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The pipeline boom: Great game, shame about the players

New pipeline projects beg a number of critical geo-strategic questions, with the prospect of Russian and Caspian crudes competing in markets where Gulf exporters have reigned supreme. In the process, Israel is emerging as a player in complex political/business games.

Pipeline politics – and geopolitics – are back on the agenda, with a host of new projects looking to cross Middle Eastern borders and secure access to the lucrative Asia/Pacific oil and gas markets. Some of these schemes bring significant new players into Gulf producers' back yards, some of them far from compatible with the Gulf states' world view – most notably, in many *OPEC* members' view, Israel.

Iraq's hopes of resurrecting its trans-**Saudi** pipeline look to have taken a step back following Saudi Oil Minister **Ali Al-Naimi**'s cold shouldering of the plan at a 16 November meeting with his Iraqi counterpart **Ibrahim Mohammed Bahr Al-Uloum** – when the two sides did apparently agree on questions of oil pricing *(see page 15)* – but other projects on the drawing board threaten to shift the regional energy balance.

The prospect of Russian and Caspian crudes competing with Gulf exporters' volumes in the lucrative Asian market is the stuff of nightmares in the power capitals of Kuwait City, Riyadh and **Abu Dhabi**. A whole set of new geo-strategic issues are being raised for the *Gulf Co-operation Council,* which is alive to the threat posed by alternative crudes reaching its key markets; the GCC is promoting its own crude export pipeline link from the northern Gulf to export terminals on Saudi Arabia's Red Sea coast or the Gulf of **Oman**. This project has risen quickly up the agenda, and could feature large at the GCC summit in **Kuwait** on 22-23 December.

Iran – which has developed a good working relationship with Saudi Arabia and several smaller GCC states – is pursuing both swap arrangements and potential Caspian-Gulf pipeline links, to free up more of its oil for export and maximise its substantial crude and product portfolio.

Then there is the regional pariah, Israel, which is about to stir up a hornet's nest by opening a long neglected internal pipeline between Ashkelon and the Red Sea port of Eilat, which could enable Russian suppliers to displace Gulf crudes from their target Asian market.

Israel's selling point is that it offers the shortest route between the Mediterranean and Gulf markets. The *Eilat Ashkelon Pipeline Company (EAPC)* completed a reverse flow project last summer, enabling it to pump crude through the 42-inch, 254km Eilat-Ashkelon Trans-Israel Pipeline (Tipline) in both directions. EAPC now has the ability to pump crude oil in both directions.

Tipping the balance

One trigger for the project was the assumption that part of the crude produced in Russia, the Central Asian republics or the Caucasus and loaded at the various Black Sea oil ports could be marketed at competitive prices for distribution in South Asia and the Far East. Tipline's design capacity of 1.2m b/d would allow substantial volumes of Russian crude, loaded at the Black Sea ports of Tuapse, Odessa and Novorossiisk,

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CbI
Cross-border Information

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to be reloaded onto large carriers at the Gulf of Aqaba for onward shipment. This would slash transit times by more than half and significantly reduce the cost of exporting Russian oil.

The pipeline's origins lie in Tel Aviv's relationship with the Iranian regime of **Shah Reza Pahlavi.** In 1968, the two countries joined forces to build the pipeline link to enable Iranian crude exports to bypass the Suez Canal, but by the time the Islamic Revolution had swung around 1979, the pipeline was shipping only small volumes of oil.

EAPC also expects to rehabilitate the non-active part of the 16-inch pipeline from Haifa to Eilat by end-2003, enabling it to transit distillates (gasoline, jet fuel and gasoil) from the Mediterranean to the Red Sea and vice versa. EAPC says one of the operating schemes involves collecting several cargoes of 500,000 bbls or 1m bbls at storage terminals and then redeliver them as bigger cargoes for VLCCs.

Since both Ashkelon and Eilat can handle supertankers – unlike the Suez Canal – the Israel option offers a viable route to market for Russian exports.

Although Russian oil production is growing, it is butting up against export capacity constraints. The Israel transit option, combined with plans for an oil pipeline from Eastern Siberia to Russia's Pacific coast for shipment to **Japan**, means Russia may soon prove a real competitor to Middle Eastern oil exports in the Far East.

In a bid to lighten its heavy reliance on Middle East oil imports, Japan has been lobbying Moscow to support the pipeline project from Angarsk in eastern Siberia to Nakhodka. "The Russians are looking for more markets for their crude," said **Stephen O'Sullivan**, chief analyst at the Moscow-based *UFG Bank*. "Sakhalin will go out that way; the **China** pipeline that Yukos is planning is also going that way. In three years' time the pipeline to China will displace imports and a pipeline to the Vladivostok area would enable Russian crudes to be exported into Asia as opposed to simply displacing imports into Asia from the Arab Gulf."

Japan has a long-term strategy to reduce its dependence on Middle East oil from 85% to 60%. Finding new ways to import Russian crude will support this effort.

Escaping the 'Asian premium'

The Tipline option has a further appeal to Asian customers: accessing Russian crude would allow them to escape the so-called 'Asian premium' charged by Gulf producers. Between 1991 and 2002 Asian buyers paid an average $0.94/bbl more than European buyers for Arabian Light crude.

This pricing mechanism – arbitrarily dictated by the vendor – means crude oil prices for the Asian market are round $1-1.50/bbl higher than for equivalent European and US markets. According to **Yoshiki Ogawa**, an economist with the ***Institute of Energy Economics*** in Japan, this premium amounted to more than $5.5bn in 2000 alone.

Tipline, in combination with other export routes – including proposed links between the Caspian and the Gulf – threatens the sanctity of that premium, which is derived from Arab oil's monopoly of the Asian market. With 40% of Saudi Arabia's 7m b/d exports in 2002 going to Asia, Riyadh will be anxious not to lose that revenue stream.

War on terror fallout

Closer strategic ties between Russia and Israel, intensified by their shared interests in fighting Islamic militancy, has provided the political context for the energy co-operation. On the other hand, Saudi Arabia's recent diplomatic efforts in Moscow have failed to secure any kind of agreement on oil production. It is unlikely to have any more success in warding the Russians off commercial ties with Israel.

The Tipline's activation will allow Israel to accrue transit fees. But the spin-offs for Tel Aviv are mainly political: besides cementing relations with Moscow, Tipline could help to undermine Arab oil's global strategic value. But amid these big geopolitical issues, initial Russian interest in Tipline

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The missile threat: should air travellers be scared?

As the war on terror beds in, airline security teams are becoming more concerned about Manpads than box-cutters. Everything from improved intelligence to on-board missile countermeasures mean the threat is controllable – but costs are rising sharply and the threat won't go away.

The potential risks to air travellers were rammed home when on 22 November civilian courier and passenger aircraft flights to **Iraq** were suspended after a surface-to-air missile hit a *DHL* aircraft taking off from Baghdad International Airport *(see box)*. Of course, Baghdad is a very different situation from **Bahrain**, **Dubai** or Muscat, but the incident showed there was a potential missile threat to air travellers, even if it is only marginal.

The threat appears to be twofold. At the global level, terrorist actors are beginning to use shoulder-launched man-portable air defence systems (Manpads) on a regular basis.

According to *British Airway*s security personnel, BA is seeing operational adaptation from a focus on 9/11-style hijackings towards missile strikes on aircraft. In part, this is because local intelligence services and airport security staff are becoming more adept at observing the patterns formed by potential hijackers. BA officers told *GSN* the company cancelled its flights to and from **Kenya** in March because suspicious patterns were detected in pre-booked ticketing, involving groups of young men that, in each instance, included an individual identified by the authorities as a trained pilot.

Since a **Palestinian** plot to shoot down an **Israeli** aircraft was foiled in Rome in 1973, there have been surprisingly few terrorist incidents involving Manpads. But at the same time as airport security has strengthened, the incidence of plots involving missile attacks has increased:

- in May 2002 a used SA-7b Manpads launcher was found in the desert near Prince Sultan Air Base in **Saudi Arabia**, where a **US** aircraft was unsuccessfully targeted;
- on 28 November 2002, two SA-7s were fired at an Israeli airliner taking off from Mombasa. The missiles (which failed to hit the aircraft) were reported by US government officials to have come from the same stock as the one used in Saudi Arabia;
- in February 2003, the **British** army deployed 400 troops to London's Heathrow Airport, primarily to patrol potential missile launch areas;
- the US government unveiled a successful sting operation focused on Manpads smuggling 2003; and
- in Saudi Arabia, security forces discovered a number of Manpads, contributing to BA's decision to temporarily suspend flights on 14 August. These weapons appeared to have come from **Yemen**, and there is little to prevent similar shipments finding their way across the borders of *GCC* countries.

Although it would be easy enough, there may be little need for insurgents to smuggle Manpads into Iraq, as an unspecified number of these weapons remain unaccounted for. According to one US Central Command (Centcom) officer, estimates of Iraq's pre-war inventory range from 3,700 to 10,000. He told *GSN* that around 1,600 Manpads had been secured at Iraqi arsenals and a further 317 had so far been handed in to US forces under a scheme that has dispensed around $100,000 worth of rewards. At just over $300 per weapon, this rate is far lower than the $5,000 that Manpads can fetch on the internal black market, the officer commented.

Almost 30 Manpads have been fired in Iraq since the end of major combat operations in May, including one that destroyed a Chinook helicopter on 2 November, causing 16 deaths.

It is in the environment of guerrilla warfare that Manpads have enjoyed their greatest successes. Along with simpler, unguided rocket-propelled grenades (RPG) they destroyed large numbers of aircraft and helicopters in **Afghanistan**, US operations in **Somalia**, and on many other occasions.

Of 42 observed uses, Manpads have been credited with destroying 27 civilian aircraft in small conflicts, causing 400 deaths.

DHL attack leaves Iraq more isolated

Civilian courier and passenger aircraft flights to Iraq were suspended on 22 November after a surface-to-air missile hit and set fire to a DHL courier aircraft taking off from Baghdad International Airport. The slender air bridge servicing the Iraqi capital transported personnel, business documents and in-demand specialised machinery in and out of Baghdad; it was a symbol of the normalisation of business operations in the city. Although the plane landed safely at Baghdad, the incident was a sufficiently close call to prompt the previously bullish DHL to cancel its operations in Iraq and **Afghanistan** until further notice. The only civilian passenger service to Baghdad, consisting of 50-seat aircraft flown by ***Royal Jordanian*** affiliate ***Royal Wings***, was also cancelled indefinitely.

Following the collapse of plans to open Basra airport to major airlines in early September, the suspension of DHL and Jordanian Wings services will further reduce the confidence of organisations considering investing or operating inside Iraq.

DHL was the first commercial carrier to operate in post-war Afghanistan. When DHL established operations in Iraq on 22 May, the very day ***United Nations*** sanctions were lifted, the **German**-owned company's commercial director for the Middle East **Ali Sarrafzadeh** stressed the benefits of market leadership and downplayed the risks associated with early market entry. DHL's retreat from Iraq may act as a cautionary tale for other companies carrying out a cost-benefit of early market entry, and illustrates the growing global and particularly regional threat to aviation.

Gulf royals fly the unfriendly skies

Gulf monarchies moved with uncommon speed to assure their subjects' continuity of government by securing cutting-edge anti-missile countermeasures for their royal flight aircraft. In September, **Bahrain**, **Saudi Arabia** and **Qatar** were prompted by **US** Central Command (Centcom) to buy new countermeasures *(GSN 720/7)*. Bahrain and Qatar spent $61m each to equip their primary royal aircraft with ***Northrop Grumman*** Nemesis laser counter-measures. The Bahraini system will protect the new Royal Flight ***Boeing*** 747-400. The House of **Saud** bought four of the Nemesis systems to equip the Boeing 747 and 737 aircraft used by **Saudi** leaders.

Vulnerability reduction is the second key avenue of threat mitigation, aiming to reduce the damage that a missile hit would cause a plane. In this field, aircraft design continues to make strides and there are encouraging precedents.

Man-portable surface-to-air missiles (Manpads) have not proved very efficient against well-maintained, modern civilian aircraft, piloted by western aircrew. Heat-seeking missiles predictably strike engines and large aircraft with three or four engines can comfortably survive the loss of one. The ***DHL*** flight hit in **Iraq** was a twin-engine aircraft and still managed to complete take-off and land with one engine.

Steps to reduce the threat

Two factors can reduce the threat from man-portable surface-to-air missiles.

Susceptibility reduction aims to reduce the chance that missiles will hit the aircraft. Intelligence may be able to prevent the attack before it occurs.

Failing this, active patrolling of potential launch sites can reduce the threat. Manpads have to be launched from a relatively constrained arc, and enjoy optimal effectiveness when targeting aircraft from behind and below during take-off, during which the aircraft is under maximum strain and produces firm heat signatures for the missile to lock onto.

According to Centcom officers, Saudi Arabia and other Gulf states have incorporated increased helicopter and ground patrols into airport security since August.

Many elements of the launch can go wrong: missile operators may launch the missile from inside its minimum range, the infrared seeker may be distracted by the sun or its reflection, and older weapons such as those used in recent attacks often have defective fuel packs or seekers.

Except at very close ranges, active defensive countermeasures further decrease the chance of a hit. These can be in the form of physical decoys – flares that mimic engine heat – or more advanced laser countermeasures that 'dazzle' the infrared seeker, forcing it to lose tracking.

BA has been considering introducing countermeasures on its aircraft operating in the Middle East, a step that Israeli airlines carried out years ago, and an issue that is receiving close attention in Washington. The US House and Senate is considering legislation that would make it mandatory for planes operating in US airspace to carry missile countermeasures, a development that could cost the cash-strapped airlines industry an estimated $10bn. US, Israeli and UK-based firms are offering systems that range in price from $2m per aircraft to $5m, and each airline could expect to pay further costs in servicing and flight safety certification.

Impacts from the missile threat

The missile threat is by no means an unsustainable physical risk – hitting aircraft is hard and impacts rarely destroy modern multi-engine civilian aircraft *(see box)* – yet various BA service cancellations and the DHL withdrawal from Iraq highlight the skittishness of companies when faced with the threat.

During *Operation Iraqi Freedom*, aviation insurance in the Gulf increased sharply through per-flight surcharges. Companies should expect these surcharges to remain for some time, compounding the financial impacts of a bad year that has seen the SARS virus and reduced traffic due to the war in Iraq and international terrorism. While other routes are forecast to benefit from a 20%-30% reduction in premiums due to over-capacity in the insurance market and a relatively benign loss year for aviation underwriters, Gulf carriers can expect continued penalties.

In Iraq, the loss of civilian flights will affect not only business confidence but will also incur additional operational costs. Many businesses will be forced to rely on the road journey from Jordan, or even longer runs from Kuwait, neither of which are risk-free. Much has changed since a host of international airlines vied to provide direct flights into Baghdad and Basra in June, and for the time being, the 22 November suspension of civilian flights is the nail in the coffin of Iraq's near-term civilian air transport recovery.

BAHRAIN

End of Ramadan nerves

Reports that 10,000 people took to the streets of Bahrain to celebrate Jerusalem Day, the last Friday in Ramadan, on 21 November, may have understated the size of the event. Local correspondents report as many as 45,000 attended, a higher-than-normal turnout for the demonstration, which featured the usual anti-**American** and anti-**Israel** sloganeering and the burning of a few American flags.

There was no violence or arrests, but a simmering unrest in the normally pro-Western kingdom could have an impact on business interests there, just as the country is trying to make its mark on the international financial scene.

With the recent security warning from the **UK** embassy in Manama, issued just hours before the 8 November bombings in Riyadh *(GSN 722/1)*, questions arise as to just how contagious the violence in **Iraq** and **Saudi Arabia** may be.

Events in **Turkey** suggest a region-wide phenomenon. But the British warning in Bahrain was later revealed to be based not on any specific information, but simply a generally "high threat from terrorism" in the region, particularly in places where Westerners might gather, the embassy said.

Whether or not terrorism is about to creep across the King Fahad Causeway linking Bahrain with **Saudi Arabia**'s Eastern Province, there have been signs of heightened unrest in the island kingdom, which has now reached a level where business interests are beginning to take notice. Some businessmen say that even a mild escalation could have an impact on prospects even as the global economy sputters ahead.

No song and dance

Several recent events point to increased activism on the part of anti-Western groups in Bahrain, though not necessarily to a rise in anti-Western sentiment. In October, Islamist MPs moved in Parliament to cancel two concerts by **Lebanese** singer **Nancy Ajram**, charging her show was indecent and provocative. Their motion was soundly defeated, but more than a 100 masked protestors disrupted Ajram's concerts on 22-23 October, throwing stones, setting rubbish on fire and smashing car windows. There were several arrests over the two nights, but the concerts managed to go on as planned.

A smaller but perhaps more telling disruption came at the end of October, when a child's Halloween party at an expat compound in a Manama suburb was shut down by an angry mob of approximately 120 Bahrainis, according to the Bahrain-based manager for a major American company doing business throughout the Gulf. The mob brandished mobile phones and threatened to summon many more supporters if the music and partying were not stopped. As the manager put it, "people want to live in a safe place."

So far, Bahrain has been one of the safest, with a per capita income right in the middle of the *Gulf Co-operation Council (GCC)* states (higher than **Oman** and Saudi Arabia), and more progressive democratic reforms in place than most if not all its fellow GCC members.

But many more disturbances of the same nature could change the feeling of security there. Western and Bahraini businessmen both tell *GSN* they view the situation with more wariness of late, though not yet with alarm. Whether the answer is heightened security, economic development, political reform, or progress in **Palestine**, Saudi Arabia or **Iraq** is far from clear. But if an answer is not found and things get much worse in Bahrain, there could be real consequences for business there just as the country is hoping its landmark Bahrain Financial Harbour (BFH) project *(see page 12)* will raise its international profile with investors.

Trouble at the mall

The tens of thousands of demonstrators that turned out for Palestine Day in Manama gathered outside the new Seef Mall, itself a very American icon, where shoppers have their pick of US-brand fast food and 16 theatres showing American and European films. On the street, some marchers carried pictures of the Statue of Liberty standing atop a pile of skulls.

Though life in Manama went on as normal in the days following the UK security warning and the latest Riyadh bombings, at least one other embassy, **Germany**'s, closed to foreigners for a reassessment of the country's security situation, officials said. The US embassy in Manama issued no security warnings in the days before or after the bombings.

Though no new domestic security measures have yet surfaced, Bahrain will be eager to dispel any notion that it is a place not conducive to Western business interests *(see Finance and policy)*. An escalation of anti-Western unrest could endanger not only new business initiatives but also the ones already in place, which have helped the kingdom establish the great deal of security it currently enjoys.

POLITICS POINTERS

SAUDI ARABIA/USA: The heat is on in Washington

Hopes of stabilising the Saudi/US relationship have taken a turn for the worse with a series of legal moves, including the introduction in the Senate of embarrassing legislation that would require the President to certify that Saudi Arabia is making a "maximum effort" to fight terrorism – and impose sanctions if the Kingdom is found wanting. Sanctions included in the bill, whose lead sponsor is Pennsylvania ***Republican*** Senator **Arlen Specter**, would include a ban on defence sales and restrictions on travel by Saudi diplomats. Adding insult to injury, in an unprecedented move, the ***Federal Bureau of Investigation***'s Washington field office seized bank records as part of an investigation into the $300m/yr reportedly spent by **Prince Bandar Bin Sultan Bin Abdelaziz**'s Embassy. US officials said the FBI subpoenaed the records of dozens of Saudi bank accounts to determine whether official Saudi money had knowingly or unknowingly helped fund extremists in the USA. The move – which was not triggered by any specific event or transaction – was approved by the National Security Council.

IRAN/IRAQ: Khatami recognises IGC, NOC to provide products during winter

President **Mohammad Khatami** on 17 November said "we recognise the Iraqi Governing Council and we believe it is capable, with the Iraqi people, of managing the affairs of the country and taking measures leading toward independence." This effectively meant Iran – or at least its executive – sanctioning the latest **US** plan to stabilise Iraq. In a shrill analysis, Austin, Texas-based ***Stratfor*** argued that this could ultimately lead to Iran playing a key role in Iraq, via the Shiite majority, with tacit US agreement as it pulls back from a difficult situation in Iraq. This seems to be (rather entertaining) supposition, but more immediately Iran has committed to supply Iraq with fuel to help it through the winter. The commitment was made on 22 November, when IGC Oil Minister **Ibrahim Mohammed Bahr Al-Ulloum** met his Iranian counterpart **Bijan Namdar Zanganeh** in Tehran. As with Ulloum's talks in **Saudi Arabia** *(see Energy pointers)*, ***OPEC*** co-operation was also discussed – not a prospect to excite some US hawks.

Often the GCC maverick, Qatar gives 'assured access' to the US military

Before 9/11, Al-Udeid was virtually a secret facility, and France and the UK were seen as the peninsula emirate's big military allies. The second article in *GSN*'s new series on Gulf militaries argues that Qatar's embrace of the US military has come a long way in a short period.

US generals and Pentagon hawks may hate its hosting of *Al-Jazeera Satellite Channel*, but they are big fans of Qatar's military basing potential – and in fully embracing an expansive US security guarantee after 11 September 2001, **Sheikh Hamad Bin Khalifa Al-Thani** has responded, with the emirate turning its back on almost 30 years of hedging its internal and external security on non-alignment with any one external security vendor.

Central Command (Centcom) strategic planners canvassed by *GSN* now believe Qatar will be the principal base for US headquarters staff and combat aircraft in the Gulf for the foreseeable future. As well as being the key forward presence location in the GCC region – along with the Fifth Fleet headquarters in **Bahrain** – US officers confirmed that Al-Udeid airbase was one of the only Gulf locations that planners regarded as giving "assured access", making it the principal power projection node in US plans to defend the Gulf.

Centcom's General **John Abizaid** announced that 10%-15% of his staff would be relocated to Qatar from Florida.

The USA will also continue to maintain a prepositioned equipment set at Camp as-Sayliyah, including 110 armoured vehicles to equip a mechanised brigade and support services to receive a further two brigades worth of equipment. As a result, the Pentagon has prioritised the hardening and defensibility of Al-Udeid and other US facilities in Qatar, most of which are collocated with Qatari military facilities.

The burgeoning US relationship comes at a time when Qatar has been slowly reining in its defence expenditure, after a period of strong procurement spending that made its per capita defence spending among the world's highest.

Buoyant oil prices reduced defence expenditure as a percentage of gross domestic product at the end of the 1990s, but cannot conceal the fact that defence spending consumed three to four times the global average share of GDP.

As Qatar continues to bridge the financing gap required by its transition from an oil-driven to a gas-driven economy, it is questionable whether current spending levels can be maintained in the near-term. Qatari defence spending is thus likely to see a decline throughout the period to 2010, as new procurement commitments tail off and the small military requires relatively small recurrent operations and maintenance expenses. Even so, Qatar is projected to spend around $1.2bn/yr on defence in 2003-05.

Like most Gulf armed forces, the Qatari Ministry of Defence will continue to build rounded armed forces with land, sea, and air components. This does not necessarily reflect the future defence requirements of the country, but reflects longer term political and social imperatives.

Emir Sheikh Hamad and recently appointed **Crown Prince Sheikh Tammim Bin Hamad Al-Thani** are both *Sandhurst*-trained army officers, and both maintain a strongly nationalist focus on maintaining Qatar's territorial integrity in the face of the **Saudi**/**Bahraini** axis. It will take some time for the country's changed threat profile to be absorbed at these levels.

In the meantime, Qatar's military establishment will initially meet the requirements of the Army – the emirate's most influential military arm. This will mean servicing the requirement for up to 50 new generation main battle tanks to replace the 28-34 operational AMX-30B2 tanks currently used by Qatar's single armoured battalion. Up to 72 new generation armoured vehicles will thereafter be required to mount Qatar's four mechanised infantry battalions. Artillery may also be purchased. The Emiri Special Security Forces may be re-equipped in an $800 million armoured vehicle deal.

At the tactical level, Qatar has long planned to acquire unmanned aerial vehicles to provide over-the-horizon targeting data for its artillery forces. With the likelihood of 'hot war' against any of its neighbours receding, these forces are likely to be reoriented towards the counter-terrorist missions of border and keypoint defence.

Investment in intelligence

The country is likely to invest some resources in updating its neglected intelligence, surveillance, and reconnaissance (ISR)

QATAR: Trend of defence expenditure

($m in fiscal years)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
781	781	330	308	700	740	1,346	1,373	1,468	1,468	1,423

Source: International Institute for Strategic Studies, Military Balance, London (IISS 1987-2002).

capabilities, plugging its sensors and headquarter nodes into the US systems in place at Al-Udeid. This will end a long period in which Qatar had no airborne radar coverage, relying on a mix of *Thales* radar, including four TRS-2100 and six 2201 units which could not see further than the radar horizon – that is, around 20 miles versus enemy ships or low-flying aircraft.

Plugging into US early warning networks will preclude the need to buy expensive airborne early warning aircraft. Qatar will benefit from secure communications lines laid at Al-Udeid, which link the base to the underground Qatari air defence operations centre in Doha. As a signatory of the US Co-operative Defence Initiative, Qatar will also receive US early warning data concerning ballistic missile launches in **Iran**, with much of the country falling under the defensive shield of local US ballistic missile defences.

International developments may further remedy Qatari shortfalls in command, control, communications, computerisation and ISR (C^4ISR). The GCC's *Hizam Al-Taawun* (Belt of Co-operation) C^4ISR project may provide a structure for Qatar to slot into, exploiting the $70m secure communications system installed by ***Ericsson*** and the $88m radar integration and C^4 work carried out by ***Raytheon***.

The Qatari armed forces will also seek to develop niche capabilities that allow it to slot into US coalition operations in the Gulf, and to make token but politically significant contributions to its own defence. Freeing up US forces by carrying out combat air patrols and ground-based air defence will be one such area. The *Mirage* 2000-5 represents a great improvement on the Mirage F-1 EDA in air-to-air combat, despite not being an optimised interceptor. The *Thales* RDY multimode radar and glass cockpit are features included to improve capabilities in both within-visual-range (WVR) and beyond-visual range (BVR) encounters, with the former boasting multi-target scanning and prioritisation.

Qatar has a powerful arsenal of air-to-air missiles for its Mirage 2000-5s; $278m of the $1.2bn Mirage deal went on Matra Magic II WVR and Matra Mica BVR missiles.

As with C^4ISR, Qatar may be willing to defer national development of more effective surface-to-air-missile systems until US and GCC air defence projects are emplaced. Qatar does not employ anti-aircraft artillery, and relies entirely on shoulder-launched missiles for low-level anti-aircraft capabilities. In 1995, Qatar bolstered its motley and ageing collection of man-portable missiles with 24 Matra Mistral launchers and 500 missiles.

Next steps may include the purchase of *Shorts*' Starburst man-portable or vehicle-mounted low-altitude missiles (following **Dubai**'s selection) or more Raytheon FIM-92 Stingers. Medium-altitude air defence could either involve upgrading Roland-2 missile launchers (with Glaive infra-red sights and Thales VT-1 hypervelocity missiles) or buying 1-2 batteries of Raytheon I-Hawk or Thales Shahine missiles.

Although Raytheon made high-profile attempts to woo influential decision-makers – such as Foreign Minister **Sheikh Jassim Bin Hamad Bin Khalifa Al-Thani** – Qatar is unlikely

QATAR: A threat assessment

Although there are no explicit threats to Qatar's national security, the emirate is conscious of past conflicts and future potential for trouble, focusing on **Bahrain**, **Saudi Arabia** and **Iran**. However, the intimacy of Qatar's relationship with the **US** military has all but eclipsed these threats, dramatically changing the threat profile facing the country.

International Court of Justice arbitration in 2001 effectively ended the dispute with Bahrain over the Hawar Islands and Fasht Al-Dibel rocks. However, in recent months there have been some tensions, with Qatari forces seizing Bahraini fishing dhows, which strayed across the maritime boundary *(GSN 718/9)*. The vessels and fishermen were subsequently returned, but this remains a periodic strain on relations. If the two states clashed over this or other issues – such as the Bahraini enclave on the Qatari mainland at Zubara – the conflict would quickly become politicised and, on past form, could spill over into armed clashes. In April 1986, Qatari helicopters fired on Bahraini positions on Fasht Al-Dibel, while in June 1991 the ***Royal Bahraini Air Force*** penetrated Qatari airspace to warn against further actions.

Historically, there has also been the potential for conflict on Qatar's land border with Saudi Arabia, where Qatari land and air forces periodically practiced holding actions in disputed wadis. But the presence of US bases means that Qatar's concerns about the Saudi/Bahraini axis on its south-eastern crescent are increasingly becoming a historical rather than a current threat, marking a watershed in the development of the security environment.

This suggests that the most pressing external threat to Qatar now comes from Iran – although the two countries have no history of conflict, even during the Iran-**Iraq** war. *GSN* was told by a military advisor to US Central Command (Centcom) commander General **John Abizaid** that control over the huge North Dome/South Pars gas field was the key area in which Qatar had detected the potential for conflict with Iran. Despite the development of stronger naval capabilities, including the purchase of four ***Vosper Thorneycroft*** Barzan-class guided-missile patrol craft, the Qatari navy has very little ability to patrol or control its offshore holdings. Qatar's closer relationship with the USA thus provides clear benefits to its ability to manage the giant gas field, which represents the linchpin of Qatar's future economic security – and, via ***Dolphin Energy*** and other projects, is the hub of future Gulf energy security.

Despite these positive advantages, forming the closest defence relationship with the US of any regional state has security costs in the post 9/11 world. Radical Islamists may find a home in Qatar, but the royal family have placed themselves firmly in the crosshairs of ***Al-Qaeda*** and its local affiliates, clearly falling into the category of "the near enemy" (Arab governments that will be targeted by terrorist groups for their support of US polices and presence in the region).

Qatar could also face direct attacks on what Al-Qaeda terms "the far enemy" (US force deployments). Adapting to the external terrorist threat is not completely novel to the Qataris, who consider Iranian hardliners to have been highly active in fomenting dissent as late as 1994. Domestic intelligence services, gathered under the ***General Administration for Public Security***, will receive US assistance in reorienting away from inter-tribal and intra-family internal threats and towards the threat from unsecured borders and internal cells.

to purchase heavy surface-to-air and anti-ballistic missile defence systems like the Patriot PAC-2 or -3.

Qatar will also develop stronger anti-surface warfare capabilities – which are evolving at a far slower rate than those of other GCC states such as the **UAE**, **Oman**, or Bahrain – to allow it to make some contribution to the strike mission.

Anti-tank and anti-surface vessel helicopter capabilities did not witness major improvements during the 1990s due to budgetary pressures. Qatar's ageing SA-342L Gazelle fleet does not appear to have received laser range-finding equipment, and only two of eight navalised Commandos are capable of firing Exocet missiles. None of Qatar's attack helicopters boast night or bad weather sensors.

Conversely, strong investment in fixed wing combat aircraft has greatly improved Qatari capabilities against surface targets. The Mirage 2000-5 carry Sextant Avionique precision navigation equipment, Damocles thermal-imaging devices, and Thales self defence suites. The aircraft boasts nine hardpoints, three of which are 'wet' – allowing the carriage of drop tanks. Qatar Mirages are capable of buddy-refuelling, increasing strike ranges. In combination with in-flight refuelling, these features give Qatari Mirages considerable reach and some survivability against strong air defences. Qatari procurement of stand-off weapons will also increase range and survivability. The emirate has so far fielded the AS-30L laser-guided bomb, Matra BGL, AM-39 Exocet, and the 150km Matra Black Pearl (Apache) air-launched cruise missile.

Finally, Qatar will homogenise and supplement its fixed wing and helicopter transport fleets to improve its ability to monitor and patrol its borders – a critical factor during the current war or terrorism, and a constant requirement to deter territorial aggression.

Qatar has an urgent requirement for at least two fixed-wing medium military transport aircraft. It also requires up to ten medium transport helicopters that can be armed for close air support missions; the S-70L Blackhawk is identified as a likely contender. Qatar now operates four different types of 15 to 20-year-old utility and transport helicopters.

Some of the gas revenues, expected to burgeon further in the next decade, will be channelled into meeting these perceived military needs.

Emir steps in at Al-Jazeera to protect diplomatic gains

Qatar's **Emir Sheikh Hamad Bin Khalifa Al-Thani** has asserted his personal authority over the controversial ***Al-Jazeera Satellite Channel (JSC)*** station with a boardroom reshuffle and an almost unprecedented public restatement of professional standards. The move comes as Sheikh Hamad has further accelerated his domestic political reform programme, while seeking to defuse diplomatic tensions.

Sheikh Hamad's JSC move came towards the end of Ramadan with the appointment of a new chief executive and three new directors *(see box)*. He instructed them to "enhance the station's capabilities and ensure the standards of professionalism".

Although the Doha-based broadcaster was set up with Al-Thani financial backing – with his key aide, Foreign Minister **Sheikh Hamad Bin Jassim Bin Jaber Al-Thani**, taking a personal 30% stake – the Emir had hitherto eschewed any overt interference. Government officials and JSC executives alike repeatedly insisted the station enjoyed full editorial independence, although we hear that earlier this year, for the first time, chairman **Sheikh Hamad Bin Thamer Al-Thani** intervened to screen controversial programming..

Amid a cacophony of complaints that Al-Jazeera's reporting style was annoying not just other Arab states but key Western allies as well, the Emir appears to have concluded that Qatar's international profile was now at risk. The **Kuwaiti** daily *Al-Siyasa* reported claims of congressional pressure on US President **George W. Bush** to demand its shutdown.

GSN has for months heard US and **British** officials moaning about JSC's 'biased' coverage of events which are embarrassing to the Coalition *(GSN 709/20)*.

There were rumours that if Qatar failed to comply, Bush might even abandon the bilateral defence treaty and pull US forces out of Al-Udeid air force base. However, given the extent of US involvement, this seems unlikely *(see above)*, and on the political front, Bush and Secretary of State **Colin Powell** have praised Sheikh Hamad's reform programme.

Washington has also valued Qatari diplomatic help on a number of issues, including nudging **Sudanese** president **Omar Al-Bashir** – who has good relations with Doha – into concluding a peace deal with the south. Sudan is one of the main US preoccupations in Africa.

There is little doubt about the depth of US annoyance over Al-Jazeera's role. But how far this anger has gone is a matter for conjecture: in a debate over free media in the Arab world, rumour, claim and counter-claim are the currency.

Washington has never really managed to shake off suggestions that the bombardments of the TV station's offices in Kabul and Baghdad were more than an accident.

But JSC's closure was never really on the cards. Not only would the public across the Arab world have blamed Qatar for such a totemic blow against the fledgling media freedoms they have begun to enjoy; the shutdown of the station would also have represented a deep personal humiliation for both Sheikh Hamad and Sheikh Hamad Bin Jassim.

It is too early to gauge whether the personnel changes will produce shifts in Al-Jazeera's editorial style. The station insisted editorial policy will not change, but it does seem to be backing away from confrontation with critics. Apparently after American complaints, two anti-US cartoons have been withdrawn from its Arabic and English-language websites.

Sheikh Hamad clearly does not want to abandon his commitment to hosting a broadcaster that, as the most internationally well-known symbol of increased media freedom in the Arab world, certainly raises Qatar's profile.

Who's the new who at Al-Jazeera

Al-Jazeera's new station chief is **Waddah Khanfar**, former head of JSC's Baghdad bureau. He replaces **Adnan Sharif**, who had been in charge on an "acting" basis since the June resignation of **Mohammed Jassem Al-Ali**. JSC rejected suggestions that Ali's departure was a response to **US** complaints, but it is hard not to see the latest changes in this light.

The new members of the station's board include a first ever non-Qatari director – **Qasim Jafar**, from **Lebanon** – and two locals: telecommunications engineer **Qasim Al-Umadi** and the head of ***Qatar University***'s ***Gulf Centre for Research***, **Hassan Al-Ansari**, a liberal academic with a wide knowledge of regional political issues. Ansari was one of the main organisers of a conference on democratic reform hosted by Qatar in April 2002; this was attended by a strong contingent of US ***Republicans***. Such transatlantic contacts might prove helpful in defusing future rows over JSC's reporting.

But it's not all change at the Arab world's favourite station. **Sheikh Hamad Bin Thamer Al-Thani** remains as chairman and **Khalaf Al-Manai** as his deputy. Most notable is the continued presence of the ***BBC***-trained **Ibrahim Hilal** as chief newsroom editor; he is the man who takes many of the day-to-day decisions on how to cover individual stories, under the pressure of broadcast deadlines and fast-changing events on the ground whose governments are so often annoyed by Al-Jazeera's reporting.

But nor does the Emir want to see the diplomatic standing that he and Hamad Bin Jassim have worked so hard to build up eroded by Gulf Arab antipathy to the Doha TV station.

Doha tests democratic sensitivities

The state of relations with neighbouring countries, so often upset by **Al-Jazeera Satellite Channel**, is particularly important for Qatar at a moment when **Emir Sheikh Hamad Bin Khalifa Al-Thani** is preparing to implement a democratic reform programme that is significantly more advanced than those of many other Arab states. Political reform has become sufficiently common in the Gulf for it not to disconcert those governments that have yet to embark on reforms. But Doha seems to be seeking to nudge the regional agenda further forward: hosting a GCC justice ministers' meeting, Qatar's **Hassan Abdallah Al-Ghanem** called for policies to secure respect for the rights of individuals within society.

Elections are expected next year. Under Qatar's new constitution, two-thirds of the 45-member Council will be elected, with the rest appointed by the emir. The Council will be able to initiate legislation.

Sheikh Hamad clearly intends to retain ultimate control via the nominated members and his final right to approve all bills. But this blocking power will be circumscribed: if this proto-parliament puts forward an amended draft of a bill the Emir has already rejected once, he cannot reject it again on the same grounds. In effect, neither Ruler nor assembly has total power: the new arrangements will pressure both into negotiating compromises where there is disagreement.

The Emir set out his development agenda in a speech opening the 32nd session of the current Majlis Al-Shura advisory council. He spoke of his plans to enact the legislation needed to put the new constitution into effect, creating a constitutional court and setting the boundaries of parliamentary constituencies.

Sheikh Hamad's wife **Sheikha Mooza Bint Nasser Al-Misnad** has been unusually frank in admitting to *Newsweek International* of a link between media freedom and political liberalisation. Sheikha Mooza said her husband was "clever enough to anticipate the needs of his people… Arab leaders always say [democracy] should come gradually, but Al-Jazeera opened our eyes. Our people are ready for democracy. Listen to their comments, their arguments, their debates on Al-Jazeera. Who can judge they are not ready?"

Aware of the increased transparency that democratisation can bring – corruption is a favourite theme of complaint among parliamentarians in the region – the authorities have been stepping up the drive against corruption, with a number of individuals sentenced in oil sector cases this year.

A new ***Human Rights National Committee*** has been set up, chaired by **Khalid Bin Mohammed Al-Attiyah**, as an official body constituted of ministry representatives. Its secretary-general, **Ali Said Al-Marri**, has indicated that expatriate labour rights and abuses by employers will be a priority.

Dynastic consolidation

Sheikh Hamad is also keen to consolidate the position of his branch of the Al-Thani and particularly youthful new **Crown Prince Sheikh Tamim Bin Hamad**, who took over the role from his brother **Sheikh Jassem Bin Hamad** in the summer *(GSN 716/6)*. Already deputy ruler, Sheikh Tamim was appointed deputy commander of the armed forces in September. Having served with an elite special forces unit, he is well-connected and popular among the military. The Emir has not forgotten how the army's loyalty to him facilitated his seizure of power in 1995 and his success in fending off a subsequent putsch plot.

However, Sheikh Tamim's main public role is for the moment confined to sport – high profile but not a core government issue. The Crown Prince has been involved with the campaign to import foreign soccer stars and athletes, and he inaugurated October's extraordinary meeting of football's governing body *FIFA* in Doha. Sheikh Tamim has also promised $38m for a new world yachting championship planned by the yachtswoman **Tracy Edwards**. The series' second big race, in 2006, would start from Doha.

He is getting experience of the more mundane practicalities of government through involvement in preparations for the 2006 Asian Games, which require hefty infrastructure investment.

Abu Dhabi and Dubai's paths diverge over real estate development

Dubai's real estate boom demands that property rights are enshrined in federal law, while in Abu Dhabi, Sheikh Zayed and others remain opposed to foreign ownership. These differences pose big questions for federal legislators – so big, the decision is likely to be stalled.

Until now Abu Dhabi and Dubai have agreed to disagree over their policies towards real estate development. While Dubai rushes headlong into ever more ambitious projects, drawing in foreign investors in its wake, Abu Dhabi remains wedded to concepts of national ownership, financed from its own huge oil wealth.

Drafts for new federal investment laws have been drawn up, but there remain critical differences of opinion between Abu Dhabi and Dubai over the issue of land and property ownership, rights to which for nationals and foreigners would be enshrined in the law.

Dubai is creating a world-scale commercial and infotainment hub, with immense pizzazz. **Crown Prince Sheikh Mohammed Bin Rashid Al-Maktoum**'s right-hand man, *Emaar Properties* chief executive **Mohammed Ali Alabaar**, says the new Burj Dubai tower will be "at least" 800 metres high, adding another headline grabber to the city skyline. A more solid investment framework would underpin Dubai's real estate play.

While Dubai is the darling of the property pages as it sells luxury developments such as *Nakheels*' Palm Jumeirah and *Damac Properties*' Palm Springs developments (the latter now subject of a competition in **UK** best-seller *The Sunday Times*), Abu Dhabi has not sold a single acre to a foreign owner.

This is not a matter of federal legislation: nothing in UAE law prevents the sale of land or property to foreign owners. Simply, Dubai chooses to sell real estate, Abu Dhabi does not.

Among the smaller emirates, there are signs that traditionally conservative **Ras Al-Khaimah** will follow the Dubai model, according to sources close to **Crown Prince Sheikh Saud Bin Sakr Al-Qasimi**.

But when it comes to making law, it is Abu Dhabi that calls the shots. Many analysts believe it is funds from the much richer Abu Dhabi that have helped the Maktoums to weather storms in Dubai's journey towards becoming a global investment centre, at whose hub now lies a huge and complex real estate play.

The Maktoums have been reassessing their money-raising potential as ever more ambitious project eat up funds in an emirate with only very limited oil production. Direct property sales to foreign investors, in a boom market, are very efficient for short- to medium-term revenue generation.

Such moves may also please Dubai's traditional business families, some of whom have privately complained that the Maktoums' increasing prominence in property plays undercut their own businesses. The prospect of developing properties for sale enhances the earnings potential for many families, during a period when the trends in Dubai city office rentals and sponsorship are changing fast – not least due to the influence of huge new Maktoum-led developments such as the Media and Internet cities, and their impact on sponsorships.

With its long pockets, Abu Dhabi could follow this direction, but senior officials in the capital have told *GSN* this will not be the case: Abu Dhabi will follow its own concept of development; it does not wish to follow Dubai.

Cynics say this view reflects past failures to make Dubai-type projects work in Abu Dhabi, most notably with the Saadiyat Island financial centre scheme. But others say there is just no need to compete: Abu Dhabi will take a lead where it has competitive strengths – for example, with its ambitious plan to develop a huge offshore oil and gas services centre, plans for which are now being drawn up.

When both emirates share the same ambitions, Abu Dhabi can flex its financial muscles to compete. According to Abu Dhabi Economic Department chairman **Sheikh Hamed Bin Zayed Al-Nahayan**, Abu Dhabi's banks hold around Dh50bn

New airline points to regional strains

Etihad Airways , one of the **UAE**'s two new airlines, has made its first scheduled flight from **Abu Dhabi** to Beirut amid growing signs that its creation is the manifestation of Abu Dhabi's dissatisfaction with ***Gulf Air***, the troubled regional airline owned by the **Bahrain**, **Oman** and Abu Dhabi governments, after ***Qatar*** pulled out to focus on its ambitious ***Qatar Airways*** *(GSN 674/8; 9)*. Parastatal tour operators and hotel groups in Abu Dhabi told *GSN* that whenever possible they will now negotiate package deals with Etihad – known as ***El Etihad*** in the local market – instead of Gulf Air.

With the apparent exception of the stellar performance turned in by **Dubai**'s ***Emirates*** airline, regional operators have been hit by the global downturn challenging airlines. In this difficult environment, Etihad is seen as an upmarket airline targeted at business travellers prepared to pay a premium for higher service levels and frills such as chauffeur driven airport-to-city transfers.

The UAE's other new airline is **Sharjah**'s ***Air Arabia***, which its promoters say is a discount airline modelled on operators such as ***Easyjet*** and ***Ryanair***. Unlike those exercises in entrepreneurship though, Air Arabia and Etihad are government-funded.

in reserves. This competitive spirit is reflected in the recent headhunting of key tourism officials from the ***Dubai Tourism Board*** and the creation of a new airline, ***Etihad*** *(see box)*.

The differences of approach are apparent – behind closed doors – as federal legislators, each accommodating the views of their emirate leaders, debate the extent to which foreign companies can buy into the UAE economy.

GSN was told that new legislation to overhaul federal foreign investment and company laws was already before the Ministry of Justice and could be enacted soon.

However, things are moving fast – albeit, potentially towards paralysis of decision-making, as senior sheikhs have started to mull the full consequences of the legislation and are minded to back from a possible confrontation.

Alabaar, **Mohammed Al-Gergawi** and other key proponents of Dubai's economic model as pushed by Sheikh Mohammed say that equity and ownership are key factors in attracting foreign investment *(GSN 720/1)*. However, there is some doubt in legal circles over whether sustained ownership by foreigners of real estate in Dubai is as assured as it should be – thus there is the argument for the sale of land and property to be enshrined in a federal law that actively considers the possibility of foreign ownership.

Abu Dhabi, however, would not like a law that provides individuals and entities across the UAE with the right to sell, and foreign purchasers the right to buy, land and property for several reasons – not least that Sheikh Zayed doesn't like it.

A question of speculation… and political theory

Sheikh Zayed nipped in the bud an onslaught from **US** property speculators to buy into Abu Dhabi in the 1970s; they were intent on buying up properties in the largest emirate at what constituted high prices for UAE nationals, but which were very low international standards. Sheikh Zayed agreed with the speculators that property prices would soar as oil-wealth flowed into the economy; the then poor majority of UAE nationals would be squeezed out of the market and have to compete with international all-comers to buy back into the property market at a later date at inflated prices.

Ironically, this is the very reason why Dubai probably wants the new law. Its economic plan is real estate-based and not dissimilar to **Singapore** or colonial **Hong Kong**'s strategy of economic growth predicated on real estate and leisure demand (a model regularly cited by Alabaar). Like Dubai, whose oil resources are depleted and apparently finite, these two territories had no real resources but created trading and financial locations that stoked property demand and prices.

The Dubai real estate strategy is about more than prices – not all purchasers are Premiership footballers and their posh wives. Property ownership gives the huge expatriate community a stake it has previously lacked. Thus one ***Emirates*** airline employee who had recently bought property in Dubai said she now felt "much more than an expatriate, moving freely from one job to another in a tax-friendly environment". She has a mortgage to pay and thus has a stake in the airline that provides the lender confidence and, significantly, she now has a stake in Dubai.

The question of UAE nationality, and those eligible, will rise up the order of priorities as the emirates' increasingly globalised economies further expand and mature. The political leadership seems uneasy when dealing with these ideas; it knows enough about the emergence of liberal, capitalist democracies in the West to fully understand the wider implications of property ownership.

Some liberals are not strongly opposed: we hear that influential Information and Culture Minister **Sheikh Abdallah Bin Sultan Al-Nahayan** thinks it illogical that land should not be sold – but he will not apparently do anything about it while his father, Sheikh Zayed, opposes such a move.

There are other reasons why Abu Dhabians are not keen on change: with land restricted to UAE nationals and concentrated in the hands of the Emirates' leading families, there is an incentive to limit the development of hotels, shops, residential and commercial buildings, because this keeps rents high. Senior officials are among the leading landlords.

Thus it is doubtful whether Abu Dhabi will follow Dubai's lead in the immediate future at least, especially as it does not need to for financial reasons. Indeed, officials in Abu Dhabi quietly argue that if it captured market share from Dubai and the smaller emirate lost out, Abu Dhabi would finish up paying higher levels of subsidy than it does now for Dubai.

Abu Dhabi wants economic diversification based on the development of classical industries like shipbuilding and more technology-based added-value manufacturing operations.

With the emirates divided, it is likely that no federal decision will be reached over whether foreigners should have the right to buy and sell real estate. Rather, the probability is that the status quo will prevail, whereby it is up to the government of each emirate to decide whether to allow foreigners to own land in any particular area or a project, leaving the legal situation vague if necessary.

UAE: Deputy premiers

The Abu Dhabi diplomatic community is waiting for clarification on the status of **Sheikh Sultan Bin Zayed al-Nahyan**. In September, Minister of State for Foreign Affairs **Sheikh Hamdan Bin Zayed Al-Nahyan** was appointed Deputy Prime Minister, a role filled for some years by Sheikh Sultan. Diplomats say they have received no notification about whether Sheikh Sultan has been replaced or whether the UAE now has two deputy premiers.

It has been a problematic year for Sheikh Sultan, whose ***Zayed Centre of International Co-ordination and Follow-up*** has come under negative Western scrutiny. There are also rumours that Sheikh Sultan has been censured over the slow pace of construction at **Emir Sheikh Zayed Bin Sultan Al-Nahayan**'s flagship mosque in Abu Dhabi city. The world's third largest mosque is not yet finished, and neither the **Italian** contractors nor any other firm has been visibly at work for two years.

BAHRAIN

Regional financial hub aspires to the heights

Bahrain has big ambitions: to achieve them the government must stay focused on details without getting distracted by big-ticket items designed to raise the country's marquee value.

Long a centre of banking in the Gulf – now with no less than 353 financial institutions located there, including 33 Islamic banks and insurance firms – the kingdom is hoping to raise its profile regionally and on the international scene with a series of initiatives and big projects intended to breathe new life into not just the financial sector, but tourism, industry and even the oil sector. But the devil is in the detail, and it remains to be seen whether government can stay focused with all the distractions represented by a number of big-ticket schemes under way or planned.

Bahrain enjoys probably the strongest regulatory regime in the Gulf, courtesy of *Bahrain Monetary Agency (BMA)*. In 2002, the central bank took on regulation of insurance companies, making it the sole regulator for the financial sector.

Local and foreign bankers in Bahrain consistently point to the BMA as one of the major strengths of Bahrain's financial sector, with a wide range of correspondents and long-established links, notably with the *Bank of England*.

The BMA is a world leader among regulators who have codified regulations covering Islamic as well as conventional financial services. The government sees great potential in the burgeoning Islamic banking and insurance industries, and is encouraged by signs of growth here.

The much heralded but slow to take shape *Bahrain Financial Harbour (BFH)* took a step forward in early November, when representatives of *Kuwait Investment Company (KIC)* arrived in Manama to make an investment in the development, according to a banker close to the deal.

BFH is planned to house a variety of local and international banks and financial institutions – as well as big retail outlets like *Barnes & Noble*, airport check-in services, a luxury resort hotel and a world-class opera house – in a development along the lines of the planned *Dubai International Financial Centre* or London's troubled Canary Wharf. Anchor tenants are to include the BMA, *Bahrain Institute for Banking and Finance*, and *Bahrain Stock Exchange*. Services provided would allow institutions to take advantage of back-office efficiencies and a critical mass of institutions located in the same development.

But the $1bn project, on Manama's corniche near Bab Al-Bahrain at the site of the city's old harbour, is a long way from completion. KIC will reportedly invest $30m in the project's Phase 2, which entails construction of twin office towers and buildings to house anchor tenants. Phase 1, the landfill to accommodate the initial structures, is already completed.

Phase 2 investments, which now amount to about 60% of the $80m-90m required, will also be used to reimburse investors in Phase 1. What happens after that remains to be seen. At this point, the project remains little more than a development plan – albeit one exceedingly elaborate and well thought-out. While all three anchor tenants have confirmed they intend eventually to move to the development, agreements have yet to be signed.

One attraction for tenants will be the establishment of a Strategic Investment Zone covering the harbour, which will feature various incentives for financial institutions to take up residence there, but these have yet to be hammered out.

The BMA supports the projects, but where the financial harbour is concerned, the prevailing mood in Manama seems to be one of watching and waiting.

Questions over EDB changes, F1

Questions are being asked about recent changes at the *Bahrain Economic Development Board (EDB)*, where former *Andersen* staffer and old friend of **Crown Prince Sheikh Salman Bin Hamed Al-Khalifa**, **Jamal Al-Hazeem**, stood down as chief executive this summer. Hazeem's departure was not officially announced, and he was not immediately replaced by the board, chaired by the liberal Crown Prince.

US new deal for Bahrain trade

One of the most significant steps for Bahraini commerce will be the signing of a Free Trade Agreement (FTA) with the USA. An initial Trade and Investment Framework Agreement, which constitutes an important step, has already been signed with US trade negotiators. Final negotiations should start in early 2004 and could be finished as early as mid-year. Bahrain, a founding member of the ***World Trade Organisation***, has declared itself ready to give 'WTO-plus' compliance, to set aside any concerns the Americans may have.

Bahrain would be the first GCC country to establish an FTA with the USA, its biggest trading partner. The benefits of an FTA – which is likely to cover trade in goods and services – could be substantial. **Jordan** signed an FTA with the USA in October 2000, which took effect in December 2001; in 2002, its exports to the USA grew by 72%, while its imports grew by 14%. In H1 03, Bahrain had non-oil exports of $161.7m to the USA, and non-oil imports of $100.3m.

The FTA could greatly increase the island's role as an entrepôt given its access to the region's most important market, **Saudi Arabia**, via the King Fahd Causeway. It is convenient for other markets, such as **Kuwait**, **Qatar** and the **UAE**, via the same route. The possible construction of the long-delayed Bahrain-Qatar causeway would make it even better connected.

Shipping and logistics companies like major player ***DHL*** are eager to see an FTA go into effect. That and the real implementation of a ***GCC*** customs union, which got off to an uneven start this year, could make Bahrain a real competitor for **Dubai** and its Jebel Ali Free Zone, which remain the more popular ports of entry for distributors shipping to the Gulf.

However, in late October, Assistant Under-secretary of Economic Affairs in the Ministry of Finance **Dr Zacharia Hejris** was appointed to become the EDB's new deputy chief executive. Hejris is to take over day-to-day responsibilities under the tutelage of his boss, Finance and National Economy Minister **Abdallah Bin Hassan Saif**, who has taken the title of Acting CEO. Saif is one of **King Hamad Bin Isa Al-Khalifa**'s most trusted ministers, but he has no great experience in promotion – the EDB's main purpose. Hejris is a long-time Finance Ministry staffer, who is respected for his work there but is not seen as a powerful innovator.

The EDB was established in 2000 to push Bahrain's claims as an attractive investment destination. Hazeem was seen as having the right qualifications for the job, but he disappointed many Bahrainis, putting huge effort into making Bahrain a Formula One destination, while other projects foundered.

The F1 policy worked, with the first Grand Prix scheduled for 2-4 April – rather than October 2004, as originally scheduled, a calendar change that worked for F1 supremo **Bernie Eccleston**, but which put Bahrain under even greater pressure than expected. While some of Hazeem's other pet projects proved much less successful, the motor racing soon attracted other, more senior officials, notably ***General Organisation for Youth and Sports*** president **Sheikh Fawaz Bin Mohammed Al-Khalifa**, who is now seen as a driving force behind the scheme, along with Crown Prince Sheikh Salman.

Hazeem has taken up an advisory post in Crown Prince Sheikh Salman's diwan.

PR professionals say Bahrain's investment drive badly needs a kick-start. A successful Grand Prix might just do that, with the estimated 70,000 crowd cheering on the winners, who will spray each other with non-alcoholic 'champagne'.

To make this happen, the authorities, Bahrain's leisure industry and the contractors (including **German** consultant ***Tilke*** and the local ***Cebarco***, who are building the F1 track at Sakhir) must show they have sufficient infrastructure in place.

The challenge facing Oman

Continued from page 20

rights to all adult Omanis and consolidated their rights vis-à-vis the state, as individual citizens. The economic advances of the Qaboos years, and more recent political reforms, provide a considerable platform for future development in a new century that is proving more economically competitive than any before, and which is posing major challenges to regional political, military and social stability.

These challenges are particularly significant for Oman because it does not have the cushion of vast low-cost oil reserves to take the strain out of budgeting and development. At around 0.9m b/d, and expensive to produce, Omani crude is a crucial mainstay of the economy but not a guarantee of future affluence. ***Oman LNG*** and other gas-based schemes will help to maintain a sustainable industry, but not without significant costs. Already, the IIF forecasts Oman's total external debt rising from $5.87bn in 2001 to $6.56bn in 2004.

Nor is the Sultanate a major trading crossroads or *entrepôt*. Oman must live from its own domestic capacity to produce goods and provide services. This makes for a more balanced economic model, which is not scarred by too much extravagant investment in unneeded prestige projects. But it also translates into an economy that has to work for its living.

This requires political, administrative and economic structures that function effectively. A prosperous well-governed state is usually more stable – as US President **George W. Bush** has been keen to argue lately.

In this new environment, where 'good governance' is the buzzword, the outlook for relations between the Sultan and his people, as represented through the newly elected Majlis, becomes an important financial and investment – even geopolitical – indicator.

In moving the country to full adult suffrage, Qaboos has allowed the election of an assembly that should be genuinely representative of national opinion. It was not surprising that elections produced a strong showing for tribal interests, and the new Majlis may take a rather conservative course. But over time, it is likely to seek to assert itself more strongly, just as its predecessors have done.

Parliamentary pressure can cut both ways: Majlis members can act as a lobby for transparency and accountability, but they also exert pressures for public spending and services for their constituencies. Sultan Qaboos and his ministers will have to balance the pressure to satisfy such demands with the need to maintain financial and economic stability.

Pressure could also build for more clarity about executive functions in Oman's political equation. The current succession arrangements provide a route forward, but viewed from a Western perspective at least, they do not provide certainty. Omanis know how the next ruler will be chosen, but they do not know who it will be *(GSN 710/9)*. This may be a necessary result of the succession system, but it places a high premium on creating a sense of continuity in government.

As Qaboos grows older – and many of the national and expatriate officials who worked with him over the past three decades move into retirement, to be replaced by a younger generation of Omanis – he may opt to step back more from the day-to-day management. This transition requires new structures and careful management: already, the weight of decisions required by a modern economy and polity mean that the implementation of projects and policies can be delayed by procedural bottlenecks in the Palace and government.

A transparent and stable governance outlook, coupled with a dynamic political evolution, is thus crucial to Oman's prospects of attracting investment and creating those jobs young Omanis so prize.

Pipeline politics

Continued from page 2

appears muted. So far few Russian oils have publicly explored the Tipline option, and alternative export routes to the Asian market have precedence over the politically sensitive Israeli route; these include ***Yukos***' planned oil pipeline to China, the massive Sakhalin venture targeted at the Japanese market and the mooted Angarsk-Nakhodka link.

Russia's *TNK* is reported to have enquired about using Tipline, but firm commitments are lacking. TNK's $6bn joint venture arrangement with ***BP*** will also weigh heavily against engaging in a potentially provocative route through Israel. "I don't think BP will be wanting to use an Israeli pipeline," O'Sullivan commented.

Tapline still on empty, GCC line more promising

Arab states' chances of resurrecting the Trans-Arabian Pipeline (Tapline) look slim. The pipeline, which once sent Saudi oil from the Eastern Province to export terminals in **Lebanon**, has been out of active service since 1975. Until the early 1990s, the Saudi-**Jordan** stretch was used to supply the Jordanian market, but Amman's perceived support for Iraq's invasion of Kuwait halted even these trans-shipments. There are no incipient moves to upgrade the pipeline, leaving Tapline only a distant alternative prospect for Gulf producers.

More promising is a proposed new GCC pipeline. US consultant *Kellogg Brown & Root* is carrying out a feasibility study on the proposed GCC crude oil export pipeline, which would link the northern Gulf to export terminals on either the Red Sea coast of Saudi Arabia or in the Gulf of Oman, bypassing the Straits of Hormuz.

The pipeline – for which the client is Doha-based *Gulf Organisation for Industrial Consulting* – was discussed during a gathering of GCC oil ministers in Doha in early November. It is expected to be formally launched at the December summit in Kuwait – if in the shape of a political fudge, given that several big issues need to be resolved.

The pipeline is intended to provide an alternative route to export Gulf oil in emergency cases such as the closure of the Straits of Hormuz, suggesting an increased sensitivity among GCC states about questions of regional political risk.

But the plan faces a long haul ahead. Ministers at the Doha summit failed to approve a plan for the pipeline, although a final decision will await the findings of KBR's feasibility study.

Iran likes pipelines, politics decree oil swaps

Iran has in the past floated its own pipeline plans. Talks between the Iranian and Kazakh governments and executives at **France**'s *Total* were held in 2002 over a feasibility study for a pipeline from **Kazakhstan** to Iran.

The *ChevronTexaco*-led *Caspian Pipeline Consortium (CPC),* which is developing the 565,000 b/d Tengiz oil field in Kazakh territory, had also charted a southern pipeline route via Iran for export. However, the political sensitivity surrounding US policy towards the Islamic Republic thwarted the plan in favour of a 990-mile pipeline to Russia's Novorossiisk port.

The prospect of direct access for Caspian crude still whets IOC appetites, despite the inimical political climate surrounding Iran. Until Washington reaches some kind of political accommodation with Tehran, US involvement in Iranian pipelines looks a distant prospect.

Even European IOCs look increasingly lukewarm on Iranian risk. *BP* chief executive **John Browne** told a conference in Washington on 24 November that it was the "wrong time" to pursue the Bangestan oil project, where BP and Total are among those shortlisted.

This leaves oil swap deals as the most effective route for "ghosting" Caspian crude for export *(GSN 721/11).*

Current Iranian Caspian imports are running at 50,000 b/d, but this is due to rise exponentially through ongoing expansion. The $200m second phase of Iran's oil swap deal programme will inflate its swap capacity by some 120,000 b/d.

A Tehran-based energy consultant told *GSN* the government was relaxed about the political pressure stunting pipeline projects so long as it was able to make effective use of swap arrangements. Under these deals, **Azeri**, Kazakh and **Turkmen** barrels are piped to refineries at Tehran and Tabriz. Equivalent volumes of Iranian crude are then shipped from their mainly southern-based concessions through the Gulf-based terminal at Kharg Island.

For *National Iranian Oil Company (NIOC)*, which has invested $400m in the 240km link from the Neka port to Tehran, the importing of greater volumes of Caspian crude has the double attraction of slashing domestic oil transport costs while freeing up more of its own oil for export. Iranian oil exports are running at around 2.3m b/d, leaving around 1.5m b/d for domestic consumption.

With oil and gas reserves concentrated in the south, while the main population centres are in the north, oil swaps have a clear commercial logic. Light crude exported through Kharg Island allows shippers to charge a swap fee of up to $2/bbl.

Tehran is eyeing new swap deals, with **Canada**'s ***PetroKazakhstan*** expecting to ink a 21,000 b/d swap deal with Tehran before end-2003.

A proposed new rail link from the Turkmen border with Iran to the southern port of Bandar Abbas, expected to start-up next year, could even open up direct access to the Gulf for up to 20,000 b/d of PetroKazakhstan's oil exports.

Bandar Abbas, straddling the northern end of the Straits of Hormuz, presents a prime export hub for potential Iranian shippers to target the Asian markets. The cost benefit is evident: sending Kazakh crude south via Iran to the Gulf export terminals allows it to charge at least $1.5/bbl more than the Brent minus $1 it sells for at the Black Sea port of Batumi.

But rail links and swap deals alone will not endow Caspian producers with the necessary volume to take significant Asian market share. For now, southern pipeline routes look off the agenda in Iraq given its susceptibility to terrorist attack, leaving Iran the only serious near-term option. The crisis over nuclear inspections has stymied hopes of a speedy political breakthrough, but if non-US players can exploit any signs of progress to their advantage, Caspian crude may one day find a route to the Gulf of Oman.

IRAQ

Communal rivalries emerge as MOO restructures

Recent changes to the Ministry of Oil's personnel and structures have raised serious concerns within MOO that experienced Sunni officials are being sidelined from positions of power, while Shiite staff are promoted, the November edition of the monthly *Iraq Focus* reported.

Officials said the changes were to improve efficiency and remove former Baathists from senior management positions.

A senior MOO official denied complaints of communal prejudice, saying there was no new strategy of favouring Shiites over Sunnis. But the ministry remains alive with gossip.

Oil Minister **Ibrahim Mohammed Bahr Al-Ulloum** took industry watchers by surprise when on 4 November he appointed **Shumkhi Farraj** as director general of the *State Oil Marketing Organisation (SOMO)*. Farraj, the former director of the MOO economic department, replaced **Mohammed Jibouri**, who has run the marketing concern since 1 May.

Ulloum then sidelined chief executive **Thamer Ghadban**, who was appointed on 10 November to one of four recently created senior advisor positions. This is considered a significant, possibly terminal, blow to former minister Ghadban's ambitions.

In changes to MOO departments, **Hazem Al-Sultan** was made director of the oil exploration department, while **Hassen Al-Rifai** was appointed department head of internal auditing and **Netaq Al-Bayati** was put in charge of exploration.

"The changes are healthy," one senior official told *Iraq Focus*: "We want people with integrity" This may reverse the slowing down of the 'de-Baathification' in recent months by **US** civil administrator **L Paul Bremer III** *(GSN 722/3)*.

He "waived the removal of Baathists, but for only a while," a senior MOO official said: "We think that time has come."

But along MOO's corridors, there are concerns and unconfirmed speculation that the Shia Ulloum's policy is being conducted along sectarian lines. It is observed that **Shumkhi Farraj**, a Shiite, took over at SOMO. Under the former regime he was Iraq's representative to *OPEC*.

One SOMO official told *Iraq Focus* it was only a matter of time until he lost his job because he was a Sunni. "They need me now, but I suspect I'll lose my job in a month, two months, maybe six… They will find someone to replace me."

According to another independent oil source, Jibouri had been passed over for a key board member position at a state-owned oil company because he was Sunni.

ENERGY POINTERS

UAE: Mirfa IWPP pulled as Abu Dhabi focuses on Taweelah-B

Senior officials in Abu Dhabi have told *GSN* that *Abu Dhabi Water and Electricity Authority (Adwea)* has pulled out of plans to privatise and develop the Mirfa independent water and power project (IWPP), tenders which were only recently published. Adwea will instead focus on developing the Taweelah-B plant. According to Adwea's director of privatisation **Ahmed Al-Neami**, this means the dozen or so international companies that submitted statements of qualification can stop waiting for requests for proposals to take a slice or all of the 40% non-government stake in a company to purchase, develop, extend, own, operate and maintain the Mirfa IWPP.

SAUDI ARABIA: 'Historic' gas deal signed

Saudi Aramco (30% partner) signed a 40-year gas exploration and production agreement with *Royal Dutch/Shell* (40% and operator) and *Total* (30%) for the development of a block in Rub Al-Khali (the Empty Quarter) – becoming the first IOCs in nearly three decades to gain entry into the Saudi upstream *(GSN 722/14)*. Oil Minister **Ali Al-Naimi** said the group's initial investment was estimated at \$2bn, but this didn't represent the project's true value, which would be revealed once gas was produced. Naimi forecast that SR75bn (\$20bn) would be invested in petrochemicals alone in the next five years. Naimi also said the Oil Ministry was evaluating bids from 27 companies for E&P contracts in northern Rub Al-Khali and other areas, with awards to be announced on 26-28 January.

SAUDI ARABIA/IRAQ: Co-operation pledge

The Gulf countries with the world's biggest and second biggest oil reserves will work together to achieve market stability and to keep prices within *OPEC*'s \$22-28/bbl price range, Saudi Oil Minister **Ali Al-Naimi** and Iraq's **Ibrahim Mohammed Bahr Al-Ulloum** said after meeting in Riyadh 16 November. However, they did not agree on reopening the Trans-Arabian Pipeline (Tapline) *(see above)*.

GSN Risk Grade — B+/2: Political stability provides firm base for economic development

Political And Social Development

Overview: The UAE remains one of the region's most stable countries. The recent World Bank/IMF annual meetings passed off without incident and rave reviews helped widen the international spotlight on Dubai.

Government: Minister of State for Foreign Affairs Sheikh Hamdan Bin Zayed Al-Nahayan, who has cultivated strong links with US President George W Bush, was recently promoted to Deputy Prime Minister. Foreign diplomatic sources say it is unclear whether his brother Sheikh Sultan Bin Zayed Al-Nahyan has been replaced or whether both men now hold the position. It has been suggested that Sheikh Sultan is in UAE President Sheikh Zayed bin Sultan Al-Nahayan's bad books, possibly connected to his position as chairman of the Arab League-sponsored Zayed International Centre for Co-ordination and Follow-up, which closed its Abu Dhabi office earlier this year after allegations that it was promoting anti-semitic views.

Succession: Abu Dhabi Crown Prince and presumptive heir to the UAE Presidency Sheikh Khalifa Bin Zayed Al-Nahayan has been taking a prominent role over recent months, in part due to the ageing Shaikh Zayed's recovery from two operations in quick succession (for a hernia and gall stones). Sheikh Khalifa has long held influence over domestic commercial matters but is now beginning to play a more prominent, public role in foreign affairs, as witnessed by a June visit to the UK and France. He holds less sway over domestic constitutional issues.

Democratisation: The UAE is behind other Gulf countries in pushing forward democratisation reforms; earlier in 2003 Dubai set up an advisory Dubai Executive Council consisting of the emirate's key governmental department heads. Sheikh Zayed's wife Sheikha Fatima Bint Mubarak continues to push for women to join the 40-member Federal National Council – an appointed advisory body with parliamentary potential; consensus among the UAE's seven rulers is regarded as essential on this issue.

External factors: Relations with Western countries and fellow GCC members are close. The UAE is keen to strike up a good relationship with Iraq. It will be helped by its humanitarian aid and political contacts. Alongside the EU, US & Japan the UAE is working with multilateral agencies in shaping the activities of donors to Iraq, a position that will informally boost its credibility as a partner in Iraqi reconstruction activities.

Economic Outlook

Overview: Strong oil prices in 2003 have boosted revenues and economic conditions remain good. GDP growth of 4.7% has been forecast for 2003, with 4.2% non-oil sector growth and 6.7% for the oil sector. Inflation is expected to continue in its present 2-3% range. Despite a generally positive investment climate, investment risks vary across the emirates and external stimuli such as terrorists threats could affect some, including Dubai, who rely heavily on tourism, and a real estate boom. The IMF has cautioned that the fiscal position needs to be addressed to prevent deterioration that could impinge on a generally favourable macro performance.

Finances: A delayed 2003/2004 federal budget was ratified in August, envisaging a deficit of Dh2.2bn. Spending has been fixed at Dh23.28bn, with revenues forecast at Dh21.07bn. External debt is expected to have risen 6% over 2003 to $18.6bn. Foreign reserves were $14.9bn at the end of July. Abu Dhabi accounts for the majority of the UAE's oil revenue and underwrites other emirates during periods of stress. Dubai's Dh1.5bn five-year bond issue successfully closed in May and listed on the Dubai International Financial Market.

Privatisation: Progress has been slow beyond independent water and power projects. Telecoms company Etisalat is traded on the DFM, but still majority state-owned. Oil firm Zadco, Abu Dhabi's electricity transmission system and Emirates Post may be part-privatised. The government is selling its stake in Abu Dhabi Shipbuilding.

Investment: The UAE is a WTO member. Foreign investors can hold 100% of companies in the free zones and 49% elsewhere. Sharjah is a manufacturing hub for SMEs, as are the FTZs. The Dubai Economic Council was created in March to help further boost private investment. The Dubai International Financial Centre is progressing, albeit slowly. The UAE's stock markets have risen around 30% during 2003 buoyed by a Dubai-led real estate and property boom but structure (lack of a single exchange) is a problem and the intermediaries industry is under-developed. The IMF has commended the banking sector's strength, profitability, supervision and capitalisation, but foreign banks say the UAE is over-banked and S&P research showed that non-performing loans equalled over 12% of total gross loans at the end of 2002, the highest level in the Gulf Co-operation Council region.

UAE: Key projects

Umm Al-Nar IWPP: Existing 855MW to be replaced by 1,550MW capacity. Desal capacity will be 95m g/d (including new 25m g/d unit) for 2006 completion; $855m commercial debt syndicated in August. Operator group led by International Power (UK). GE Power Systems to service gas turbines.

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

Other power and water schemes: EPC tender for phase two of Fujairah's Qidfa power/desal project expected early 2004, for mid-year award; expansion of Abu Dhabi's Mirfa plant put on hold. New fast-tracked Taweelah plant now planned; request for proposals expected January. Abu Dhabi's $1.6bn 1,500MW Shuweihat S1 power and desalination project is to start 2004 operated by the US' CMS Energy and IP.

Dolphin Energy: $3.5bn project to import Qatari gas led by Occidental, Total and UAE Offsets Group. Final 25-year gas sales agreements with Abu Dhabi Water & Electricity Authority and Fujairah's Union Water & Electricity Authority signed October. Dubai Supply Authority expected to sign by year-end. Omani gas will supply Fujairah until Dolphin comes onstream 2006.

GCC power grid: Plans for the connection of the UAE's five grid systems by Q4 05 are advancing. Bids for seven packages received in September; awards expected by end-year.

GSN Risk Grades

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

UAE: Selected Economic Indicators

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

f = Forecast.

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

GSN Risk Grade — GSN Risk Grade – D/3: Saleh focuses on US, Saudi security links

Political And Social Development

Overview: Recent arrests show that President Ali Abdallah Saleh remains committed to security co-operation with the USA, despite the unpopularity this engenders in many quarters at home. Domestic critics – not all of them Islamist – are deeply suspicious of Saleh's US alliance, but the government is heavily reliant on financial support from international aid donors. Saleh sees hardline Islamism as a threat to his own power and not just to Western interests.

Al-Qaeda: Extremist Islamists, allied to tribal groups, pose a threat. Security forces have captured Mohammed Al-Ahdal (also known as Abu Asem Al-Makki), a close associate of Abu Ali Al-Harithi, who was assassinated by a missile fired from a US spy plane near Mareb. Unlike some essentially local Islamists, Ahdal is thought to be the co-ordinator of Al-Qaeda activities in Yemen and suspected of involvement in the bombing of the USS Cole at Aden in 2000 and the French oil tanker *Limburg* near Mukalla in 2002. He was finally run to ground in mountains west of Sanaa; five other Al-Qaeda suspects were picked up a few weeks earlier.

Domestic criticism: Security is not just an Al-Qaeda issue: domestic militants are a concern in a country calculated to contain more guns than people. In October, the government announced that Islamic Army of Aden leader Khaled Abdul Nabi was still alive and had surrendered. The main opposition parties, representing Islamic and socialist views, have called on the government to disclose the details of security agreements with Washington. The notably liberal Yemen Times has carried coverage that is highly critical in tone in references to US security co-operation, even if it also notes the extent of American support for civil society and democratisation programmes.

Saudi relations: Much-improved relations with Saudi Arabia since the demarcation agreement are reflected in heightened security co-operation, a critical issue given the security concerns for both countries posed by the border region. Opposition sources said a Saudi, Mohammed Al-Sharif Al-Hosni, captured with three colleagues trying to cross into Yemen, committed suicide in detention after the government rejected the group's request for asylum. The other three were handed over to the Saudi Embassy. The two governments have also swapped Al-Qaeda suspects and Yemen handed over Bander Al-Ghamidi, accused of involvement in May's bombing in Riyadh, while Riyadh handed Yemen two *Limburg* suspects.

Economic Outlook

Overview: The security environment continues to impinge. The fiscal account moved into deficit in fiscal year 2002/2003 for the first time in two years, helped by a 68% increase in defence spending. Underlying poverty and unemployment are major concerns; unemployment is estimated at 25-30%. A downward trend for oil output is also a worry. Production averages around 440,000 b/d but the World Bank has warned that output could fall to less than half this by 2008 unless more work is undertaken. On the plus side recent years have seen a creditable payments record, low debt service ratio and careful use of oil revenues. The Central Bank of Yemen forecasts real non-oil GDP growth of 4.1% for 2003. Inflation has receded since reaching double digits during the first quarter of 2003.

Development: An IMF Poverty Reduction Strategy Paper for 2003-05 calls for structural and governance reforms, average 4.7%/yr GDP growth, non oil sector growth of an average 6.3%/yr and a 13.1% reduction in poverty to 35.9%, but the IMF has held back on providing new funds until a number of requirements are satisfied; talks are scheduled for early 2004. Donors pledged $2.3bn over three years in October 2002. In November Italy agreed to forgive $16m debts and turn them into a development grant. South Korea has pledged a $30m loan to help expand and modernise telecoms infrastructure.

Finances: Sustained high oil prices look set to produce more favourable figures for 2003. Oil averaged $27.52/bbl in the first half of 2003 compared to the $21/bbl oil price envisaged by the 2003 budget, which forecast a YR64.1bn deficit (YR668.4bn and YR604.3bn revenues). The 2004 draft budget envisages a YR63.4m deficit (YR744.6bn expenditure and YR681.1bn revenue. Total external debt was $4.95bn at end-2002. Forex reserves were $4.8bn at end June.

Liberalisation: The EU is providing technical assistance to help on the long road to World Trade Organisation membership. The IMF has called for budget reform, reduced energy subsidies, a clearer public spending focus, poverty reduction and efforts to cut the non-oil deficit. Reforms to the civil service and judiciary, tax system and customs service are planned.

SALEH CRITICISES GERMANS: Germany's recent decision to hand over the Yemeni scholar Mohammed Ali Al-Mu'yaad and his assistant Mohammed Mohsin Zayed to the USA has provided President Saleh with a chance to take a more independent stand, criticising Berlin's action and asking it to hand the men over to Yemeni custody if there was evidence against them. Meanwhile, security precautions have been tightened, with extra barriers installed outside the

YEMEN: Selected Economic Indicators

	1999	2000	2001[p]	2002[e]
US$ millions unless stated				
Real GDP Growth (%)	3.7	5.1	3.9	3.3
Consumer price inflation (%)	8.0	10.9	11.9	12.2
Exports	2,478.3	3,797.2	3,366.9	3,619.4
Of which crude oil	2,131.2	3,398.8	2,905.1	3,146.6
Imports	2,120.5	2,484.4	2,600.4	2,932.0
Trade balance	357.8	1,312.8	766.4	687.4
Services balance	–535.5	–598.6	–677.6	–750.5
Current account	549.7	1,336.6	670.9	410.3

[p]– preliminary. [e] – estimated

Source: IMF, Yemeni authorities

Yemen: Key projects

Aden port: Container throughput at the Port of Singapore Authority managed container terminal reached 388,000teu in 2002, representing 2.8% growth on 2001 and would have reached more if it hadn't been for the crippling after effects of the October *Limburg* attack.

Hydrocarbons: Oil exploration has increased since production-sharing agreement terms became more favourable. Settlement of the Saudi border has opened potential exploration zones along the fringes of the Rub Al-Khali. Recent oil successes include India's Reliance Industries Al-Roidhat-1 discovery (Block 9) and the extension of TransGlobe Energy Corporation's Tasour field (Block 32). Other established operators include Nexen, Occidental Petroleum and Hunt Oil. Total reserves are estimated at 4bn bbls. Gas reserves of 16.9trn ft^3 remain untapped.

Refineries: Two new refineries planned, plus the rehabilitation and possible expansion of the 170,000 b/d Aden refinery. EPC bidding for Hadramaut Refineries Company's initial 50,000 b/d Mukallah refinery closed in October; award due January. A $1.2bn long-term offtake agreement was signed in August with Samsung Corporation. UAE and Saudi businessmen are sponsoring the project. US-based VECOA has undertaken a feasibility study for a 30,000 b/d refinery at Ras Issa.

Power projects: Bid evaluation started early September for a gas turbines contract for a planned 300MW plant in Safar (Marib region). Ten bids received for 200km 400kV Marib-Sanaa transmission link; award expected January. The Arab Fund for Economic and Social Development is providing an $84m loan.

DIARY: Events around the region

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, Vienna

Discipline, rather than more quota cuts, should dominate the cartel's ministerial meeting in Vienna. Markets have been quiet with the Eid and Thanksgiving holidays, but turbulence in Iraq, a surprise drop in US stocks and winter stockbuilds have left markets edgy. OPEC is benefiting from strong prices and pumping hard: its 900,000 b/d November quota cut (to 24.5m b/d) has been negated by 1m b/d-plus over-production.

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, Oman

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, 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, as is the planned Gulf oil pipeline.

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.

11-12 February 2004. Electrical power in Iraq

A conference concentrating on the prospects for suppliers and investors – and the problems to be overcome – in the Iraqi electricity industry. To be held at Le Meridien Piccadilly, London. Contact CWC Group: +44 (0)207 089 4200. *www.thecwcgroup.com/conferences*

DATA: Stock markets, trade payments and exchange rates

Stock Market (Index)	Index value (19-20.11.03)	Index % change One week In local currency		Index % change From 31.12.02	Collection experience	Preferred terms	Exchange rate $	£	€	¥
Bahrain[1]	2,285.07	1.5	↑	25.5	Fair-Good	ULC	1 Dinar = 0.37700	0.64420	0.44945	0.34570
Iran[2]	9,615.90	0.5	↑	90.6	Fair-Good	CIA	1 Rial = 8362.00	14191.6	9969.59	7668.04
Iraq	—	—		—	Poor	CIA	1 Rial = 0.31100	0.52780	0.37079	0.28520
Jordan[3]	246.46	1.8	↑	44.0	Fair-Good	ULC	1 Dinar = 0.70900	1.21150	0.84530	0.65020
Kuwait[4]	4,455.80	-0.6	↓	87.6	Fair-Good	ULC	1 Dinar = 0.29500	0.50400	0.35170	0.27050
Oman[5]	270.25	1.1	↑	40.9	Fair	ULC	1 Riyal = 0.38500	0.65790	0.45905	0.35300
Qatar[6]	734.60	3.2	↑	74.7	Fair	CIA	1 Riyal = 3.63950	6.21900	4.33920	3.33750
Saudi Arabia[7]	4,199.92	2.3	↑	66.8	Fair-Good	ULC	1 Riyal = 3.75040	6.40850	4.47140	3.43920
Syria	—	—		—	Fair-Good	CLC	1 £ = 51.5750	87.5305	61.4903	47.2948
UAE	4,430.60	0.3	↑	30.0	Fair	ULC	1 Dirham = 3.67310	6.27640	4.37925	3.36830
Yemen	—	—		—	Fair-Poor	CIA	1 Rial = 178.005	302.101	212.226	163.233

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

The challenge for Oman, an economy that must work for its living

A sustained period of high oil prices have buoyed up Gulf governments' financial reserves and alleviated payments concerns, but this is still a time for long-term thinking as countries adjust to the demands of a competitive, liberalised international market, and changing political and social attitudes. Such trends were apparent when **Sultan Qaboos Bin Said Al-Saeed** took the significant step forward of granting universal suffrage to all Omanis over the age of 21 in Majlis Al-Shura (consultative council) elections which took place on 4 October *(GSN 721/8, 720/4, 719/4, 710/8).*

On many fronts, Oman has made a notable success of the transition from feudal backwater to modern Arabian society since Sultan Qaboos took power in July 1970. The Sultanate has made good use of limited oil resources and its excellent strategic location to transform itself into a key strategic partner of the West and a solid player in the ***Gulf Co-operation Council***' development as an economic bloc to be reckoned with.

It has one of the region's most respected armed forces – which remains a key strategic partner for the **UK** and, increasingly, the **USA** – and its police function better than many in the region. ***Amnesty International*** has welcomed recent "judicial and legal reforms with a potentially positive impact on human rights".

These reforms reflect the slow evolution of a more responsive political system in the Sultanate – and this process is more than a luxury: it is essential given the challenges that Oman's largely youthful 2.5m population confronts (up from around 400,000 when Sultan Qaboos took over).

These challenges were spelt out in a largely positive *Oman Country Report* by the Washington-based ***Institute of International Finance***, distributed to IIF members in April. "Despite robust economic activity over the past few years, unemployment of Omanis poses a major challenge to the government," the IIF said. "No unemployment data are published, but the number of Omanis registered with ***The Public Authority for Social Insurance*** continues to rise," it observed – by an average 16%/yr in 1997-2001 and by 8.9% in 2002, when just under 66,000 were seeking work.

The IIF estimated this was equivalent to an unemployment rate of about 20% of the Omani workforce and 7% of the total workforce. It added: "The situation may get worse, however, as around 50% of Omanis are under the age of 15 and about 50,000 will be graduating from high school each year (of which about 16,000 will go on to higher education)."

The government is well aware of this problem: an ambitious programme of 'Omanisation' has created jobs and promoted skills training among the national population. Privatisation, liberalisation and controls on state spending have become policy priorities. As the IIF observed, "the prospects for job creation in the public sector are extremely limited given ongoing efforts to contain the size of the civil service.

There has been heavy investment in education and training, for women as well as men, which has provided Oman with a genuinely broad-based national workforce that reduces the need to rely excessively on expatriate foreign workers.

However, the reliance on incomers during the 1970s/80s boom years has created a dependence on cheap Asian labour and expensive British and other managers that is proving hard to overcome. Shortfalls in national education and training levels, and skewed remuneration rates, mean that many young Omanis are unqualified and/or unwilling to take jobs.

Those active in the local education scene say this is creating a dissatisfied and potentially angry constituency.

Recent constitutional innovations have extended voting

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