforth be a player in Middle East issues.

While Aznar hosted donors in Madrid, his government was signalling its engagement with the wider Arab world, with an official visit by **King Juan Carlos** and **Queen Sofia** to **Syria**, **Bahrain** and **Qatar**. Aznar also chose the occasion to make a major speech on foreign and defence policy, setting out his vision for the role that "anticipatory action" could play in combating the threat of terrorism.

Faced with threats such as violent Islamist extremism, Aznar believes Western governments have to be prepared to intervene beforehand, provided the cause is right, the means proportional and the potential risks to innocent civilians are considered. His words sounded like a call to arms. But the next day, even the pro-government *El Mundo* newspaper warned him against signing up to **US** President **George W. Bush**'s doctrine of unprovoked pre-emptive military action.

Spain is at the southern fringe of Europe. At the Straits of Gibraltar, **Morocco** is just 12 miles away. Traces of many centuries under Arab rule, in the Middle Ages, run like a thread through language, culture and architecture. It is a country that in the modern, post-**Franco** era is fully integrated into Western Europe, but also believes it has no choice but to remain involved with the Arab/Islamic world. Policy-makers believe that means dealing with threats as well as the opportunities.

The last 25 years have seen Spain develop strong support for Arab concerns – particularly the **Palestinian** cause – as a central plank of foreign policy. But since 11 September 2001 the centre-right Aznar government has positioned itself as a firm supporter of the "war against terror" prosecuted by Bush. Madrid now hopes to capitalise on both those positions.

A timely gamble

Hosting the donor conference for Iraq offered Aznar the chance to build a bridge between the two contrasting wings of his Middle Eastern policy. It usefully combined support for the American intervention with a subtle reassertion of Spain's independent profile in dealing with the Middle East.

The more or less universal acceptance of the Iraqi people's need for large-scale aid, and the presence in Madrid of *UN* Secretary-general **Kofi Annan** and other top international officials helped to position Spain in the role of honest broker. This is a position from which many believe **UK** Premier **Tony Blair** has been disqualified by his decision to join in the invasion.

Hosting the conference carried risks. The turnout and the pledges would certainly have been less impressive had the UN Security Council failed to agree Resolution 1511 the week before. But Aznar's gamble that a UN deal would be struck in time paid off, and it was the **French**, **Germans** and **Russians** – in choosing not to make pledges in Madrid – who ended up looking out of sync with international opinion.

It was in the run-up to the conference that Aznar chose to make his speech declaring Spanish readiness to engage in "anticipatory actions". But this concept is in the earliest stages of development, *GSN* was told. It was not prefigured in Spain's national defence strategy agreed by all major parties at the end of last year

Firm but independent

There is more to Aznar's policy than firmness. He shrewdly opted not to send Spanish troops to participate in the invasion of Iraq, though they are now in the country as part of the expanded peacekeeping force – and in the US-led Coalition Provisional Administration. This policy has not been without cost. A third Spanish soldier died and others narrowly escaped injury in the 26 October attack on the Al-Rasheed Hotel.

Aznar has made a point of asserting Spain's independence of thought on Middle Eastern issues. His response to Bush's 'axis of evil' speech was to invite **Iran**'s President **Mohammad Khatami** for a state visit. Aznar was the first Western government leader to visit **Libya** after the UN embargo was lifted, and when Washington fiercely criticised Syria earlier this year, Spain's premier defended the country.

His government is sticking strongly to the traditional policy of close friendship with Arab countries. After re-establishing the principle of Spanish sovereignty in the dispute over the islet of Perejil (Leïla) off the coast of Morocco, Madrid rapidly pulled out its troops and sought to leave the episode behind. Strong support for the Palestinians' right to a sovereign and economically viable state remains a cornerstone of policy.

Late October's high-profile state visit to Damascus by Juan Carlos and Sofia saw the royal couple staying for three days, even touring the historic desert ruins of Palmyra in a mock-up Roman chariot with President **Bashar Al-Assad** and his wife. The King took advantage of the atmosphere of friendly bonhomie to publicly offer Assad the benefit of Spain's own relatively recent experience of economic reform.

The decision to go ahead with the visit amounted to a reaffirmation by Madrid of its belief that diplomatic and economic engagement – rather than threats – is the best way to ensure that the likes of Syria do not give succour to violent radicalism. Such messages suggest that least Spain will seek a louder voice in Middle East affairs, and one that may provide a welcome note of balance in a region fraught with tension.

Gulf project finance sources set to diversify

A series of upcoming industrial projects in the Gulf region could draw on financing next year that goes far beyond the commercial debt that has provided much of the region's needs in recent years. As commercial debt dries up, the increasing syndication risk in regional project finance is making alternative financing techniques increasingly necessary, according to one senior executive at a big **Bahraini** bank that has withdrawn from long-term project debt underwriting.

"The syndication risk is what has been keeping us away," said the banker. "Export credit agency financing will be necessary, probably Islamic financing also, and then bonds to re-finance," he predicted. Pricing, security and documentation risks have also increased steadily in recent years, all favouring sponsors at the expense of banks.

A more diversified financing approach has already been seen with the ***Aluminium Bahrain*** financing signed earlier in 2003, which included a commercial component alongside a metals trading facility, a local bond, an Islamic tranche and a $450m export credits portion.

Many international banks have withdrawn from project finance, and both regional and local banks have stretched themselves in a string of recent deals. "Tenors have been pushed beyond the economic means of projects, and if sponsors hope to continue raising local and regional commercial money, they must inevitably ask for shorter debt tenors," the banker told *GSN*. "Most Arab banks can only go out to seven years with any comfort, due to the tenor of their deposits, so they have been taking enormous re-financing risks."

Paradigm shift

Almost all deals in the region now syndicate at the initial underwriting stage, gathering together as many banks as possible on a club basis. Five to 10 years ago, the situation was reversed.

The new paradigm is illustrated in the Umm Al-Nar independent power and water project in **Abu Dhabi** *(GSN 717/21)*, the banker told *GSN*. In that deal, only three banks came in at the retail syndication level. This contrasts with a Sadaf-sponsored project during the earlier period, when there were "125-140 banks that the lead arrangers could sell down to".

"The project finance market is going through a difficult period," he said. "Nobody can underwrite $200m anymore, but to make money you have to underwrite big, at around $100m, otherwise the risk isn't worth taking."

Such a stance in today's syndication market entails holding onto around $75m of the debt, the banker stressed. His bank moved out of the underwriting market for 10-year-plus deals some two years ago, as it was unwilling to assume the risk of not being able to sell down its exposures.

Nat'l Bank of Oman sets hope by new share issue

With the revelation of yet more bad loans at the National Bank of Oman (NBO), a private placement is the latest tactic the bank is taking to try to lift the institution past its tribulations of recent years and put it on the road to fiscal health and profitability again.

Following an emergency general shareholders meeting on 21 October, NBO approved a private equity placement worth OMR53.229m ($139m), or almost 24.2m shares at OMR2.2 ($5.74) per share. The shares will be sold to ***Suhail Bahwan Group (Holding) LLC***, a diversified Omani holding company.

The placement came after a review by NBO's management found that non-performing loans would likely increase to OMR271m by the end of the year, from OMR211m at the end of Q3 03, requiring further provisioning of OMR50m. An extraordinary provisioning of OMR6m was also needed to cover a dispute between NBO and the ***Central Bank of Egypt***.

Much of the provisioning will be used to continue the clean-up that was necessary after the bank's huge losses in 2001 from its involvement with the ***Ali Redha Trading Group (ARTG)*** *(GSN 688/14)*, NBO indicated. NBO took OMR31.6m in provisions to cover 2001.

The new provisioning is expected to lead to an operating loss of about OMR52m in 2003, the bank said. NBO hopes to return to profitability in Q1 04, and expects to reinstate its shareholder dividend in the same calendar year.

The moves could make or break the tenure of NBO chief executive **John Finigan**, who took over at the bank after the sudden departure of CEO **Aubyn Hill** in late 2002. Hill was at the helm during the disastrous ARTG affair, in which Gulf trading magnate **Ali Redha Darwish Al-Lawati** allegedly defrauded a number of Omani banks out of millions.

The share issue leaves **Suhail Bahwan** – which pays a 20% premium over market prices for its shares – with a 34.56% stake in the bank, making it the largest shareholder. Public sector ownership falls to 29%. More than 35 manufacturing, trading and service companies operate under Suhail Bahwan's umbrella, in areas from oil and gas to shipping, information technology and others. Headed by wealthy industrialist Sheikh Suhail Bahwan, the company employs more than 7,000.

Gross loans in Oman, Egypt and Abu Dhabi currently stand at OMR591.6m, OMR85.76m, and OMR76.37m, respectively (total: OMR753.73, or $1.968bn). Of that, non-performing loans stand at OMR178.89m, OMR61.4m, and OMR31.1m (total: OMR271.39m, or $708.5m). Provisions are about OMR116.6m, OMR49.12m and OMR26.99m (total: OMR192.71, or $503.1m).

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Azadegan pressures could have wider impact in Central Asia

US pressure on Japan to pull out of Iran's Azadegan oil field looks to be paying off, but Washington's strong-arm tactics could backfire, if they lead oil companies to pursue southern export routes for Caspian oil.

Iran's acceptance of a tougher nuclear inspection regime in early October had raised hopes of a revival of talks on the deadlocked development of the country's $2bn, 3-6bn barrel Azadegan oil field. Iranian President **Mohammed Khatami** announced in mid-October that a Japanese consortium, led by *Japan Petroleum Exploration Company* and *Indonesia Petroleum*, still retained priority access to the field, despite losing their exclusive rights to the project at the end of June.

But Tehran's olive branch to the Japanese over Azadegan has met with a cold shoulder in Tokyo, and the Japanese consortium's interest in the field has waned substantially since the summer in the face of pressure from Washington to pull out *(GSN 715/16)*. US lobbying efforts on **Russia** to back an oil pipeline to Japan – seen as recompense for Japan's lost Iranian imports – have received renewed impetus after talks between Tehran and Tokyo on the Azadegan field were suspended earlier this year.

Tokyo has now thrown its weight fully behind the Russia pipeline venture, offering Moscow a $7bn financial package in October to persuade it to support a project which would pump Siberian crude along a 4,000-km pipeline to Nakhodka.

It was not just Washington's nuclear-inspired pressure that turned Japan against the Iran project. Commercial terms on the scheme, intended to produce 100,000 barrels a day (b/d) of oil, rising to 370,000 b/d, have not been agreed, and Tokyo officials feared that the buyback conditions would not produce the volumes of oil that Japan needs. There are technical bugbears as well. "The Azadegan structure is huge but there's significant water flooding, and being near the Iraq border, it needs a lot of mine clearing," said **Adam Sieminski**, chief oil analyst at *Deutsche Bank*.

After Japan

National Iranian Oil Company (NIOC) has attempted to woo non-Japanese companies, approaching *Royal Dutch/Shell* and the **Norwegian** duo *Norsk Hydro* and *Statoil*, as well as **France**'s *Total* and a host of **Indian**, **Chinese** and Russian players. Aside from an expression of interest from Statoil – currently mired in corruption allegations over an Iran slush fund *(GSN 718/18)* – international oil company (IOC) appetite for Azadegan seems muted, though analysts see future interest likely from Total, *Shell* and other non-US majors.

But having expended considerable time and effort in talks with the Japanese in the past two years, it seems Tehran would still prefer the original consortium to move ahead with the project. Shell itself is constrained by an exclusive technical assistance agreement with the Japanese consortium on Azadegan.

Europeans have been subjected to the same US pressure as the Japanese. US Energy Secretary **Spencer Abraham** urged the **Italian** and **Dutch** governments to dissuade their oil companies from investing in Azadegan, which led to assurances from *Eni* that it would not pursue the investment. But Shell has given no such assurances. If the nuclear issue fails to heal, analysts say European oil companies could yet have to navigate *European Union* sanctions against Iran.

If the Japanese exit is final, Iran won't be the only loser from the deal. Russia's proposed crude link to the Pacific would force China to seek out alternative supply sources, if that project eclipses the mooted 2,400km pipeline link from Siberia to Daqing in China. One option available to the Chinese is to re-open talks with **Kazakhstan** over a proposed pipeline into western China, tapping undeveloped Kazak oil reserves.

Conspiracy theory

Conspiracy theorists have homed in on the Kazak link with glee. Sending Central Asian crude south for export has long been an ambition of IOCs active in the region, and the Japanese withdrawal from Tehran could just provide the opening they seek.

Although Chinese oil companies are reputed to be mulling new exploration licences in the Central Asian country – *China National Petroleum Company* took ownership in October of a 65% interest in a block formerly held by *ChevronTexaco* – they are not alone. Total and the state-owned Russian oil company *Rosneft* are set to develop the Kurmangazy oil prospect in the Russian/Kazakh region. And the latter two are also potential developers of a Caspian-Iran oil link, pumping Caspian crude south to the Persian Gulf.

The ChevronTexaco-led *Caspian Pipeline Consortium*, which is developing the 565,000 b/d Tengiz oil field in Kazakhstan, had originally wanted a southern pipeline route via Iran for export through the Persian Gulf. Now a 990-mile pipeline will send the crude to Russia's Black Sea port at Novorossiisk.

Rosneft, which has close ties to Russian President **Vladimir Putin**, signed a deal to develop the Kurmangazy oil field in the Caspian in 2002. It began drilling exploratory wells in Kurmangazy, where it holds a 50% interest, in June 2003, investing some $35m. Some estimates suggest the Kurmangazy field may hold as much oil as the giant 7-9bn barrel Kashagan field, also in Kazakhstan's Caspian waters. If *Rosneft* can get Total involved, as some analysts suggest, it would become the only Caspian partnership without US players and therefore in a strong position to build a Caspian-Iran link for export to the Gulf – the holy grail for Caspian players.

Pushing south

Existing Caspian-Iranian oil links are limited, although Tehran is in the process of re-equipping its existing infrastructure to accommodate oil swaps involving the delivery of Caspian oil from **Azerbaijan**, Kazakhstan and **Turkmenistan** to refineries in northern Iran. The same volume of Iranian oil would then be shipped south through terminals in the Persian Gulf.

Iran's Oil Minister **Bijan Zangeneh** has backed the construction of a \$400m, 350km pipeline from Iran's Caspian port of Neka to Tehran. Sources tell *GSN* that much of this pipeline is already laid, with pipe sections already in the trench but not yet welded together.

Ultimately, some 370,000 b/d of Caspian crude could find its way to Iran, with Tehran boosting capacity at the northern refineries of Arak, Tabriz, and Tehran to about 800,000 b/d in order to process the oil. In November 2002, Russia's ***Lukoil*** began transporting around 25,000 b/d of Siberian Light crude from the Caspian port of Astrakhan to Neka.

If everything falls into place as it should, Iran could yet end up a winner from a Japanese pullout from Azadegan. But squaring the circle looks a difficult play, given so many possible pitfalls and a geopolitical climate that is largely inimical to Iran's interests.

If the nuclear issue is resolved to the US and EU's satisfaction, a Japanese re-entry to Azadegan is plausible. Whether this would negate Russia's plans to pump oil to Japan is a moot point. Since ***Yukos***, the Kremlin's current *bête noire*, had backed the alternative pipeline route to China, it isn't beyond the realms of possibility that the Putin government will still push for the Japan route, particularly in light of Japan's generous financial inducements. But even then, big oil in Central Asia will still hold out for southern export routes via Iran, which, compared to Iraq, appears a beacon of stability.

Energy pointers

OMAN: GCC mulls Oman crude pipeline

The Dolphin gas pipeline project's rapid strides this year could prompt GCC states to consider a similar oil pipeline that would allow exports of Gulf crude through a link to Oman's southern Arabian Sea coast. Oil ministers will discuss a feasibility study looking into building a crude oil pipeline from the six GCC member states to Oman at their meeting in Doha in early November, regional oil sources said. The feasibility study on the pipeline, which would bypass the Persian Gulf's exposed export routes through the Straits of Hormuz, is ready for discussion among the GCC's oil ministers. Recommendations would then be passed on for decision at the GCC's next annual summit, scheduled for December in **Kuwait**.

Qatar proposed building the pipeline at last year's GCC summit in Doha, one of a number of proposals designed to improve security of oil supply from the Gulf. The \$3.5bn Dolphin gas pipeline, sending gas from Qatar's North Field to the **UAE**, also has the option of routing through Oman to the Arabian Sea – thereby bypassing the politically sensitive Straits of Hormuz. No details of the proposed oil pipeline have been made available.

Abu Dhabi-based ***Dolphin Energy*** signed two key agreements in mid-October to supply UAE utilities with Dolphin gas. ***Abu Dhabi Water & Electricity Authority (ADWEA)*** and ***Union Water & Electricity Company (UWEC)***, have committed to buying Dolphin gas for 25-year periods. Another offtake deal with ***Dubai Supply Authority*** is anticipated by year-end.

ADWEA is expected to lift some 1bcf/d of gas while UWEC will take around 150mcf/d. ADWEA's gas is earmarked for its power generating subsidiaries in the eastern region. UWEC's gas is intended as feedstock for the Fujairah power and desalination complex. Until the Qatar gas comes on stream in 2006, the Fujairah plant will lift Omani gas supplies.

RUSSIA: Moscow extends hand to Baghdad oilman

Russia's government has invited Iraqi Oil Minister **Ibrahim Bahr Al-Uloum** to visit Moscow, a sign of the country's eagerness to seal major oil deals inked during **Saddam Hussein**'s reign. No dates have been firmed, but Russian energy ministry official quoted by ***Reuters*** said, "We want to meet him, as we are looking to understand whether all the contracts signed with the previous regime are still considered valid."

Russian oil companies signed contracts worth \$4bn with Saddam's government to drill oil wells, deliver equipment and develop Iraq's massive oil reserves, dominated by ***Lukoil***'s huge West Qurna field development. Baghdad scrapped the contract late last year, alleging Lukoil had sought US guarantees to retain the field under any regime change. In January 2003, Iraq awarded a contract to Russia's ***Stroitransgaz*** to develop block four in Iraq's western desert.

IRAN: Tender for 16-block oil round

National Iranian Oil Company launched a new 16-block oil licensing round in October, offering acreage to international oil companies on buyback terms. The offering comprises 14 onshore and two offshore blocks. Although the exploration and development contracts look appealing, enabling companies to develop the fields they discover, the acreage is not thought to be especially encouraging. Five of the blocks were salvaged from a previous tender in 1998. These are Mohgan 1 and 2 near the Azeri border, the East and West Makran fields covering onshore and offshore areas near **Oman**, and the Tabas block in the eastern desert. Three blocks near Tehran were also offered. Two other blocks are on the Turkmen border. The expressions of interest were invited with a 28 October deadline.

DIARY: Events around the region

25 October-22 November. The holy month of Ramadan

Ramadan is determined by the sighting of the moon; local variations of one or two days are possible.

21 November. UN Oil-for-Food programme scheduled to end

The programme's remaining assets and responsibilities will be passed to the US-led Coalition Provisional Authority.

28 November-5 December. UK trade mission to Iran

Organised by the London-based Middle East Association. Contact the MEA's Iran enthusiast Michael Thomas: +44 (0)20 7839 2137.December.

GCC Annual Summit, Kuwait

Attended by the GCC heads of state, the summit will discuss pressing regional issues such as Iraq and Palestine and inter-GCC issues. A unified single GCC passport is one proposal on the agenda.

1-2 December. Investing in Saudi Arabia 2003

Business conference at One Whitehall Place, London. Contact MEED Conferences:+44 (0)20 7505 6044.

4 December. OPEC ministerial conference

The cartel's 128th Extraordinary Meeting of the Conference, to be held at base, in Vienna, Austria.

4-5 December. CWC's 4th Annual World LNG Summit

Gas conference at the St Regis Grand hotel in Rome. Contact CWC Group: +44 (0)207 089 4200. *www.thecwcgroup.com/conferences*

7-8 December. The World Islamic Banking Conference

A conference in Bahrain, to be held at the Gulf International Convention and Exhibition Centre. Contact Middle East Global Advisors: +971 4343 1200. *www.megaevents.net/wibc*

8-9 December. GCC Power 2003

A conference and exhibition for power professionals focused on the GCC region, to be held at the Novotel Seeb Hotel, Muscat. Contact CWC Associates: +44 (0)207 089 4200.

9-10 December. Iraq – A Nation to be rebuilt

A conference and networking event on rebuilding Iraq, in association with the British government, to be held at the Four Seasons Hotel, Amman, Jordan. Contact Michael Thomas at the UK's Middle East Association: +44 (0)20 7839 2137.

12-22 January 2004. UK trade mission to Saudi Arabia

Organised by the Middle East Association with UK Trade Partners backing. Contact Michael Thomas: +44 (0)20 7839 2137.

1-4 February 2004. Eid-al-Adha

The Eid holiday can vary slightly from country to country.

Saudi Arabia's middle ground (continued from page 2)

extremism. This argument was later taken up by ***Al-Imam Muhammad Ibn Saud Islamic University***'s Dr **Ahmed Turkistani**, also a member of the recently formed ***Saudi Human Rights Committee***, who went on to suggest that Wahhabism had been badly misunderstood in the West.

During a relatively short time, Turki has made the London Embassy a major cog in Saudi Arabia's response to charges that it has been soft on so-called "Islamic terrorism". One senior US policy analyst told *GSN*, "Saudi Arabia has needed a co-ordinated response to these claims… In Washington [high-profile spokesman] Adel [Al-Jubair] does a good job, but the response is uncoordinated."

In London, Turki has energetically courted the media and strengthened Saudi Arabia's image with canny appointments such as making former ***Al-Watan*** editor **Jamal Khashoggi**, a leading liberal, his media advisor. Such moves are seen as essential to regain international confidence at a time when the Kingdom is wracked by unrest even as it takes its first small steps on the road to democratic reform.

Iran's nuclear deal (continued from page 16)

But the three hours of talks in Tehran are best understood as marking the end of the beginning, not the beginning of the end. Iran made a tactical sacrifice to move one step closer to strategic victory on a range of economic and diplomatic fronts, and in the process split the international coalition that had been gathering against it. Thus ends Act One of the Iranian nuclear issue.

In Act Two, expect to see Washington and the European powers attempt to tie Iran down to a more concrete set of commitments, while Tehran employs delaying tactics. Most likely, attention will shift back to parallel proliferation concerns–notably the Bushehr nuclear reactor *(see page 5)* – turning the clock back to the debates that had prevailed before ***International Atomic Energy Agency*** inspectors uncovered Iran's enrichment facilities in February.

The 21 October agreement was a moment worth recording in European and Iranian diplomatic history. But it was perhaps not a defining moment – and if a new crisis develops, deception rather than congratulation might yet prove the *leitmotif* of European/Iranian relations.

GSN Risk Grade — B/2–: Economy poised to benefit from post-election stability

Political And Social Development

Overview: The political situation looks not much changed in the wake of 4 October Majlis Al-Shura (consultative council) elections, which for the first time gave all adult Omanis the vote. *GSN* holds Oman's political risk grade at B. Sultan Qaboos Bin Saeed remains one of the Gulf's more enlightened leaders, though his steps toward democratisation are smaller than many would like. Current moves should strengthen international ties with the likes of the UK, Russia and India, though succession remains a question, there being no Crown Prince in Oman.

Elections: Only about 10% of the population registered to vote, and fewer turned out. With campaigns barred from buying media time, most of the 500-plus candidates went all but unknown. Scepticism over political effectiveness kept voters away from the polls in Muscat, while in the interior votes were largely cast in line with the advice of local leaders. As a result, few seats changed hands, though the two women incumbents retained their posts. Sultan Qaboos, however, has extended Shura members' terms to four years (from three), and removed terms limits (formerly set at two terms). Qaboos mentioned "democratic action" in his speech opening the joint council, but also warned the council to show "unity" and support the enterprise of government.

Women's rights: Sultan Qaboos would have liked to see more women win seats in the October elections. 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. Oman remains a conservative sultanate that has nevertheless worked to promote women's rights.

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. Unemployment is becoming a problem; an estimated 67,000 young Omanis will enter the workforce in 2003. Omanisation is addressing the issue, if imperfectly so far.

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. Current moves include strengthening business and political ties with Russia and India, among others.

Economic Outlook

Overview: The economy is expected to shake off first-half blues and post GDP growth of 3-4.4% for 2003. 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 the trend.

Finance: The 2003 budget envisages a OMR400m ($1.04bn) deficit, based on $20/bbl oil; higher oil prices should help erode the deficit. An OMR80m five-year government bond launched in early May was 25% over-subscribed; further issues were launched in July and October. The funds will be used for development projects. Bank consolidation is under way but structural weaknesses remain.

The IMF view: A recently concluded IMF article IV assessment forecast that Oman's strong macroeconomic performance would continue in 2003. The IMF also noted that fiscal and current account surpluses were posted in 2002 and that Oman's debt burden fell to 16% of GDP at the end of 2002 compared to 32.3% in 1998. IMF directors have recommended that Oman introduce an excise tax on luxury goods and services and a simple property tax to support the country's fiscal position in the short-term.

Liberalisation: Oman Telecommunications Company is to be restructured 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 and 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 boost its output to 800,000 b/d by 2007 and a further $2bn to boost gas production over the next five years. New enhanced recovery schemes are scheduled from 2004; this could push production costs to $8/bbl from $4 currently. The results of a three-block offshore licensing round are expected by end-2003.

OMAN: Key Projects

Oman LNG expansion: Japan's Chiyoda Corporation and Foster Wheeler are constructing a 3.3m t/yr third train for LNG shipments from 2006. A new shareholder structure has been put in place for 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 for Sohar Refinery Company. Sub-contracts awarded October. A $1.2bn 14-year financing is envisaged; syndication of a $647m commercial loan was launched early October. Two $261m tranches are also being provided by Nippon Export & Investment Insurance and The Japan Bank for International Co-operation.

Ports expansion: Bidding phase for $150m Salalah expansion project consultancy contract. Work includes expanding two deep-water berths and the existing breakwater. Companies have also prequalified for additional infrastructure at Sohar port. Work includes new communications, transport, power, and water treatment facilities.

Sohar IWPP: Tender awaited 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)	7,228.6	11,303.9	11,059.7	11,155.8
Of which: oil & gas	5,524.7	9,363.6	8,867.5	8,592.2
Non-oil (fob)	522.1	644.2	690.9	677.9
Imports	4,293.5	4,587	5,303.9	5,626
Trade balance	2,935.1	6,716.9	5,755.8	5,529.8
Current account	-348.1	3,379.2	2,137.7	1,945.5
Total public revenue	4,665.2	5,947.8	6,596.9	7,810.4p
Of which: oil & gas	3,270.6	4,660.8	5,061.3	5,914.5p
Total public expenditure	5,893.5	6,899.2	7,429.1	7,629.4p
Of which: defence & security	1,784.9	2,100.3	2,423.4	2,487.8p
Fiscal surplus/deficit	-1,228.3	-951.4	-832.2	181.0p

Source: Central Bank of Oman, Ministry of Finance

p = preliminary

GSN Risk Grade — B/2+: Stable political climate provides foundations for hydrocarbons growth

Political And Social Development

Overview: The country remains stable ahead of elections to a new Shura Council, expected in 2004. The US military presence acts as indemnity against unwanted influence from regional players including Saudi Arabia and Iran. Emir Sheikh Hamad bin Khalifa Al-Thani named his fourth son Sheikh Tamim as Crown Prince and heir apparent in early August, replacing third son Sheikh Jassim who was increasingly unhappy in the position.

Government: The Emir has made a number of recent changes to formalise the power structure around him. This has included the appointment of Sheikh Tamim as heir apparent and the formal acknowledgement of Foreign Minister Sheikh Hamad Bin Jassim Bin Jaber Al-Thani and Energy Minister Abdullah bin Hamad al-Attiyah's positions as key players by their appointments as first and second deputy prime minister, respectively. Sheikh Tamim has also been appointed deputy commander in chief of the armed forces, a position that makes him *de facto* defence minister according to western diplomatic observers.

Democracy: Qatar's new constitution is a significant move towards pluralism, but also enshrines power in Al-Thani hands. It envisages a 45-member Shura Council two-thirds elected by universal suffrage of Qatari nationals aged 18 and over, with the remaining third appointed by the Emir. All bills must be passed by a two-thirds majority and endorsed by the Emir to become law. Political parties are not allowed. Expatriates do not have voting rights but will benefit from equality before the law. Qatar appointed its first female cabinet minister in early May. This followed the election of a woman to the Central Municipal Council in April.

External factors: Qatar continues to make its voice heard at international level. The Al-Thani-sponsored Al-Jazeera Satellite Channel is a source of irritation to both Arab and Western governments; US criticism has not visibly impacted on other areas of Qatari/US relations. Regional relationships are generally firm despite a number of irritations including Al Jazeera. Optimism of a new era of close relations with Bahrain has cooled since the historic 2001 Hawar islands settlement. Qatar has good relations with the Palestinians, but controversially for an Arab state, also maintains informal contacts with Israel.

Economic Outlook

Overview: The economic prospects remain good, with strong fiscal and current account surpluses fuelled by a buoyant hydrocarbons sector and related infrastructure. 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: A new world record seven-year $700m sovereign Islamic bond offering was completed in early October. According to recent S&P analysis Qatar has the lowest rate of non-performing loans in the Gulf Co-operation Council region, at just over 6% of gross loans for the end of 2002. High oil prices mean that the $474m deficit envisaged by the 2003/04 budget, which was based on a $17/bbl oil price, will be turned into a healthy surplus, part of which will go to the Oil Stabilisation Fund.

Hydrocarbons: Qatar is pushing ahead with a new raft of projects in the downstream gas sector. Shell recently signed an agreement for a gas-to-liquids plant as part of Qatar's wider ambitions to corner the GTL market (see box), while agreements have also been signed with ExxonMobil and ConocoPhilips for new phases of the Rasgas and Qatargas LNG developments. LNG output is slated to hit 26m t/yr by 2005. Two out of three firm supply agreements have also been signed for the Dolphin project. Qatar is presently permitted to pump 635,000 b/d under the OPEC quota system. Oil production capacity of 1m b/d has been targeted for 2006.

Liberalisation: An IPO of 30% equity in Industries Qatar – a company formed 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. Further IPOs can be expected, while 100% private ownership in the agriculture, and tourism sectors is mooted. Privatisation of electricity transmission and distribution assets is under study, while private investors may be courted for a mooted restructuring of Qatar Petroleum. Land ownership by foreigners will be permitted with the development of the planned West Bay man-made island project.

GTL CAPITAL: Qatar is pushing plans to become the global gas-to-liquids capital. In October Royal Dutch/Shell signed an initial deal to build a $5bn two-train 140,000 b/d plant at Ras Laffan, while discussions continue on plants with ExxonMobil, Marathon, ConocoPhillips and Sasol/Chevron. A 34,000 b/d Sasol-led project closed $700m financing in January 2003. Marathon Oil announced plans in June for a detailed study of a proposed 120,000 b/d plant. If all projects are implemented GTL production will be more than 500,000 bpd by 2010.

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: ConocoExxonMobil signed a heads of agreement with QP in October for the $12bn two-train 15.6m t/yr Ras Gas II project. This followed a preliminary agreement signed by ConocoPhillips for a 7.5m t/yr Qatargas III project. Thee offtake from both projects will supply the US market. Total, meanwhile, is understood to be angling for a stake in ExxonMobil's 7.8m t/yr Qatargas II project that would supply the UK market. The new projects are expected to come onstream over the 2007-2009 period.

DOLPHIN PROJECT: The UAE's Dolphin Energy – a joint venture of the UAE government's Offsets Group, Total and Occidental Petroleum – has signed binding agreements with Abu Dhabi Water and Electricity Authority and Fujairah-based Union Water and Electricity Co for the 3.2bn ft^3/d project to pipe North Field gas to the UAE. A similar 25-year deal is pending with Dubai-based utilities.

PETROCHEMICAL PROJECTS: FEED work on the $1.1bn Q-Chem II project is underway, with an EPC award expected mid-2004; prequalification was launched in September. 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), for which invitations to bid are expected early 2004, and a $470m 1.3m t/y Ras Laffan ethane cracker, for which invitations to bid were released in July.

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.

Iran's nuclear deal: defining moment, or the end of the beginning?

Enthusiasts saw the 21 October deal between Iran and a triumvirate of European foreign ministers as a defining moment in contemporary geopolitics – for Europe, for Iranian reformists and for the wider cause of global peace.

According to this view, the joint initiative – which united the USA's closest ally, in the person of UK Foreign Secretary **Jack Straw**, with the **Bush** administration's *bête noirs*, **Dominique de Villepin** of **France** and **Germany**'s **Joschka Fischer** – showed that key ***European Union*** members could act together despite the deep splits engendered by the **Iraq** crisis, engineering an initiative that outflanked US neo-cons and pro-**Israeli** lobbies.

The European initiative offered a lifeline to Iranian reformists, who were suffering under Washington's disfavour over both Iran's alleged weapons programme and the country's intervention in Iraq via Shia groups. Key reformists had argued that full disclosure would yield results. They were faced with the usual hard-line opposition at home.

The European triumvirate's presence showed that Tehran could do business with the international community. European economies and their governments have a big stake in Iran, reflected in the high levels of export credit support now provided for Tehran, and do not see regime change as an option *(GSN 714/13, 708/10)*.

Amid smiles all round, Iranian Supreme National Security Council secretary **Hassan Rouhani** said, "Relations between Iran and Europe have entered a new phase." The initiative also helped considerably to ease the increasingly poisonous relations between London and Tehran *(GSN 719/5)*.

But it is unclear how far the agreement represented a defining moment, just as it is unclear the extent to which Iranian reformists should really rely on European diplomatic initiatives. There is a disturbing precedent that might be considered – the EU's support of **Palestinian** rights and economic development, which has periodically made relations between the ***European Commission*** and Israel problematic. Encouraged by European support, **Yasser Arafat** and his team have at times put great store in the Europeans – only to learn, through persistent disappointments, that an EU foreign policy that might act as a counterweight to the USA remained elusive. Europe's failure to deliver has hammered home the point that America remains the only game in town.

The Americans themselves seem confused by events. An official from the State Department's Bureau of Intelligence and Research told *GSN*, "We're not sure who our interlocutor with the Europeans should be. Is it [EC External Relations Commissioner] **Chris Patten**, [EU Foreign Affairs Commissioner] **Javier Solana**, or should we approach the individual states?"

Straw staffers, on the other hand, insisted the visit was "closely co-ordinated" with US Secretary of State **Colin Powell**, who saw a European initiative as a way to defuse tensions – and outflank rival hawks in the administration in the process. If so, Iran's reformists should exploit the EU connection for all it is worth.

Meanwhile, the European mission was an important step in dealing with Tehran's nuclear programme – a potential *casus belli* for those in Washington who believe that Iran, as much as Iraq, is in need of regime change. The ministers secured a commitment to suspend uranium enrichment that went beyond their expectations.

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