Gulf States Newsletter

INDEPENDENT ANALYSIS AND NEWS OF POLITICAL RISK AND BUSINESS TRENDS

ISSN 0953-5411

Volume 27 • Issue 722 • 14 November 2003

Exiles and Al-Sauds seek to outflank Saudi jihadis

Al-Sauds and their critics have been edging towards political reforms and a new social compact, but exiled opponents want more. They want to outflank the Jihadi insurgency with a peaceful protest movement.

Outwardly calm and claiming to be mastering the situation, the Saudi leadership has been shaken by the latest bombings in Riyadh and the prospect of further armed conflict pitting the security forces against Jihadi insurgents in Makkah and other hotspots.

The murderers who attacked the Al-Muhaya housing compound in Riyadh on 8 November may have hit at such a soft target because of the success of Interior Minister **Prince Nayef Bin Abdelaziz**'s police and other public and private security forces at tightening security in the capital and rounding up potential Islamist extremists since Riyadh was first wracked by Jihadist suicide bombings, on 12 May. Their actions, according to a number of Saudis canvassed by *GSN*, may well have alienated many of those disaffected subjects who admired **Osama Bin Laden** and felt there was substance to *Al-Qaeda*'s war on the ruling Al-Sauds.

Even so, one senior source who met with him recently described Prince Nayef as "an extremely preoccupied man", whose comfortable assumptions about policing Saudi Arabia had been "completely floored" by a jihadi offensive surging up from the streets.

Another well-informed observer in Riyadh commented that even with experiences such as the 1979 Makkah siege behind them, the Saudi leadership were "totally unprepared" for events of the last six months. With reference to the recently released UK subjects alleged to have orchestrated a bombing campaign to settle scores in the underground alcohol bootlegging industry, this source commented: "When they gave an amnesty to the 'turf war Britons' the authorities really thought they were doing the UK government a favour – it didn't occur to them they could have been wrongly convicted [with the police covering the tracks of domestic extremists]."

Security sources have confirmed that police vehicles were used by the 8 November attackers; it is said these vehicles were stolen, but sceptics suggest there was collusion involving elements in the security forces. Pro-Jihadi sentiments have been registered in the security services.

Exiled Saudi opposition activists fear the 8 November bombing marks a new lurch towards polarisation, at a time when momentum had been gathering behind more peaceful routes to change.

Islamists canvassed by *GSN* were concerned that the failure of mainstream Wahhabi leaders to give a political lead had left the field open to violent extremists, such as those who mounted the suicide attack on Al-Muhaya, killing dozens of people, mainly Arabs.

The Al-Muhaya assault's authorship was claimed by Al-Qaeda in an e-mail message received the London-based Arabic weekly *Al-Majalla*, signed by an operative identified as **Abu Mohammed Al-Ablaj**. The bombing showed a further tactical refinement:

In this issue

CbI
Cross-border Information

Gulf States Newsletter
Volume 27 • Issue No 722 • 14 November 2003

Editor
Paul Melly
paul@gulfstatesnews.com

Managing editor
Mark Wallace
wallace@gulfstatesnews.com

Washington correspondent
Michael Knights
mike@gulfstatesnews.com

Contributing editor
James Gavin
james@gulfstatesnews.com

Editorial director
Jon Marks
jon@gulfstatesnews.com

Production
Jill Macfarlane-Miller
admin@gulfstatesnews.com

Webmaster
Chris Light
webmaster@gulfstatesnews.com

Publisher
Mark Ford
mark@gulfstatesnews.com

Gulf States Newsletter
Published fortnightly since 1974

PO Box 124, Hastings
East Sussex TN34 1WP, UK
Tel: +44 (0) 1424 721 667
Fax: +44 (0) 1424 721 721
Email: admin@gulfstatesnews.com

Cross-border Information Ltd
Registered office: 19 Wellington Square,
Hastings, East Sussex TN34 1PB, UK

Managing Director: J.J. Marks
Directors: J.M. Ford, N.J.Carn
Tel: +44 (0) 1424 721 667
Fax: +44 (0) 1424 721 721
Email: admin@cbi-publishing.com

some sources reported that only two attackers – the drivers of two suicide bomb vehicles – died; the others escaped *(see page 8)*.

The bombing came barely three weeks after the London-based *Movement for Islamic Reform (MIRA)* – led by that exiled thorn in the Al-Sauds' flesh Dr **Saad Al-Fagih** – managed to summon thousands of people on to the streets of Riyadh and Jeddah to stage peaceful demonstrations.

These met an immediate and harsh response from the security forces, setting up a public relations disaster for the authorities – just as senior ambassadors **Prince Turki Al-Faisal** in London and **Prince Bandar Bin Sultan Bin Abdelaziz** in Washington were repositioning the Kingdom as a moderate player in the 'war on terrorism' *(GSN 721/1)*.

The demonstrations were evidence of MIRA's capacity to mobilise significant popular support within Saudi Arabia itself, to the surprise of liberals who are concerned that political changes takes a pluralist, rather than an Islamist direction *(GSN 720/6)*.

A mass movement for change?

The mid-October protests vindicated those opposition spokesmen who argued there was scope for a campaigning middle way which involves neither engaging in terrorist violence nor "colluding" in the gradualist liberalisation process launched by **Crown Prince Abdallah Bin Abdelaziz**.

CPA's road map for reform has been widely welcomed for leading the Kingdom towards qualitative political reform, if not democracy, but it does not go fast enough for exiled opponents and some critics in the Kingdom – where President **George W. Bush**'s 6 November speech on democracy in the Middle East struck home with members of the ruling family, as well as opponents.

One senior prince told *GSN* the speech was "extremely important" because it signalled to ruling elites in the region that "the rules of the game have changed and standing still is no longer an option". This source, firmly implanted on the Al-Sauds' more liberal wing, commented: "It was salutary, not because it came from Bush, whose personal credibility is zilch, but because we understood that it marked a bipartisan change in US policy."

Among exiled opponents, both London-based Islamist **Mohammed Al-Massari** and Washington-based liberals of the ***Saudi Institute*** feel there is scope to develop a mass popular movement campaigning for change. Both Massari and Saudi Institute executive director **Ali Al-Ahmed** were unusually positive about Fagih, when they spoke to *GSN* on 11-12 November.

Massari argued that the development of a popular, peaceful protest movement was being held back by the failure of domestic religious leaders to set an agenda; political leadership was being provided by exiles, whereas independent-minded Ulema in the Kingdom – such as **Salman Al-Awda** or **Mohsen Al-Awaji** – had failed to translate their religious ideas into a consistent political programme. "If they are inside the country their feelings are different. They can't see the wood for the trees," Massari told *GSN*.

Critics in the West have blamed traditional establishment Wahhabi-ism for encouraging radicalism, especially in conflict zones such as **Afghanistan** and **Bosnia**, and the authorities have cracked down on potentially dissident Ulema *(GSN 721/2, 718/5)*. However, exiled Islamists argue the established Ulema is "intellectually bankrupt" because of its historic co-operation with the Al-Sauds.

According to this argument, space was created for the Jihadi militants to operate in an environment where Islamist scholars such as Awda and Awaji have not yet reached the point of developing a political agenda.

Filling the vacuum

Liberals see potential in CPA's gradualist reform plan, which will lead to elections within the next year. However, there are clear limits to the extent the Al-Sauds will devolve power.

(Continued on page 8)

CPA still trapped within walls of its own making

Washington has failed to shock and awe Iraqis with its peace-keeping tactics, the CPA's record is mediocre and policing operations have alienated swathes of Iraqi opinion, but civilian administrators' failures mean that most Iraqis still fear an early US military withdrawal.

When Coalition Provisional Authority administrator **L Paul Bremer III** was called in to replace **Jay Garner** in May, the White House sought to wipe away the impression that the *Office for Reconstruction and Humanitarian Assistance (ORHA)* was closeted in the Republican Palace and lacked "grip" of the situation in Iraq. Six months on, the same accusations can be fairly levelled against the CPA – and it is the US military, rather than the CPA or Iraqi Governing Council (IGC), that remains the recognisable face of the occupation to most Iraqis.

Compared to the shuffling scruffiness of Garner, Bremer's personal style and heroic input of man-hours have given the CPA a sharper image outside Iraq; he was and remains President **George W Bush**'s chosen man for the job – and the prospect that he might leave when his initial one-year contract expires next May is sending jitters through the White House, where master tactician **Karl Rove** is gearing up for a potentially tougher-than-expected re-election campaign.

However, the US-led administration has little to show in terms of concrete achievements. Iraqis still lack a clear image of what the CPA is or does, and Bremer remains "that guy in the suit". Bremer's radical de-***Baathification*** programme has added to his administration's woes, and as the US leadership rethinks its Iraq strategy, senior officers in **Saddam Hussein**'s military are quietly returning to play their part in the new Iraq.

Most worrying for those willing the experiment in military-led regime change to succeed in Iraq, the above observations were among the overwhelming impressions that senior CPA members communicated to *GSN* on returning to Washington.

Some very impressive technocrats have been flown into Baghdad by the USA and its allies, but there persists a feeling that many CPA staffers are above all on a mission to bring neo-conservative values to the Middle East. *GSN* was party to a conversation where two CPA staffers explained to friendly Arab journalists that "the difference between us and the **British** guys [running the south] is that some of them don't even support **Tony Blair**, while we're all ***Republicans***."

Some roots of today's security crisis are highlighted by analysis of the situation that prompted a change of management at ORHA and its re-badging as the CPA six months ago, because following the rapid conduct of the war, ORHA's underwhelming entrance had a distinctly counterproductive effect on the security situation at a critical moment.

A senior US Central Command (Centcom) general told *GSN* that *Operation Iraqi Freedom* was originally conceived as a two-stage process. The first stage of combat operations aimed to isolate Baghdad from the north, west, and south, by placing US and British divisions on each of the four main routes leading to the capital. The second phase, lasting up to 125 days, would have effectively involved the siege of Baghdad, with a slow reduction of the city's perimeter while psychological and covert operations sought to crumble the regime from within.

This concept of operations was used in Basra, foreshadowing what the eventual siege of Baghdad might have looked like. The extended timeline would have allowed the USA to flow forces to the region in sufficient numbers to flood Baghdad and the 'Sunni triangle' with a massive show of strength.

Some things that went wrong

In crumbling the entire Iraqi military in 26 days, the plan's timeline was derailed and the USA entered the capital with light forces. In addition to the lack of forces still being shipped to the region, the USA also lacked the 4th Infantry Division thrust from **Turkey**, and had many troops tied up in securing the lines of supply to the south.

Despite this, Iraqi loyalty appears to have been ripe for the picking if Garner and ORHA had struck the right tone when they belatedly arrived from **Kuwait**. According to one Iraq returnee from the Office of Secretary of Defense (OSD), the Iraqis expected Garner to "cut the head off the cat"– a phrase used to describe a violent opening move that a coup leader uses to impose his dominance.

As an unnamed Iraqi Ministry of Oil (MOO) official told *Financial Times* journalist **Charles Clover**: "We have a lot of experience with coups d'état and this one is the worst. Any colonel in the Iraqi army knows that when he does a coup, he goes to the broadcasting station with five announcements. The first is 'long live this', 'down with that'. The second one is your new government is this and that. The third is a list of people that will go into retirement. The fourth one is that every other official is to report back to work tomorrow morning. The fifth is the curfew. This is usually done within one hour."

ORHA broke all these rules. A meticulously planned coalition media effort, which aimed to quickly repair lightly damaged Iraqi broadcasting facilities and utilise airborne and ground-based coalition psychological operations transmitters, was never executed "due to organisational disputes and friction," one Centcom planner told *GSN*.

Government ministries were looted to their bare walls and personal security concerns kept most government employees at home. By the time ORHA got to Baghdad and visited the ministries, instead of carrying out selective purges in key Baathist-dominated organisations like the Ministry of Planning and Foreign Ministry, Garner's teams undertook

Big turnout for media contract

Representatives of 29 international media groups visited **Iraq** on 3-7 November in the run-up to the 24 November closing date to bid for an estimated $100m contract to operate the national television and radio networks and the daily *Al-Sabah*. The contract is to run from 1 January for one year, plus two possible six-month extensions. It will be priced on a cost-plus-fee basis, to include infrastructure refurbishment, training and programming. At least one local group expressed interest – ***Al-Ghelf Company for General Trading*** – while others who made the trip included such heavyweights as ***Australian Broadcast Corporation*** and ***BBC World Service Trust***, and around 20 **US** organisations including security-focused services company ***MPRI*** and ***SAIC***, the contractor selected last January to run ***IMN*** – and subject to recent negative reports in the USA over the cost of its services. The **UK**'s ***Independent Television News*** has also expressed interest in participating. Several Arab companies are involved, some lining up with Western partners.

'Imperial habit' helps Brits to win the media war

Some **US** advisors at the Coalition Provisional Authority look to the Basra area with envy; although **UK**-led solutions have often been hit-or-miss, the Americans note that with less resources, smaller budgets, and less complicated interagency relations, the British enjoy more freedom of action and can score the right note through trial and error. Instead of designing a multi-media and politically correct media network, British forces in the south very rapidly focused their resources on the key media that all Iraqis use – AM radio and newspapers. All but one of the AM radio transmitting towers in southern Iraq was dropped early in the war or soon after the end of hostilities, leaving the remaining transmitter in British hands. Some 30,000 copies of **Saad Al-Bazzaz**'s London-based newspaper *Al-Zaman* were rushed into the south as soon as possible. Lacking the numbers of their US counterparts, British military psychological operations personnel have been retained in Iraq, retaining their skills and knowledge. Americans canvassed by *GSN* attributed the peremptory steps taken by the British to what they longingly referred to as the "imperial habit."

Turks decide not to send troops

The decision of the Turkish government not to send troops to Iraq was widely interpreted as a setback for the **Bush** Administration and allies who want a 'Muslim presence' in the occupation force. However, as *GSN* pointed out in October, although both sides had hammered out a politically expedient agreement on deployment, which was sanctioned by the Turkish parliament, few policy-makers wanted to set up a situation that would carry a very high tariff for all concerned *(GSN 720/3)*.

IGC/CPA pressures prompt constitutional rethink

Even before **Paul Bremer** surprisingly hit Washington on 11 November, there was considerable speculation within the Beltway over reports of increasing CPA disillusionment with the "special interests focus" of an increasingly troublesome IGC and plans to move away towards a larger, more populist '*loya jerga'* style council. The *loya jerga* is the **Afghan** tribal council, convened to rubber stamp **Hamed Karzai**'s administration in Kabul. The idea of a national conference to create a new Iraqi leadership was gaining prominence as *GSN* went to press – and ahead of the ***United Nations***' 15 December deadline to submit constitutional proposals.

lengthy investigations to try to trace the spiderweb of Baathist appointees in the government. As one OSD official told *GSN*, "with hindsight, we should have just looked at their salaries – the regime loyalists all received ten times what the other technocrats got."

Out go the Baathists

The appointment of Bremer and CPA's establishment began with an attempt to 'cut the head from the cat' in the shape of a blanket de-Baathification initiative that stripped known Baathists from all government ministries; the Hussein regime security forces and military were dissolved on 23 May. Moving from one extreme to the other, this step would have far-reaching and negative effects in the months to follow.

It had to be reduced in scope almost from its outset: the CPA began processing waivers for MOO and other key ministries almost as soon as the CPA de-Baathification directive was announced. But in some cases, this was too little, too late.

One CPA oil specialist told *GSN* that *Northern Oil Company* – which lost 300 employees to de-Baathification – had discovered that some of the released employees sold information to resistance elements that pinpointed the key nodes to be targeted to cause the most damage to the pipeline infrastructure.

The dissolution of the military and security establishment placed 440,000 armed men on the streets, only 320,000 of whom have thus far received partial compensation for their loss of employment.

Donald Rumsfeld's imperfect world

Since 23 May, the impact of Bremer's action has been gradually eroded, as the CPA has accelerated its recruitment of former security personnel.

First, the CPA rebuilt a new range of parallel security structures to replace the 17 it abolished, claiming that at least the new bodies were carefully vetted and trained by the USA. But, increasingly, the CPA has rearmed Iraqi forces with minimal training:

- numbers of Iraqi security personnel will jump from the current 58,000 to 118,000 by the start of December;
- the Facilities Protection Service jumped from 18,700 troops to 36,000 between 27 October and 7 November;
- the border guard jumped from 6,500 to 11,600 during the same period.

As Secretary of Defence Donald Rumsfeld was forced to note: "In a perfect world these forces would be carefully vetted, but this is not a perfect world, so we will vet the best we can."

CPA sources told *GSN* that the CPA had even begun to release Baathist colonels and generals from detention to resume command positions in the new security apparatus.

The massive expansion of Iraqi security services – which are planned to number 220,000 by late 2004 – is a necessary step, but marks a humiliating climb-down for the CPA that will further undermine its authority in Iraq.

Nor has the CPA fostered a firmer grip on the Iraqi media or political process. To a large extent, this is because the CPA has become swamped in bureaucracy.

GSN was told that in Iraq US agencies each replicated their bureaucratic fiefdoms, first as ORHA in Kuwait before the war – where the Marriott headquarters of ORHA was referred to as 'Washington on the beach' – and then as the CPA in post-war Baghdad, where it became 'Washington on the Tigris'.

Still entirely closeted in the hotels and walled compounds of Baghdad's 'green zone', the CPA is an inconsequential and invisible construct that Iraqis are largely unaware of. Most CPA members never leave the green zone, and Iraqi labourers are kept out of the CPA headquarters where possible, being replaced with third country nationals, largely from Asia. The Al-Rasheed Hotel rocket attack – targeted at the floor habitually used by high-profile visitors during a stay by US Deputy Secretary of Defence **Paul Wolfowitz** – indicated that security concerns about Iraqi workers remained valid. A recent OSD returnee stated that the Rasheed was "crawling with Mukhabarat"– as it always was.

Losing the media war

The ***Iraqi Media Network (IMN)*** has fared no better under the CPA than it did under ORHA in the immediate post-war period – and the CPA is now looking to private management to sharpen its approach *(see box)*. IMN is structured from the 18 TV stations, state radio and *Al-Sabah* newspaper inherited from Saddam Hussein.

Most CPA media people rarely come into contact with Iraqis and display little curiosity about the motivations and interests of their audience. Insiders complain that just as military psychological operations (psyops) personnel gain an insight and interest in Iraq and Iraqis, they are routinely rotated out of their positions.

These factors have led IMN programming to remain dull, uncompetitive, and often intensely patronising; one CPA member told *GSN* that when asked about the programming, Iraqi partners chided the USA for "treating Iraqis like **Liberians**". Like so many other areas of CPA business, the media effort has been hindered by what CPA figures call "the baggage of good intentions" – the need to meet Western standards and hone initiatives to perfection at egregious cost in man-hours.

Washington on the Tigris

The CPA's other main preoccupation, the establishment of a representative government, has been similarly blighted by the Byzantine complexities of 'Washington on the Tigris'.

In investing so much political capital in building the IGC, a CPA official said, "we are reifying a political construct that most Iraqis think of as fictive."

The IGC is very active, with some ministers making a very positive impression in their first weeks *(GSN 720/8, 717/10)*. However, that activity is not necessarily in the field of representative government for which it was devised.

According to CPA sources speaking on strict condition of anonymity, certain IGC members have approached US officials involved with the privatisation of the Iraqi economy to indicate their willingness to open certain industries to foreign capital for a price – proposing what one CPA official referred to as "a hand-over-fist grab for public assets."

In other ways, the CPA policy of creating an IGC which is representative of all Iraq's communities has exacerbated political tensions. The imposition of ethnic quotas in ministries and the IGC has given further cause for alarm to Sunnis, giving tangible proof of their fears of dispossession following Saddam's fall. Iraqis joke that the CPA phone number is 13-5-5-1-1, referring to the 13 Shia, five Sunni, five Kurds, one Turcoman and one Christian sitting on the IGC.

CPA officials state that the initial attempts to found the IGC resembled a "Jeffersonian democracy seminar", but over time the reality of trying to transform a country like Iraq into a Western democracy has dispirited many US ideologues.

Such shifts in sentiment may help explain why some policy-makers are now muttering about the need for a more populist "*loya jerga*" style grouping to supersede the IGC *(see box)*.

Iraqis look to the US military

The US military, rather than the CPA or IGC, is the recognisable face of the occupation to most Iraqis, and for all its problems in the 'Sunni triangle', it is the military that continues to display the firmest grip on events in Iraq.

Combined Joint Task Force 7 (CJTF-7) is the headquarters dealing with Iraq; it operates in parallel with the CPA, but in many senses, CJTF-7 is the main authority, with a budget, manpower, and grasp on events that outstrips the CPA.

According to former CPA staffers and military opinion canvassed by *GSN*, despite the perfunctory nature of many interactions between the US military and common Iraqis, CJTF-7 has a far clearer idea of the situation and views of the Iraqi populace. CPA sources noted that "very little of this intelligence passes through the membrane that separates the CPA and the military."

CJTF-7 has also proven to be much faster than the CPA at making a real difference to Iraqi quality of life, both through the $200,000 brigade commander's funds that are constantly kept replenished and fund local repairs, and through specific projects such as the CJTF-7 *Restore Iraqi Electricity* project. Meanwhile Iraq has become "a playground for contractors", but firms such as ***Bechtel*** have still not completed basic projects such as the vital Beiji pipeline bridge.

The US military presence is the only clear indicator to many Iraqis that America remains engaged in the country, and most Iraqis express concern when faced with the prospect that the USA may leave. Recent plans suggest that the USA will draw down its forces to 105,000 by May 2004 – and as forces pull out, Washington could gradually lose one of the last points of contact it has with ground truths in Iraq.

The CPA has enjoyed near perfect ability to communicate with Washington and London since its inception in May, while simultaneously being unable to reach its personnel when they ventured 50 metres outside their compounds, and enjoying minimal interface with CJTF-7. Some have suggested there is a "whiff of decay" about the CPA.

Six months down the line, Iraq remains under military occupation, with many of its success stories coming despite the CPA. Power is gradually shifting to Iraqis, but it will probably not do so in the way originally envisaged by the CPA.

The IGC may not have much legitimacy for some time, and the central authority of a Baghdad government will initially be underpinned by the strength of 220,000 government security forces plus a declining number of US and international reinforcements. Complex inter-agency politicking and elections aside, 'Washington on the Tigris' will not resemble Washington on the Potomac for some time.

Supporting Washington: a view from Madrid

With Turkey deciding not to send troops after all, President Bush needs firm friends more than ever. For Spain, participation in Saddam Hussein's overthrow was an essential element in a complex political/philosophical mix.

The conviction that terrorism must be faced down, whether at home in the Iberian peninsula or in the Middle East, is driving Prime Minister **José Maria Aznar** in his determination to maintain support for the US military presence in Iraq, and in an uncompromising defence of an invasion that was deeply unpopular among the Spanish electorate.

Aznar's Spain cultivates friendships with **Syria** and **Iran** – both firmly in Washington's sights – and it is strongly committed to European integration, rarely a popular policy among conservative Americans. But when it comes to the war on terror, Madrid remains firmly behind President **George W. Bush** – and in recent weeks Aznar has warned his military commanders to be ready to meet any need for "anticipatory actions" to combat violent extremism *(GSN 721/9)*.

The determined and high-profile nature of Aznar's diplomatic backing for the US decision to invade Iraq took many observers by surprise. Aznar's approach contrasted notably with that of **Italian** Prime Minister **Silvio Berlusconi**, whose support for Bush's unpopular policy was much more nuanced and politically cautious. Like **Tony Blair** in the **UK**, Spain's Premier and his ruling ***Partido Popular (PP)*** took big risks in identifying so closely with Washington.

In a wide-ranging interview, PP parliamentary foreign affairs spokesman **Gustavo de Aristegui** told *GSN* the political battle had been very tough: "I myself appeared in the media in Spain and abroad on more than 400 occasions on this issue; we had more than 50 parliamentary debates." Aristegui was abused at Barajas Airport, when he was spotted by protesters returning home from holiday with his wife and children.

However, the troubled Socialist opposition has failed effectively to exploit this political opportunity to the full, and in October elections to the Madrid regional assembly, the PP increased its majority.

While Aznar shows no sign of shifting ground on the terrorism issue he has been careful to maintain good relations with Arab governments and Western leaders who have taken a different view. On 6 November he was in Carcassonne, **France**, for a bilateral summit with President **Jacques Chirac** at which he confirmed Spanish support for intensified European defence co-operation. But on Iraq, Aristegui said Aznar was never in doubt about committing Spain to support the USA.

Ever since 11 September 2001, the centre-right PP government had positioned itself as a firm supporter of the 'war against terror' prosecuted by the Bush Administration.

Gulf observers seeking to understand the strength of Aznar's views on this issue need to take note of the domestic context.

Spanish governments are used to dealing with terrorism. The Basque group ***ETA*** continues to mount attacks on civilian as well as security targets; Aznar himself escaped a car bomb assassination attempt in 1995; the PP administration has banned the ***Herri Batasuna*** party because of its links to ETA.

Just a short hop across the Mediterranean from North Africa, Spain has become a hub for people traffickers, drug smugglers and extremist Islamist cells which flourish in this underworld. This environment provided the backdrop for investigating magistrate **Baltaser Garzon** to accuse ***Al-Jazeera Satellite Channel*** correspondent **Tayssir Alluni** of links to ***Al-Qaeda*** *(see box)*.

Media wars revisited: Alluni released

Arab opinion railed against Madrid when in September Spain's most media-savvy investigating magistrate, **Baltaser Garzon** (of **Pinochet** fame), formally accused ***Al-Jazeera Satellite Channel*** war correspondent **Tayssir Alluni**, a **Syrian**-born **Spanish** national, of terrorist activity. Charges of financing, logistical support and recruitment for the ***Al-Qaeda*** network, included in Garzon's 23-page report, were based on Alluni's alleged links to extremist Islamists in **Afghanistan** and **Germany**.

In late October, Alluni was released on €6,000 bail after his lawyers presented a doctor's report showing the veteran journalist was suffering from heart problems. Speaking on his release, Alluni said he was the innocent victim of a smear campaign that began in 2002. "I came to Spain mainly to clear up those accusations," he said. "I didn't expect at all to be officially accused and imprisoned, which I consider was very humiliating and intimidating… not only for me but for the millions of Al-Jazeera viewers."

The case made headlines world-wide, but apart from a leaked letter to Spanish Prime Minister **José Maria Aznar** from Al-Jazeera director **Sheikh Hamad Bin Thamer Al-Thani**, which called for Alluni's release, the Al-Thani family tried to avoid commenting on the case – including during the mid-October visit to **Qatar** of Spain's **King Juan Carlos** and **Queen Sofia**, who were received by **Emir Sheikh Hamad Bin Khalifa Al-Thani** and (very unusually for Gulf protocol) his wife **Sheikha Mouza Bint Nasser Al-Misnad**.

Garzon ordered Alluni's arrest as part of a wider investigation into terrorist groups following the Spanish authorities' dismantling of an eight-strong cell in November 2001. Al-Jazeera editor-in-chief **Ibrahim Hilal** defended Alluni saying that contact with suspected Al-Qaeda operatives and sympathisers was simply part of his job. "There are other journalists who have relations with Al-Qaeda suspects, and there are other networks who air tapes and statements from Al-Qaeda," Hilal said early in the process: "Why is Al-Jazeera's correspondent the one arrested then?"

The 'threat' from Saddam

Madrid's approach to Iraq has been conditioned by its analysis of the serious threat it believes that **Saddam Hussein** posed. In a passionate defence of the US/UK invasion, Aristegui pointed out that the Iraqi leader failed to take up numerous opportunities to disarm and allow comprehensive inspections. He insisted that a responsible government could not take the risk that eventually Baghdad's weapons of mass destruction technology might pass into the hands of Islamist radicals and be used in a major attack on civilians in a Western capital. In any case, Saddam was already effectively financing **Palestinian** suicide bombers by rewarding their families.

Aristegui added that the Hussein regime was in a state of "decomposition". There were internal fights within the Tikriti clan; Saddam was paranoid. One could not have ruled out the risk that the beleaguered Iraqi leader might try to re-consolidate domestic support by launching a fresh attack on a Western ally in the region – perhaps **Israel**. That would have risked provoking major retaliation.

Opponents of the war have argued there was nothing to link Saddam and militant Islamism, but Aristegui believes the danger was real and "Iraq could have become the non-conventional weapons supermarket for serious terrorist groups".

…and Islamist extremism

Aristegui pointed to the wider challenge of coping with the threat posed by radical Islamism. He believes that many analysts have failed to appreciate the truly absolutist thinking of today's Jihadi militants. Radical Islamists do not, he argued, acknowledge any room for pluralism of thought or recognise the validity of the four different madhabs (schools of thought). Regarding Muslims who do not share their conception of Islam as apostates, extremists justify to themselves the right to kill and to overthrow governments to propagate their own purist views.

This analysis is now shared by others confronting Jihadist groups, notably the **Saudi** ruling establishment *(GSN 721/2)*. Going further, Aristegui argued that radicals were "colonising" traditional conservative Islam, and while ultra-conservatives tend to see themselves in exclusive terms, they felt that if they do have a connection to any other Muslims it is to those who define themselves as even more purist. This mindset leads them to indulge militant radicals, creating space for extremist Islamist thinking to gain in influence – the argument used by other analysts against the Saudi Wahhabi establishment.

Aristegui concluded that it was important for democracies not to respond to this challenge with police state tactics. Devising a strategy to cope with the extremist threat poses a complex challenge for a country such as Spain, which has Arab states as near neighbours and a long tradition of serious interest in Middle Eastern affairs (with more than 20 faculties of Arab and Islamic studies.

Those close to Aznar and **Mariano Rajoy** – who has taken over as PP leader and will be the party's candidate for the premiership in the 2004 general election, when Aznar steps down – insist they are not backing the US neo-conservatives' controversial policy of 'defence through offence'.

However, Madrid has yet to work out what this proposed readiness to engage in "anticipatory action" should really mean. It appears that Rajoy will be looking to combine firmness of tone with Spain's traditionally pragmatic and moderate approach to the realisation of policy.

SAUDI ARABIA

New Riyadh bombings underline the extent of the crisis

The ferocious and ruthless nature of the latest attack in Riyadh, the 8 November bombing of the Al-Muhaya housing complex, in the Irqah valley – where there are palaces belonging to Interior Minister **Prince Nayef Bin Abdelaziz** and other members of the royal family – showed that Jihadi militants are still a major threat.

Security sources confirmed that police vehicles were used by the attackers to get close to the compound unimpeded. Officially, the vehicles were stolen, but sceptics suggest there may have been collusion with the militants by some elements in the security forces. Opposition sources say that one vehicle was used to blow open the secure main gate, which was guarded by two armoured personnel carriers. This first explosion killed at least nine police by the gate. Two suicide bomb vehicles then drove in through the open gap to attack the buildings in the compound.

Most of the dead and injured were non-Saudi Arabs. The complex was seen by the authorities and diplomats as a very soft target. Exile sources noted that it was heavily guarded, and claimed the complex housed technicians, translators and others working for **US** security services. However, this view is hotly contested by other sources.

The bombing caused widespread shock and highlighted the continued capacity of Islamist militants to mount serious attacks, despite Prince Nayef's much-touted security crackdown. Numerous arrests, the discovery of arms caches and the deaths of several prominent militants in clashes with government forces have not prevented Jihadis from causing massive carnage in bombing a location near many royal palaces and at relatively little cost to their own personnel.

The episode has raised fresh questions about the efficiency and commitment of the elite forces under Prince Nayef's command. The Interior Minister is under heavy pressure. In the days after the bombing he slipped off to **Tunisia**, ostensibly to open a new mosque, but also perhaps for consultations with his friend **President Zine El Abidine Ben Ali** – an efficient operator with roots deep in the security services, who has had no qualms about crushing Tunisian Islamists while maintaining a tight grip over his country's 9m people.

Senior Saudi royals had believed they were making considerable headway in confronting *Al-Qaeda*'s grassroots recruitment in the Kingdom. But there is evident deep-rooted disillusion with central government in poor outlying provinces such as Jizan – which neighbours lawless northern **Yemen** – and conservative Al-Jawf, in the north. This has created a recruiting ground for militancy.

But members of the Al-Saud leadership had been encouraged by the results of amnesty offers to "misguided young men" who had "got mixed up" with the extremists. Worried parents of missing sons had been contacting the authorities. Some Jihadis have been rounded up after the authorities received tip-offs from the suspects' families; this was how they managed to identify some suspects in Makkah on 5-6 November (when some Jihadis blew themselves up rather than face capture).

But even before 8 November senior princes were privately admitting that they still faced the challenge of trapping the ringleaders and those financing the militant campaign.

It seems clear the leadership has been slow to recognise the full dimensions of the problem they face. Some Al-Sauds at least genuinely believed that the westerners accused of involvement in bombings over the last three years – and only released in summer 2003 after persistent **UK** lobbying – really were responsible for terrorism, rather than the underground Jihadi groups who should have been the focus for investigations.

Such problems require political as well as hard security solutions. President **George W. Bush**'s 6 November speech pressing for democracy in the Middle East has been taken by some Al-Sauds as a reminder of the changed political climate in the USA – where there is now broad bipartisan agreement on the necessity for political reform in the Kingdom.

That may further strengthen the hand of **Crown Prince Abdallah** in moving towards local elections and, almost certainly, elections to the Majlis Al-Shura. But CPA has yet to convince the mainstream exiled opposition that it is worth co-operating *(see page 1)*.

Saudi exiles: Fagih runs with the ball

The claims of *Movement for Islamic Reform (MIRA)* leader **Saad Al-Fagih**, who is resident in London, to enjoy extensive contacts and support within the Kingdom have long been treated with scepticism; in such a closed political environment, it has been difficult to test the real extent of his support base. But via his MIRA website, and new radio and television channels Fagih – an Islamist who can be very talkative and very cagey at the same time – has managed to mobilise considerable support, as was shown by the 14 October demonstrations *(see page 1)*.

According to the Washington-based *Saudi Institute*'s executive director **Ali Al-Ahmed**, who is not a natural MIRA ally, Fagih has taken a big step forward with the demos, which were violently broken up with some 271 arrests *(GSN 721/1, 720/6)*. "He really gained credibility when he called for something and it happened," Ahmed told *GSN*. "Other people had discounted him, but he proved them wrong."

Fagih could now be seen as "the main Sunni Islamist opposition person," Ahmed claimed: "He is a capable person".

Ahmed – who is well-connected in Eastern Province Shia circles – reported strong Shia support for the 14 October protest, which took place in Jeddah, Hail and Riyadh; many people came from the Gulf coast city of Jubail to join in. "Peaceful change can happen," he told *GSN*: "Saad articulated it and made it possible."

Ahmed also now sees another London-based Islamist, **Mohammed Al-Massari**, as an individual who should be taken seriously, because of his role as an early Sunni opponent ready to launch a public campaign against the Al-Sauds.

The authorities are clearly worried about Fagih's appeal. *GSN* was told that in one case, interrogators tried to get one of the arrested protestors to sign a statement saying he had been misled by Fagih. The man refused.

Recent comments suggest that exiled opponents are beginning to set aside political and religious differences, although they are still some way from formulating a shared reform agenda. Massari and Fagih have had their differences, but there appears to be a new readiness to recognise each other's strengths. From the liberal perspective, Ahmed hints at a recognition of more common ground, especially given Fagih's success in demonstrating MIRA's reach.

The exiles remain largely disdainful of those advocates of reform in the Kingdom who have been ready to collaborate in the political dialogue promoted by **Crown Prince Abdallah Bin Abdelaziz**. They see this as helping the Al-Sauds to survive, at a time when the ruling family looks vulnerable.

"The fall of the dynasty is imaginable," said Ahmed, who believes some liberals who co-operated with CPA had discredited themselves by condemning the 14 October protests. The government's promised local elections plan is widely viewed with scorn by exiled figures. It is pointed out that the Al-Sauds scrapped traditional local councils which already existed in Hijaz.

The Saudi Institute has plans for an all-embracing conference on the way forward, to be held in London in January, while Massari has been working on early drafts for constitutional and human rights frameworks.

But deep differences remain over the future shape of a new Saudi Arabia for which all groups could campaign. Fagih, in particular, has shown he can be a player in Saudi politics, but the most likely prognosis is still that with the opposition divided the Al-Sauds will rule on, if with an altered ruling dispensation. Constitutional issues, as much as Jihadi terrorism, should be the order of the day.

Saudi terrorism crisis (continued from page 2)

Massari believes it is not too late for a peaceful popular campaign to emerge and force change. This had been shown by the success of his old rival Fagih's call for demonstrations.

The Saudi Institute promotes a non-violent, pluralist liberal view of Saudi Arabia's future, is deeply sceptical of Wahhabi-ism and does not support the Islamist agenda. But Al-Ahmed has also been encouraged by the success of Fagih's call for peaceful protest.

Observers have been unsure how to gauge the strength of MIRA and the exiled opposition still has some way to go before it can offer a coherent alternative to the Al-Saud model. Fagih has tended to be extremely cautious about offering his own positive agenda (and old ties with Bin Laden and his supporters may yet come back to haunt him).

The gathering pace of extremist action seems to be exerting pressure on the exiled opposition, as it is on the Al-Saud leadership. The mid-October demonstrations showed that at least some of the exiles can tap into considerable popular support. If they are to exploit this they will have to come up with a credible programme and peaceful campaigning strategy to engage the Al-Sauds.

The October protests were broken up, but they have shown them how this might be realised. Potentially as much as when elections were announced last month, the demonstration phenomenon could mark a defining moment in Saudi history. It could provide an opportunity not to be lost if the direction of the Kingdom's politics is to be defined by more than the extent of its security crisis.

POLITICS POINTERS

Governments gear up for GCC summit

Preparations are under way for the annual Gulf Co-operation Council (GCC) summit, to be held in **Kuwait** on 22-23 December. On the agenda will be endorsement of the single GCC passport, agreed by Gulf foreign ministers recently in **Qatar**, and the planned regional oil pipeline. Differing views on social issues may find voice, notably on the proposed formation of a GCC women's committee. Behind closed doors, there are a number of bilateral issues to resolve, including the **Bahrain**-Qatar fishing dispute. The **UAE** has indicated it may have words to say on how **Saudi Arabia** intervenes in the free movement of GCC goods and citizens across its borders.

KUWAIT: Halliburton attacked once more

The *Kuwait Times* reported that around 2,000 employees of four **US** firms, including ***Halliburton***, were working in Kuwait and **Iraq** with invalid documentation. They were still using the Common Access Card (CAC), issued for key contractors to gain quick entry during the **Iraq** conflict. The report quoted Kuwaiti officials saying the contractors flouted the CAC and other immigration rules. It said the US Embassy in Kuwait had taken "little or no effective action". Not long before, two members of the US House of Representative raised questions about the price the USA paid Halliburton to secure imports of Kuwaiti gasoline for Iraq.

UAE: Sheikh Zayed 'recovering' in London

UAE President and **Abu Dhabi** Ruler **Sheikh Zayed Bin Sultan Al-Nahayan** is recovering at his London residence from abdominal surgery *(GSN 721/5)*. On 1 November he received **UK** Foreign Office Minister **Baroness Simons** to accept goodwill messages from **Queen Elizabeth II** and **Tony Blair**.

Radical shifts in US theatre strategy demand a profound rethink by GCC militaries

Gulf militaries face a new set of challenges after the US-led occupation of Iraq. The first in a new *GSN* series on Gulf militaries' changing priorities focuses on shifts in US strategic thinking. Later articles will provide country-by-country analysis of trends to give a picture of Gulf militaries by the 2008-13 period.

Western security guarantors, their *Gulf Co-operation Council* allies and the non-GCC Gulf States are adjusting to the second major shift in the regional security landscape in two years. Following the 11 September 2001 attacks, the change was driven by global events; the global war of terrorism and President George W. Bush's 'Axis of Evil' speech reordered the Gulf's security relationships. **Iraq** and **Iran** were put on notice; **Saudi Arabia** fell further from grace on Capitol Hill; and the smaller GCC states and **Yemen** were courted intensively by Washington.

The security of each Gulf state has been complicated by the intensified threat of terrorism and changing perceptions in Washington, where the Pentagon announced its plans to transform its global posture by moving to a model of "flex-basing" that stressed a broad range of access options but fewer long-term forward-deployed garrisons in the Gulf.

Since the occupation of Iraq, a new set of changes specific to the region have shuffled the deck of security challenges facing local states. Most importantly, the Iraqi role in Gulf security has changed: Iraq no longer presents an overt military threat to its neighbours or the USA, reducing the need for the northern Gulf States and their external security guarantors to focus resources on the mission of deterring or defeating a short-warning overland invasion.

For the Western powers, the no-fly zones (NFZs) and maritime intercept operations are no longer a necessity, relieving them of an onerous commitment. However, in the poisonous post-invasion environment Iraq has become a potential haven for radical Islamists and other agents of instability.

Meanwhile Iran will remain firmly in the crosshairs of whichever US administration is elected in 2004, due to the Islamic Republic's strong connections to weapons of mass destruction and terrorism, creating a further enduring security tension in the region.

Centcom strategy in the new era

US *Central Command (Centcom)* theatre strategy is slowly changing in line with the altered threat profile facing Gulf States and the Pentagon's internal plans for transformation. From its pre-war focus on militarised dual containment of Iraq foremost and Iran secondarily, Centcom is now focused primarily on four missions:

- ensuring Iraq's internal and border security, which is seen as the linchpin of US policy on the region;
- maintaining the internal and border security of the GCC allies and Yemen;
- maintaining sea lanes of communication (SLOC) underpinning the flow of oil while interdicting terrorist movement or WMD proliferation at sea; and
- deterring Iranian expansionism in the Gulf.

According to Centcom long-range planners canvassed by *GSN*, detailed plans for transition to a post-***Baathist***, post-9/11 model of Gulf security will remain on the drawing board as long as Centcom remains preoccupied with operations in Iraq. However, *GSN* has learnt that some classified planning is being undertaken at ***Rand Corporation***, focused on a 2008 timeframe.

Drawing on comments by Centcom and Rand personnel, the broad outlines of emerging Centcom theatre strategy can be traced. Centcom traditionally relies on three pillars to support its theatre strategy: forward presence, power projection, and building and exploiting local coalitions. Each of these will undergo changes in the coming years.

Forward presence

Centcom has traditionally kept forces in theatre to guard against rapidly developing or omnipresent threats. Such forces were envisaged to slow down an Iraqi overland invasion (while US reinforcements arrived), patrol NFZs, maintain *United Nations* sanctions and guard SLOC, and carry out theatre missile defence (TMD).

Including a carrier battle group, over 100 aircraft and light land-based and amphibious forces, US troop levels in the Gulf were 10,000-22,000 at any time. According to Joint Staff planners contacted by *GSN*, this figure is likely to drop to under 5,000 by 2008.

Centcom's naval headquarters in **Bahrain** will likely remain and, harkening back to the days before the 1990 invasion of **Kuwait**, the US Navy will once more become the principal US service operating in the Gulf, albeit with less regular carrier presence. According to officers, the USA will move to a "0.8" carrier ratio for the Gulf, meaning that a carrier will be in or near the Gulf 80% of the time, compared to the 1.0 ratio while Iraq was being contained.

Permanently deployed forces in the Gulf will include enhanced intelligence assets – airborne and shipborne – that will provide support to local allies and help the USA to generate early warning.

Power projection

A decrease in rapidly developing threats and increased strategic warning are two factors that will motivate Centcom to rely more on power projection from bases in the continental USA and abroad, and less on forward deployment. Other factors include the Pentagon's new focus on increasing personnel retention by reducing the strain on the armed forces caused by long-term deployments overseas.

Following Operation Iraqi Freedom, the US military is much more confident that it can project power rapidly, as long as it can train for this eventuality in regular exercises and develop assured access to bases and prepositioned equipment stores. By the 2008 timeframe, the Pentagon aims to field a larger number of rapid-deployment medium weight brigade-sized forces.

Building and exploiting local military coalitions

In the early 1990s, Centcom sought to build regional forces up through three tiers of capability; Tier III would allow them to assist US forces in their own defence; Tier II sought to foster a regional collective defence capability between GCC states; Tier I would make regional allies individually capable of self-defence. Centcom officials now privately admit that the USA has given up on developing Tier I and II capabilities in the Gulf, and Tier III is as good as it will get for most of its regional allies.

The USA is likely to reorient its combined exercise and security assistance programmes to adjust for this changed outlook. Large-scale manpower-intensive combined arms exercises involving air, land, and sea forces from the USA and its local allies may become less likely, reducing the capability of regional states to field balanced armed forces.

Instead, the Pentagon will encourage development of niche capabilities and areas of interoperability with the USA through its exercise programme and military aid initiatives.

Buy American: the trajectory of force design

With the exception of Iran, the Gulf's armed forces will be strongly guided to develop in certain directions by the USA in the coming years -– notably through increased pressure to buy American. In Iraq, the armed forces will literally be built and equipped by the USA.

In Saudi Arabia, Centcom officials recently indicated that the USA will extend the same management support to the Royal Saudi Land Forces that it provides to the Saudi Arabian National Guard, which is trained by Centcom and ***Vinnell Corporation***.

In the other Gulf States, including Yemen, the USA will guide defence planning through its joint military committees, allowing such states to utilise the force management and procurement expertise of the Pentagon.

It will be interesting to observe the military forces and equipment purchases that evolve out of the mixture of US and local preferences. The Pentagon will guide its local allies to increase interoperability with US forces through the procurement of US equipment and the purchase of military training in the USA.

According to *GSN*'s soundings, Washington's priority is to establish GCC, Iraqi, and Yemeni forces capable of monitoring internal security, effectively policing their borders and littoral areas, protecting key domestic and western infrastructure and personnel from terrorist attacks, putting a 'local face' on counter-terrorism operations, and providing niche capabilities (missile and air defence) to US coalitions in the area.

Local rulers will instead wish to maintain their full compliment of land, sea, and air forces for reasons of national pride and freedom of action.

The following parts of this series will explore the likely trajectory of Gulf military development in the 2008-13 timeframe, looking at how US and local perspectives on Gulf security will shape the procurement and force design policies of the GCC states, Iran, Iraq, and Yemen.

PERSPECTIVE: 20 years ago

The *Peninsula Shield* military manoeuvres, now under way in the **UAE**, have perhaps as much political as military significance for the six participating states of the ***Gulf Co-operation Council***. At a time when the GCC states are expressing increasing concern about the continuing **Iran-Iraq** war and the recent threats by both parties in the conflict of expanded military operations, the exercises will give out some clear political signals.

Holding the joint manoeuvres overcomes an earlier difference of view between GCC members. In the past, **Kuwait** had made known its opposition to taking part in joint exercises which included **Oman**. The Kuwaiti reluctance was based on its dislike of Oman's separate military arrangements with the **USA** and some feared that Kuwaiti participation might be interpreted as endorsing the Sultanate's position in that regard.

However, with the despatch of its 'Jaber' mechanised force to the Emirates, Kuwait has demonstrated those earlier considerations no longer apply. Certainly the GCC has to show, in every way it can, that its solidarity is backed by a unified political position, extending into all spheres of their mutual capacities and capabilities.

Although the *Peninsula Shield* manoeuvres have been described by some Gulf leaders as marking the foundation of a Gulf Rapid Deployment Force, the exercises can only be a very short step along that particularly lengthy road. In the view of military experts in the area, *Peninsula Shield* will be testing command structures, intercommunication between the different national units, and compatibility of logistic systems.

It will be a long time and after many joint manoeuvres before the GCC will claim to have welded together a unified force for the single defence of the region.

Gulf States Newsletter, Vol. 8, No. 223, 17 October 1983

IRAN

Syndication beckons for power firm's mega excred deal

Iran is keen to get its latest major export credit deal – for a €1bn ($1.16bn) power project, backed by ***Hermes*** of **Germany** and the ***Export-Import Bank of Korea (Kexim)*** – wrapped up as soon as possible.

The hope is to have reached closure on all major issues in the project's main tranche of financing by the end of the current Iranian year, on 20 March 2004. The arranging bank is ***BNP Paribas***.

Thought to be the largest ever such multi-sourced export credit transaction with the Islamic Republic, the facility for ***Iran Power Development Corporation*** is an indication of Iran's resilient financial credibility, in European and Asian eyes, despite continued **US** hostility and wider international pressure over the nuclear issue.

The €1bn package combines a seven-year commercial loan – for about 10% of the cost – and a 12-year export credit facility.

Hermes is underwriting about 75% of the export credit facility, with Kexim covering 20% and the balance of exposure shared between the **UK**'s ***Export Credits Guarantee Department (ECGD)*** *(GSN 709/12)* – now an established Iran enthusiast – and *NCM* of the **Netherlands**.

The deal entails supply and installation of 22 heat steam recovery generators and 22 gas turbines, principally by ***Siemens*** and ***Doosan Heavy Industries & Construction Company***.

The end buyer is IPDC, although the deal is being fronted by a management offshoot, ***Iran Power Plants Project Management Company (Mapna)***.

However, the project is sovereign risk, with the loan formally assumed by an Iranian commercial bank and underpinned by a Ministry of Finance guarantee.

The transaction will be syndicated, **Jean-Paul Riolacci**, export finance manager in BNP Paribas' energy and commodities export and projects team, told *GSN*.

Iran has been able to secure export credit on this sort of scale for some time *(GSN 703/18)*. But Riolacci said the government Eurobond issues of 2002 had clearly helped to put the Islamic Republic on the financial map, even though the terms and the investors targeted by the bond were rather different from those involved in a classical export buyer credit such as this *(GSN 700/14, 691/MEI)*.

The government has also suggested that now a benchmark has been established, bonds could be used by Iranian corporates to finance infrastructure deals *(GSN 714/13)*.

BNP Paribas is already financing the near-$200m Assaluyeah power deal for ***National Petrochemicals Company***'s ***Mobin*** subsidiary, signed early this year. It has hopes of other transactions although none is yet close to completion.

Iranian budget pressures

Major power sector investments are being instigated at a time when the Iranian government is under gentle pressure from the ***International Monetary Fund (IMF)*** to slow down the rate at which its capital spending budget is growing.

The government budgeted for an 80% increase in the year to 20 March 2004, although the actual achieved rate is probably 60%. Although this is from a low base – about 4% of GDP – the growth rate is still extremely high, and sources told *GSN* there was some concern about the administration's ability to effectively manage the expansion, at a time when inflation is a relatively high 15%-17%.

The latest indications are that the capital budget will be significantly under-spent in 2003/04, with funding approved for projects that have not gone ahead.

The IMF believes a target of 20%-30% capital spending growth in 2004/05 might be more sensible, especially as bank credit has been growing by around 30%/yr. Government budget capital spending – a figure which does not include the parastatal entities – now accounts for 4.8% of GDP, while the IMF would regard 5%-6% as a desirable long-term range.

The IMF has been broadly approving of Iranian policy *(GSN 695/9, 694/8)*, and thinks the economy does not need a massive new injection of credit or expenditure, given that non-oil GDP is already growing by a dynamic 7%/yr. This is partly because – like **China** or the post-communist transition economies of eastern Europe in the 1990s – Iran is now feeling the revivifying benefits of liberalisation, as controls on a hitherto tightly regulated and structured economy are lifted.

The effect of high oil prices is felt even in the non-oil economy. But Fund analysis suggests that even if oil prices stabilised, in the $22-28/bbl range, Iran could still sustain around 5% annual growth in non-oil GDP. Indeed, provided oil stays above $15/bbl, the Islamic Republic should be able to maintain continued steady growth without excessive adjustment and only limited borrowing.

Earlier this year, the IMF firmly reminded the government that the purpose of its Oil Stabilisation Fund (OSF) should be to provide extra resources at a time of weak oil revenues. When they are buoyant, as is the case now, the keys to the OSF should remain locked; recent dipping into this reserve had simply helped stir inflation.

This message seems to have been taken on board by Tehran in its planning for the next budget, while both the government and the IMF agree that the major challenge is to step up the rate of job creation. Unemployment is already 16% and some 1m young Iranians enter the job market each year, yet the economy can only provide new jobs for half of them.

Services such as tourism, hotels, insurance or communications are the sectors which could most effectively meet the demand for employment. The IMF is keen to see action on liberalisation and privatisation of these areas.

Finance Minister **Tahmasb Mazaheri** has promised a privatisation plan, but the dossier appears to be moving slowly.

An IMF team will visit in early December to review progress and discuss the next budget. It will press for action to reduce energy subsidies, which consume 10% of GDP.

It also wants to see more transparency, notably concerning the operation of the bonyad charitable institutions, which play a major role in the economy. However, Fund sources said it was impressed by the bonyads' role in providing social services; they are highly efficient and appear to be providing services more cost effectively than either conventional government departments or private sector providers could do.

The IMF team will remind Tehran of the need to keep a lid on inflation, which it would like to see nudged back towards single figures.

One reform which has been successfully implemented is exchange rate liberalisation. The single, market-based rate has proved economically and politically sustainable – and the cost of meeting residual contingent liabilities bequeathed by the old system is affordable, at least at current levels of oil income.

There are still a large number of medium-term import payment commitments that were taken on before the reform at the old official rate. Local buyers have made their contracted rial payments into the banks at this old rate – which massively over-valued the currency. Yet the banks have to satisfy letter of credit obligations to foreign institutions at the new rate: for every rial they have received from an Iranian buyer, a further IR3 must be found to meet the full forex cost.

The shortfall is made up by the government budget, with the outstanding cost of around $2bn to be spread over five or six years. Unless interest rate terms are unusually expensive, it will probably not make sense to clear the obligations up front, for a discount.

Hawk's Eye: Riyadh keeps oil prices firm… for now

Is Saudi Arabia's transformation into an oil price hawk complete? Riyadh's successful bout of arm-twisting in September enforced a surprise 900,000 b/d cut in *Organisation of Petroleum Exporting Countries (OPEC)* production from 1 November, keeping prices in the upper reaches of the cartel's $22-28/bbl price band and beyond.

Revenue maximisation, rather than protection of long-term Saudi market share, now appears to have primacy in determining the Kingdom's oil price strategy.

The price of a Saudi barrel of crude has averaged some $10 above the budgeted figure of $17.50/bbl in 2003. Meanwhile production has ballooned, partly to account for missing **Iraqi** barrels in H1 03. *Saudi American Bank (Samba)* forecasts that Saudi average output will hit 8.6m b/d for 2003.

The combined impact of flush prices and rampant output means the Kingdom is on course for its strongest year for oil revenues since the *annus mirabilis* of 1981, accruing at least $85bn in oil export earnings.

Amid the cricket score figures, Riyadh is maintaining a public pretence as a price moderate. Petroleum and Mineral Resources Minister **Ali Al-Naimi** has publicly set his stall out on $25/bbl – the mid-way point in OPEC's price band – underlining Saudi Arabia's eagerness to portray itself as a counterweight to **Venezuela**'s price aggression.

But Riyadh's smoke and mirrors act cannot mask the sharp reversal in the Kingdom's oil price policy since **Crown Prince Abdallah Bin Abdelaziz** assumed full control in 1995. Where **King Fahd** would err on the side of caution, for fear of alienating the **USA**, Abdallah's instincts are more assertive.

"Defending market share now takes a back seat," said **Fareed Mohammedi**, chief economist at Washington-based *PFC Energy*. "Whereas Fahd was very insistent that they didn't offend the US, since 1995 the leadership has decided it needed to distance itself from the US as the latter was seen more as a liability than an asset in terms of internal security."

The evolution in its relationship with the USA since the early 1990s has undergirded the high oil price strategy. During former oil minister **Sheikh Zaki Yamani**'s lengthy tenure, the main tenet of Saudi strategy was to keep prices stable and low – a sure-fire way of ensuring that market share would ultimately accrue to the Kingdom. "In the battles of the 1980s, the hawks would push for $21/bbl and the Saudis would go for $18/bbl," Mohammedi observed.

This analysis is echoed by analysts with long memories. The Yamani-run *Centre for Global Energy Studies (CGES)* points the finger at Saudi price aggrandisement. "The danger is that they'll lose on both volume and price over time as they found in the 1980s," says CGES chief economist **Leo Drollas**. "The trouble is that the collective memory in the Kingdom is getting hazy. There's very few people left from the 1984-85 era when production slipped to just 2.5m b/d."

It is not just forgetfulness driving Saudi policy. The present primacy of revenue also has its roots in Saudi Arabia's disastrous fiscal position in the 1990s. "They'd gone bankrupt by 1994. Higher oil prices helped build up foreign reserves which had been severely depleted," says Mohammedi.

The Saudis feel they can sacrifice market share on the altar of high prices – which encourages non-OPEC investment and effectively loses the cartel customers – so long as the loss on volume does not infringe on revenues. Few doubt that a crunch is coming, when prices will no longer respond to production tweaks.

The CGES sees this painful event occurring in 2004, possibly by as early as Q2. It argues that global demand buoyancy is flat and was only disguised this year by exceptional circumstances, such as the cold winter, the **Japanese** nuclear shutdowns and rapid **Chinese** stock-building.

"If you look at underlying demand, there's not a great deal: it's about 0.8%, whereas the world economy is likely to grow at 3%," said Drollas. "That's less than one-third of growth and it's entirely due to high oil prices."

With supply hike, crunch time looms

Samba too notes a looming oil market challenge for the Kingdom as the amount of non-OPEC and Iraqi oil entering the market outstrips growth in global demand. It sees Riyadh needing to make substantial cuts in production to defence pries, or accept a lower price band.

Yet while this concern is on the horizon, Samba sees it as unlikely to be a factor in 2004 primarily because Iraqi oil has been slow to return to market at pre-war levels. A reviving US economy is also likely to feed into upward revisions to oil demand forecasts in 2004, further putting off the challenge of the declining need for OPEC oil.

Analysts are looking for clues as to Riyadh's likely response to the oil price crunch, whenever it arrives.

PFC Energy envisages Saudi Arabia ultimately engineering a price collapse, should it lose sufficiently heavily on both the volume and price fronts. It argues that having built up its assets in the past two years, Saudi Arabia can sustain $15/bbl prices for two years.

Towards a Riyadh/Tehran axis?

Saudi Arabia has a useful ally in **Iran**, which has also paid down debt and built up assets during this period.

If Riyadh and Tehran join forces in pushing for a price collapse to win OPEC back lost market share, the cartel's remaining price hawks are unlikely to be in a position to do anything about this.

Mohammedi doesn't see this coming in 2004, as Iraq's retarded production revival and **Nigerian** and **Venezuelan** supply worries help to keep markets tight and prices firm.

Conditions could be more conducive to radical prescriptions the following year. "Prices are still going to be lower than the year before and by 2005 we see the forces coming together," Mohammedi told *GSN*. "Iraq could hit maybe 3m b/d by 2004, but world demand is supposed to only grow by 1m b/d and this will be absorbed by non-OPEC supply." These factors will force OPEC to keep quotas flat or even drop them again.

However, Mohammedi observed that "for those members with internal overcapacity other than Saudi Arabia, there will be increasing irritation at the Saudis for not relinquishing some of its market share." Saudi Arabia has at least 2.5m b/d of shut-in capacity of its own.

Many OPEC members – particularly **Algeria**, **Libya** and Nigeria, all of whom are pushing for higher quotas to go with their rising production – see Saudi Arabia as being the main beneficiary of **Saddam Hussein**'s invasion of **Kuwait** in 1990. Then, the Kingdom was producing only 5.6m b/d, compared to Samba's 8.6m b/d forecast for 2003.

If OPEC members feel that Riyadh is using its market weight to keep them to artificially constrained quotas, their sense of grievance will be fuelled.

Mohammedi believes "when the Saudis have to cut below a level they think is acceptable, which I put at around 7m b/d, and OPEC disarray intensifies, this could be the trigger."

Tactics shift, strategy remains the same

So much for the theory. But if Saudi tactics shift, the underlying strategy of Saudi oil price policy is likely to remain unchanged.

According to Mohammedi, there are three main drivers to Saudi oil policy: maximise revenues to manage the rentier state; ensure oil is the most important fuel in the world and that Saudi Arabia is its most important producer; and use oil as a geostrategic asset in its relationship with the superpowers.

The core of that strategy is to ensure the longevity and survivability of the **Al-Saud** regime. Amid the turbulent winds assailing the Kingdom, the government needs to show it has full control of the one bankable asset that can see off foes from within and without.

Saudi gas deal signals start of upstream opening

A group led by ***Royal Dutch/Shell*** was due to sign a deal on 15 November for development of a 209,160 km² block in the southern part of the Empty Quarter – the first fruits of the vaunted Saudi gas upstream opening was first mooted more than five years ago.

On 10 November, the cabinet mandated Petroleum & Mineral Resources Minister **Ali Al-Naimi** to sign the contract, estimated to be worth around $2bn.

The deal – salvaged from the wreckage of core venture 3 (CV3) – is likely to provide the model for similar upstream contracts involving international oil companies (IOCs), covering upstream exploration, appraisal and development of non-associated gas reserves in the Shaybah and Kidan regions.

Lining up alongside operator Shell, which has a 40% stake in the venture, are ***Total*** and ***Saudi Aramco***, whose equity is divided evenly. A project company is due to established before year-end.

Gas exploration licensing round

The other blocks from the three core ventures have been repackaged into a three-block gas exploration licensing round, likewise denuded of the integrated downstream water, power and petrochemicals elements.

Since Naimi's invitation to more than 40 IOCs to a roadshow in London in July, at least 25 companies have paid a non-refundable $100,000 for the data.

The Saudi authorities are keeping technical data rooms open until year-end, in the aim of attracting further interest. Bids are due in by end-January.

Contract terms remain a closely guarded secret, but the authorities are unlikely to offer the Shell/Total group special rates on the sale of gas. Shell is on record as saying the deal as signed will allow a 15% internal rate of return (IRR), broadly compatible with terms on offer in other regional states with upstream openings, such as **Iran** and **Kuwait**.

However, the government is not sweetening the $0.75/m Btu gas price (minus $0.15/m Btu transport costs) that has existed since 1997. Given estimated exploration and production (E&P) costs of some $2/m Btu, some consultants are sceptical that this could afford a 15% IRR.

GSN understands that Naimi's decision to allow condensates and natural gas liquids (NGLs) to be sold at market (export) rates will prove the real selling point for IOCs. Even so, if Shell does have a contractually guaranteed 15% IRR, there is unlikely to be too much upside.

Other potential sweeteners include an option to sell gas direct to domestic end-consumers, circumventing Saudi Aramco's distribution system. Tax rates are said to be based on concessionary terms, with a flat 30% rate until the IRR hits 8%. These terms should apply for the three contract areas that will form the anticipated licensing round.

Political play with business credibility

The Shell/Total/Aramco deal looks a distinctly political play by the Saudi authorities.

The fact the two foreign partners are European majors is hardly coincidental in the post-9/11 climate. But they are also highly credible business developers, particularly in the wake of **US** major *ExxonMobil*'s exit. *ConocoPhillips* had been expected to come on board the Shell/Total deal, but withdrew at the eleventh hour in favour of its **Qatar** North Field gas development.

Yet not all US players have fled the scene. *ChevronTexaco* is seen as a potential bidder in the forthcoming licensing round, alongside a host of European, **Russian** and Asian players. "The Saudis have moved from monogamy to polygamy," commented US-based *PFC Energy* chief economist **Fareed Mohammedi**. "The US is no longer the one and only strategic ally."

The gas initiative's origins are intrinsically linked to the Kingdom's shifting political landscape in the 1990s. **Crown Prince Abdallah** saw a need for change in its relationship with the USA following his emergence as *de facto* leader in 1995. This was seen in a more independent stance on oil prices, and a greater reluctance to keep spending on crippling US arms purchases. But CPA understood that the Kingdom needed to offer US Inc. something in return. Opening up development of the gas sector and investment in Saudi infrastructure was one way of compensating for the loosening of commercial ties to the USA.

The failure of Crown Prince Abdallah's gas initiative came at the internal level. Analysts see Saudi Aramco's obstruction of the original integrated gas initiative (abetted by Aramco old boy Naimi) as a textbook manoeuvre by Saudi Arabia's technocratic elite. The 'Aramcons' wanted to show they were not against foreign participation in principle – but that it needed to be done in the right way.

"The rulers ran up against the displeasure of the technocrats," said Mohammedi. "Naimi and the Aramcons are some of the most knowledgeable and capable technocrats in the Kingdom, and they have a clear idea of what they want to do – work as hard as possible to ensure the survival of the regime, but ensure that they do it their way. Sometimes this meant protecting the ruling family from its own excesses and they felt the CVs as initially designed would fuel those excesses."

Naimi's spiking of the original core gas venture model has put Aramco in a strong position to concentrate on cherry-picked parts of the initiative that it wants to pursue by itself.

Some leading Saudis remain bitter about the Aramcons' shafting of the original initiative. Billionaire investor Prince **Alwaleed Bin Talal** accused the government of missing a big opportunity to attract foreign investments in an interview with the pro-reform *Al-Watan* daily on 10 November.

Alwaleed said the way the gas initiative was handled had tarnished the Kingdom's commercial reputation and credibility overseas. He blamed Naimi and Aramco for the unravelling of the initiative and the ExxonMobil deal.

Others question whether the stripped down gas packages will prove attractive enough for foreign players.

"The price for gas is pretty low," said one Riyadh-based lawyer who had advised on one of the CVs. "What's on offer is not all that sweet, and with huge Saudisation requirements that raises costs substantially. It's the right thing to do, but if you strap the programme with so main constraints are you going to turn off potential investors?'

He observed that after the recent terrorist attacks "many IOCs will be asking whether they have better alternatives in other countries – in most cases, the answer must be yes."

OMAN: PDO to slash costs from 2004

Petroleum Development Oman (PDO) is to cut its operating costs by $2bn over the next five years, beginning with a reduction of $150m in 2004. The plan, which follows a review of PDO's operations by **US** consultants ***Booz Allen Hamilton***, sees over 50% of the cuts coming from reduced well-head engineering and servicing costs. The $2bn represents around 20% of PDO's total spending programme. However, PDO still plans to ramp up declining crude output, which in 2002 fell to a new low of 703,000 b/d. But it sees enhanced oil recovery (EOR) projects restoring long-term production back to 800,000 b/d, targeted at three areas – Qarn Alam, Mukhaizna and Harweel. By 2010, PDO hopes to be producing 250,000 b/d of EOR crude. This will hit the bottom line hard: recovery costs could hit $7-8/bbl if the schemes come to fruition.

Meanwhile, Omani domestic gas demand is expected to double by 2010. According to ***Oman Gas Company***, the Sultanate would need to produce about 26m m^3/d of gas by 2010, up from 13.5m m^3/d now. An extension of Dolphin to import **Qatari** gas could beckon.

GSN Risk Grade — C-/2: Terrorism triggers political downgrade, big oil receipts fuel payments upgrade

Political And Social Development

Overview: Assailed by domestic terrorists and international criticism, Saudi Arabia is being buffeted by a series of pressures: this is reflected in GSN's risk ratings. The 9 November suicide bombing in Riyadh and shootouts in the Makkah region undermine the Saudi spin machine's view that the situation is under control. The Kingdom's political risk rating is thus downgraded to C-. However, booming oil prices and output mean public finances are much-improved, and although an oil price crunch seems likely in 2004-05, for now the economic outlook is upgraded, to payments grade 2.

The radical challenge: The 12 May Riyadh suicide bombings were a defining moment, and events since have forced the authorities to face up to some of the Kingdom's problems in the glare of negative international publicity. They have coupled a security crackdown against Islamic militants with pressures on tribal and religious leaders to ensure they are 'on message'. More than 600 people have been held in a widespread crackdown on Islamist militants and many Saudis believe the latest Riyadh bombings will alienate Jihadi ultra-radicals from much of their domestic support base, but the underground movement retains strong local support, notably in the far north, south-west and conservative parts of Najd. Islamist opponents of the Al-Sauds have succeeded in channelling some public resentment, reflected in the exiled Saad Al-Fagih's call in October for Saudis to demonstrate, leading to widely publicised events in Riyadh when hundreds were arrested and beaten.

Al-Saud rule: Against a background of growing poverty and unemployment, mastering conservative/liberal rivalries within the ruling family holds the key to the Al-Sauds fashioning an effective response, as the leadership, under Crown Prince Abdallah (CPA) due to King Fahd's infirmity, struggles to remake its ruling social compact with a predominantly youthful population. CPA's Charter for Arab Reform has proved a launchpad for internal change, with unprecedented local elections to be held in 2004, almost certainly to be followed by polls for half the Majlis Al-Shura consultative council's members.

External relations: The USA has downgraded its military presence, while issues of 'terrorist financing' and the Bush Administration's decision to classify parts of a Congressional report on 9/11, which might implicate the Saudi government, have caused major tensions in the Kingdom's key international relationship. Among warming relationships is the growing community of interests between Riyadh and Iran.

Economic Outlook

Overview: Saudi Arabia is set to reap the benefit of a sustained period of high oil prices. Despite a public pretence of being a price moderate Riyadh is leaning towards a revenue maximisation oil strategy rather than a focus on long-term Saudi market share. Saudi American Bank (Samba) has forecast 8.6m b/d average oil output for 2003 and predicts real GDP growth of 6.8%. The Saudi Stock Market (SSM) has performed well (4,075 points in early November) after passing the 4,000 points mark for the first time in late August. However, despite positive noises about attracting investment the collapse of the gas projects initiative and ongoing security problems are detrimental to the investment climate. Underlying problems remain: debt levels are high ($630bn expected at year-end) while unemployment pressures and population growth of 4-4.4% are a concern.

Budget: Oil prices of some $10/bbl above the conservative $17/bbl average price envisaged by the budget will produce a healthy surplus. Samba expects this to reach $6.3bn, compared to a forecast $10.4bn deficit, with oil exports reaching $85bn (a 20-year high). Oil revenues should reach $85bn, with a $20bn current account surplus. Higher oil prices have also helped to push up foreign reserves.

Financial regulation: An anti-money laundering law was approved in August. It will be policed by a special investigation unit. The OECD's Financial Action Task Force is expected to undertake a 'mutual evaluation' of Saudi Arabia in Q4 03/Q1 04. A joint Saudi intelligence/US' FBI team will also help to tackle terrorist financing, while a new body to oversee Islamic charities and the Supreme Saudi Relief and Charity Foundation have been approved.

Liberalisation: A trade agreement has been signed with the EU, paving the way for World Trade Organisation membership. The next stage will be the conclusion of bilateral negotiations with the USA, which it is hoped will be achieved by end-year. The Supreme Economic Council has plans to open more sectors to foreign investment. These include some telecoms services, insurance, educational services and publishing.

Corporate financing: Major financings for blue chip Saudi companies and joint ventures continue to provide healthy income for Saudi banks and their partners. Among deals currently in the market is a 12-year $470m club deal arranged by a nine-bank group for Saudi Chevron Phillips Company, for refinancing ($225m) and new money purposes.

SAUDI ARABIA: Key projects

Gas Projects Initiative: The scheme has been broken up, with a Shell-led consortium signing an agreement to develop the upstream gas reserves that formed part of Core Venture Three. A joint venture will be formed with Total and Saudi Aramco. Upstream elements of Core Venture One are being offered under a licensing round, with bids due and awards scheduled for late January 2004. The three gas blocks are in the Rub Al-Khali region.

Independent power sector: A request for proposals for the Kingdom's first independent water and power project is expected by end-year. The 700MW plant will be built at Shouaiba. Other IWPPs are expected to follow at Shuqaiq, Ras Al-Zour and Jubail. Siemens signed final project agreements in July for the $170m Sadaf IPP. Saudi Aramco is evaluating bids for four IPPs totalling 800MW at Juaymah, Ras Tanura, Shedgum and Uthmaniyah. Technical proposals are under evaluation for a 1,500MW stage two expansion of an existing Shouaiba power plant.

Electricity expansion: Saudi Electricity Company (SEC) has extended bidding for the Riyadh PP7 expansion to 1 December. Bids are also expected in December for the expansion of the Arar, Rafah plants. Other expansion projects include the Asir, Bisha, Jizan and Riyadh PP9 plants.

GSM Licence: Prequalification for a second GSM mobile telecoms licence is expected by year end, with bids in H! 04 for a Q4 04 award. The new operator is timetabled to launch services January 2005.

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.

SAUDI ARABIA: Economic indicators

($ billion)

	1999	2000	2001	2002
Nominal GDP	161.0	188.4	186.2	182.8
Nominal GDP growth rate (%)	10.4	17.1	-1.2	-0.5
Real GDP growth rate (%)	-0.8	4.9	1.2	0.7
Current account	0.4	15.6	14.5	10.5
Central gov. domestic debt	44.4	43.8	45.6	48.8
as % of GDP	119.0	87.0	90.0	95.0
Oil price Saudi avge ($/bbl)	17.45	27.0	21.5	21.8
Official Foreign Assets	69.4	73.5	82.6	78.5
Cost of living (% change)	-1.2	-1.0	-0.8	-0.4

Source: Saudi American Bank, Ministry of Planning, Central Department of Statistics, Saudi Arabian Monetary Authority, IMF

GSN Risk Grade — D-/4: US sanctions add to pressures on Assad

Political And Social Development

Overview: *GSN* has further downgraded Syria's already low political risk rating, following the passing on 11 November of the USA's Syrian Accountability and Lebanon Sovereignty Act, which reflected the Bush Administration's hostility towards President Bashar Al-Assad's regime. This could have a big economic impact, as will the loss of free Iraqi oil, but we maintain the payments risk rating at 4, hoping that accelerated reforms compensate for sanctions and old ally Iran makes up the grant oil shortfall.

Government and opposition: New Prime Minister Naji Otari's cabinet is expected to push reform, but the reactionary Arab Baath Socialist Party will fight to block accelerated economic or political change. The security services remain highly efficient, and are monitoring an apparent increase in grassroots Islamist activity; some of it permitted as a safety valve. The USA is target for much of the Islamists' public ire; US intelligence has long seen exiled cells associated with the Syrian Muslim Brotherhood as a key elements in the groups now under the Al-Qaeda umbrella.

US relations: The USA remains focused on terrorist groups, claiming Al-Qaeda elements cross from Syria into Iraq. Stopping this traffic is one condition among several demanded by Washington to lift the Syrian Accountability Act sanctions (see below). Although not imminent, the threat of military conflict remains, while sanctions will set back efforts by Assad's reform team to introduce a more globalised, market-oriented economy

Israel and Middle East peace: The USA will also ratchet up pressure on Syria to rein in Hizbollah, while Israel takes more overt action, underlined by the 5 October bombing of an alleged Palestinian training camp 15 miles from Damascus. Chief of Staff General Hassan Turkmani has told troops to maintain the highest level of readiness to ward off Israeli "aggressive adventures", and Israeli occupation of the Golan Heights (still home to some 24,000 Syrians) could become a major issue again – but for now a war of words, rather than a new shooting match, is under way. Indeed, Prime Minister Otari has said Syria wants to revive the peace process.

European role: Key European powers France and the UK could have a significant role to play in bringing Damascus and its enemies to the (secret or public) negotiating table. Assad is to visit Brussels in December, pushing a new association agreement with the EU. This will provide international support to his reform effort, but is likely to be linked to ongoing talks on issues including human rights, good governance and democracy which could add to internal pressures.

Economic Outlook

Overview: With US economic sanctions looking increasingly likely, the new government needs to make good on pledges to prioritise administrative and economic reforms. If US sanctions are imposed, Iran has promised to support oil supplies, while relations with the EU will take on even greater importance. A new seven-year economic plan was unveiled in early November and there are plans for a stock exchange. All this is much needed, however, as Syria remains stifled by bureaucracy and corruption and there is a distinct lack of international appetite for project risk.

Financial sector reforms: Financial services are under-developed and in the process of being opened up to private investment. Reforms under a new seven-year plan include creating a stock exchange, standardising the exchange rate and modernising state banks. Three banks with foreign equity participants have full licences and launched share offerings in October for resident and non-resident Syrians (a potentially major investor class) only. Three other banks were granted preliminary approval in June. The October issuers included Jordan's Housing Bank, Banque de Syrie et d'Outre Mer (BSOM) and the new International Bank for Trade and Finance. Foreign banks may take up to 49% equity in joint ventures; Housing Bank offered its whole 51% local equity to the public. BSOM is led by Lebanon's Banque du Liban et d'Outre Mer (BLOM), and includes a 10% International Finance Corporation participation.

Liberalisation and EU association: The government wants to secure a "balanced" association agreement with the EU, possibly in December. This will include free movement of goods and capital. The government has indicated its desire to revitalise efforts to join the World Trade Organisation (WTO), although US sanctions are likely to check this ambition. Tax reforms and a clamp-down on tax evaders have been mooted. A one-stop shop investment initiative is expected to be launched after delays.

Hydrocarbons sector: Much hinges on a attracting new investment. Oil production is around 550,000 b/d and declining. A new oil licensing round has been launched but consists mainly of previously offered acreage. There are plans to modernise oil refining capabilities and establish a petrochemicals industry. Shell is a major player and won a four-year contract in July to expand the Thayem oil field. Exploration deals have been signed this year with Shell, Stratic Energy, HBS International, ONGC Videsh and Ocean Energy (now part of Devon Energy).

US SANCTIONS: The Syrian Accountability and Lebanon Sovereignty Act passed into law on 11 November after the State Department dropped its opposition. The Hamas and Islamic Jihad presence and support for Hizbollah in Lebanon are root problems. The sanctions will go into effect unless Syria meets a series of conditions. The bill directs the president to impose at least two of six sanctions – banning most exports, investment and Syrian overflights of US airspace, restricting diplomatic movements and contacts, and/or freezing Syrian assets.

SYRIA: Economic indicators

($m unless stated)

	1999	2000	2001	2002	2003[f]
GDP	15,600	17,300	18,400	18,900	19,500
Growth (%)*	-2.0	2.5	1.7	1.8	2.3
Population (m)	15.9	16.3	16.7	17.1	17.5
Inflation (%)*	-2.1	-0.6	0.4	0.9	1.6
Imports*	3,600	3,700	4,300	4,500	4,600
Exports*	3,800	5,100	5,000	5,800	4,900
Current account/GDP (%)	0.6	5.8	1.2	3.4	-0.9
Capital investment**	36.0	59.0	122.4	–	–

[f] Forecast.

Sources: Syrian government; Coface, Guide Risque Pays; Investment Bureau of Syria**.*

SYRIA: Key projects

Power sector: Syria plans to install some 3,000MW of new capacity by 2010. A tender for the 750MW Deir Ali combined cycle plant is awaited, while a 750MW plant is also planned in Deir Ezor, with a tender expected by end-year. But there are questions over investor interest. The distribution network is in poor condition, with one-quarter of generated capacity estimated to be lost. Awards are awaited for the conversion and expansion of three plants to combined cycle operation: the 200MW Tishreen, and 300MW Nasirieyh and Zeizoun plants. Three consortia short-listed for the Nasirieyh and Zeizoun plants, submitted bids late October. Seven bids have been received for Tishreen. The Nasirieyh unit is being re-tendered after lack of interest in 2002.

Transmission upgrade: The European Investment Bank and Arab donors have committed some $265m to expand and upgrade the national grid by 2005. This should boost Syria's prospects of participating in a future region-wide electricity grid with Egypt, Jordan and Turkey.

Petrochemicals: A consultancy tender is awaited for an economic and technical feasibility study into establishing a local petrochemicals industry. The consultant is expected to look at proposals for an initial polyethylene plant and caustic soda unit to supply the domestic market.

Homs refinery modernisation: Award is awaited of the EPC contract to upgrade crude distillation units. FEED work is under way for two other packages, with EPC tenders expected 2004/05.

DIARY: Events around the region

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 Michael Thomas: +44 (0)20 7839 2137.

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, 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, 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.

22-23 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.

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.

DATA: Stock markets, trade payments and exchange rates

Stock Market (Index)	Index value (07.11.03)	Index % change One week In local currency		Index % change From 31.12.02	Collection experience	Preferred terms	Exchange rate €	Exchange rate ¥	Exchange rate £
Bahrain[1]	2,240.62	–1.2	↓	23.0	Fair-Good	ULC	1 Dinar = 0.43255	0.34410	0.62920
Iran[2]	9,626.8	3.4	↑	90.9	Fair-Good	CIA	1 Rial = 9.588.82	7626.74	13949.1
Iraq	—	—		—	Poor	CIA	1 Rial = 9.588.82	7626.74	13949.1
Jordan[3]	236.86	2.6	↑	39.3	Fair-Good	ULC	1 Dinar = 0.81350	0.64700	1.18340
Kuwait[4]	4,471.30	1.9	↑	88.2	Fair-Good	ULC	1 Dinar = 0.33835	0.26910	0.49220
Oman[5]	266.64	0.4	↑	39.0	Fair	ULC	1 Riyal = 0.44175	0.35140	0.64270
Qatar[6]	700.81	3.8	↑	66.7	Fair	CIA	1 Riyal = 4.17650	3.32190	6.07570
Saudi Arabia[7]	4,074.89	1.8	↑	61.8	Fair-Good	ULC	1 Riyal = 4.30305	3.42250	6.25970
Syria	—	—		—	Fair-Good	CLC	1 £ = 52.7804	41.9804	76.7810
UAE	4,384.19	0.5	↑	28.6	Fair	ULC	1 Dirham = 4.21425	3.35200	6.13060
Yemen	—	—		—	Fair-Poor	CIA	1 Rial = 204.243	162.450	297.117

[1] Bahrain Stock Exchange Index. [2] Tepix Index, 12 November. [3] Amman Stock Exchange Index. [4] Kuwait Stock Exchange Index. [5] Muscat Securities Market Index. [6] Commercial Bank of Qatar Index. [7] Tadawul All Shares Index.

ULC Unconfirmed letter of credit
CLC Confirmed letter of credit
CIA Cash in advance

Source: Bakheet Financial Advisors, Riyadh. Global Consultants, New York. Cross-border Information, Hastings. Financial Times, London.

The USA in election year: Deciphering the Kremlin on the Potomac

What was last week's most striking photo image? The shell-shocked **Italian** soldier standing in the ruins of the Nassiriyah barracks where 18 Italians and eight **Iraqis** died in a 12 November suicide bombing; or the Iraqi child lying prone on an operating table, his head swathed in bandages covering the spot where before the bomb attack an eye had been? Or was it President **George W Bush**, standing hand on heart in heroic mode on his Veterans Day podium, while his top team were, in the words of *The New York Times*, "huddled with Mr [**L Paul**] **Bremer** in the White House Situation Room to plot ways of speeding the transfer of sovereignty" in Iraq?

It is not just analysts of, say, **Syria**'s security elite, Gulf princes or the **Iranian** clergy who can benefit from applying skills once honed by 'Kremlinologists' studying **Russia** and the Warsaw Pact. Deciphering the puzzle of who punches heaviest in Bush's Washington also requires Kremlinological skills – to find answers to questions that are critical to understanding the direction of geopolitics in a US election year.

Well before Bremer's hasty recall to Washington, Beltway gossip had focused on a change of course in Iraq, with the Administration planning to speed up its timetable for self-government – as had been previously demanded by the awkward squad of **France**, **Germany** and **Russia**, but which had been roundly rejected by the USA and **UK** (which now likes the idea).

Elections may seem an unappetising prospect in such a poisonous security situation, but they are in prospect for Iraq in H1 04 – long before envisaged by the Pentagon hawks who drove policy in 2002 and H1 03. This seems necessary to ***Republican*** planners who are anxious to get some 'closure' in Iraq before Americans return from their summer holidays to vote.

Even before elections are held and a new constitution is written, civilian authority could be handed over to a temporary government. This may not be the Interim Governing Council (IGC) created by Bremer. Kremlinologists note: Republican Senate Foreign Relations Committee chairman **Richard Lugar** on 11 November said IGC members "are not doing their job". Apparently long gone are the days when the Pentagon believed its favourite, ***Iraqi National Congress (INC)*** leader **Ahmed Chalabi**, would enter Baghdad in triumph to steer in a popular, pro-American administration. (Though this does not mean that Chalabi's Beltway fans won't be pushing his claim to become 'interim leader', **Hamid Karzai** style.)

GSN has long argued that US policy has suffered from being driven by ideologues. Since the dawn of the Bush presidency, we have analysed trends in Washington as a defining feature in setting the course of events and policy in the Gulf. Nothing since 2001 has intervened to alter this view, even if Bush enters election year apparently much weakened.

The US economy could prove the defining issue, but Middle East questions will play their part in the election campaign, especially if the neo-cons stay on top and Bush wants to play tough – and if the ***Democrat*** challenger gets a head of steam up over Iraq, as **Howard Dean** managed to do in launching his unlikely campaign. Shifts within the presidential team as things hot up will show the extent to which the neo-con thinking that dominated 2001-03 will survive into 2004 and the scrutiny of the much-maligned American electorate.

Defining issues include: the Iranian nuclear debate (further heated up by Tehran's plutonium admissions, but still likely to follow the path traced out in (*GSN 721/7*); Syria, with sanctions almost certain to be implemented (*see Risk management report, page 17*); and relations with **Saudi Arabia**. And that is before tackling wider issues of **Israel** and Middle East peace, and the full meaning of Bush's 6 November battle cry for democracy in the Middle East, which so upset **Egyptian** President **Hosni Mubarak** and some other rulers.

Entering election year, as the first term Bush team shakes out, policy-makers world-wide must pay close attention to who is on the up in Washington. Ask what America can do for you, but perhaps more importantly, what advantage your support or whipping boy status can bring to the President's re-election campaign.

Cross-border Information Ltd.
PO Box 124, Hastings, East Sussex
TN34 1WP, United Kingdom

Telephone **+44 (0) 1424 721 667**
Fax **+44 (0) 1424 721 721**
Email info@gulfstatesnews.com