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With MBZ's promotion, Sheikha Fatima sons take centre stage

By promoting his favourite wife's sons, Sheikh Zayed has moved to clarify the long-term succession line in Abu Dhabi, in the process shaping the future direction of UAE politics.

Abu Dhabi's Ruler **Sheikh Zayed Bin Sultan Al-Nahayan** has moved to clarify the long-term succession line in the Emirate – and implicitly the presidency of the UAE – by appointing armed forces Chief-of-staff **Sheikh Mohammed Bin Zayed** as Deputy Crown Prince.

The consensus is that Sheikh Zayed will be succeeded as President of the UAE and Emir of Abu Dhabi by the present Crown Prince, **Sheikh Khalifa Bin Zayed**. But Sheikh Khalifa is not a young man, while his half-brother Sheikh Mohammed – widely known as MBZ – was born only in 1961.

MBZ is already one of the most prominent figures in the ruling family, a chief of the armed forces and a significant diplomatic and policy player.

The MBZ move comes only weeks after his full brother **Sheikh Hamdan** was promoted to Deputy Prime Minister *(GSN 723/11)*.

The MBZ appointment reinforces stability in the leadership of the UAE, setting out a long-term leadership line while implicitly confirming the allocation of roles and responsibilities that has emerged in Abu Dhabi over the past few years, and particularly since the octogenarian Sheikh Zayed's kidney transplant in 2000. Sheikh Zayed continues to undergo regular medical treatment *(GSN 722/9, 721/5)*.

Sheikh Khalifa's own position as Crown Prince – once the subject of some resentment among younger siblings – is now undisputed. He is effectively head of day-to-day government in Abu Dhabi, having developed his court into what is effectively a prime minister's office, with its own administration, research department and public relations team, linked to the *Akhbar Al-Arab* paper.

Sheikh Khalifa has recently begun to assume an international diplomatic role, for example, through visits to the **UK** and **France** *(GSN 716/7, 712/20)*.

But the Crown Prince has left much of the day-to-day management of foreign policy and international public relations to Sheikh Zayed's four sons by **Sheikha Fatima Bint Mubarak**, the Ruler's most prominent wife and a substantial liberalising influence – MBZ, Deputy Foreign Minister Sheikh Hamdan, Information Minister **Sheikh Abdallah** and **Sheikh Hazza**, head of the security services *(GSN 698/7)*.

This led to some (hotly contested) speculation that while Khalifa would eventually take over in Abu Dhabi, MBZ could emerge as a future federal president. This is unlikely, although Sheikh Mohammed's appointment has shifted the conventional hierarchy.

Sheikh Zayed's second son, **Sheikh Sultan**, is older. However, MBZ has assumed a more prominent role and broad range of responsibilities. Sultan, like Khalifa, has cultivated strong connections among the tribal networks that play such an important role in Abu Dhabi politics, but there have been whisperings about his position following delays to such high-profile projects as the huge Sheikh Zayed mosque in Abu Dhabi city.

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CbI
Cross-border Information

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Editor
Paul Melly
paul@gulfstatesnews.com

Managing editor
Mark Wallace
wallace@gulfstatesnews.com

Washington correspondent
Michael Knights
mike@gulfstatesnews.com

Contributing editor, business and energy
James Gavin
james@gulfstatesnews.com

Editorial director
Jon Marks
jon@gulfstatesnews.com

Production
Jill Macfarlane-Miller
admin@gulfstatesnews.com

Webmaster
Chris Light
webmaster@gulfstatesnews.com

Publisher
Mark Ford
mark@gulfstatesnews.com

Gulf States Newsletter
Published fortnightly since 1974

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

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

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

MBZ, has taken on a string of public positions. Not only is he chief-of-staff and his father the President's official adviser on security, MBZ also steered the UAE's policy response to the challenging post-11 September 2001 environment. He frequently receives foreign visitors and accompanied Sheikh Khalifa on an important official visit to London in mid-2003.

MBZ is close to **Dubai**'s Crown Prince **Sheikh Mohammed Bin Rashid Al-Maktoum**. Because of the latter's federal Defence Minister post that is partly a professional necessity; but it also reflects personal sympathies. The two Mohammeds enjoy each others' company, not just as political partners.

This Dubai connection gives MBZ an important role in UAE federal decision-making. He has also built up a position of considerable influence in economic matters, as a member of the ***Petroleum Council***, a regular participant in policy and legislative planning, and head of the of the *UAE Offsets Group*, the parastatal vehicle for major infrastructure and business projects.

Like many of the Gulf's younger military officer princes, the *Sandhurst*-trained MBZ also has a shrewd eye for roles that will bolster his popular profile. He is chairman of Al-Ain football club, which has been featuring prominently in the Asian Champions League. A veiled hint at his forthcoming rise in profile came in late October, with the renaming of Al-Jazira Sports Stadium as the Mohammed Bin Zayed Stadium.

Clarifying the succession

There have been times when MBZ was rumoured to be resentful of Sheikh Khalifa's prominence as Crown Prince. But more recently he has appeared comfortable in his reinforced role.

After his appointment, MBZ went out of his way to ensure that his rise was not interpreted as any kind of weakening in Khalifa's position, stressing his personal loyalty both to the revered Zayed and to the Crown Prince.

Now he is officially designated as second in line to the Emirate, MBZ is certain to attract more attention, among emirates, foreign governments and business interests. He will be seen as a key player whose interest and support is potentially valuable.

Until his official designation, it had been unclear how the succession would evolve. Both Sultan and MBZ were seen as possible crown princes to Khalifa. The latter's own sons, notably **Sheikh Sultan Bin Khalifa**, had also begun to take a more prominent role.

But Sheikh Zayed's 30 November decree on the succession makes matters crystal clear, stating that appointment as Deputy Crown Prince authorises Mohammed to assume the position of Crown Prince when this becomes vacant. The decree formally revokes any earlier provisions that might have had a contrary effect.

In theory Khalifa could yet change the succession in favour of his own sons once he does become ruler. But the decision of Zayed – who commands a unique degree of personal respect and popular affection – to set out a clear succession line will carry enormous weight well into the future. The course he has set could not easily be ignored, especially in a political system where consensus and tribal support is so important.

The Abu Dhabi authorities also announced that, in making the decision, Sheikh Zayed had reviewed *Law No. 1* of 1974, which established the structure of governance, and *Emiri Decree No. 15*, of 1976, which dealt with the formation of the Crown Prince's Court and chairmanship of the Executive Council.

This obliquely raises the question of whether MBZ will develop a formal office of the deputy crown prince, which assumes officially designated functions, or whether he will continue essentially to work through the various positions he already holds.

GSN 725

The next issue of *Gulf States Newsletter* will be published on 9 January. The staff, contributors and everyone associated with *GSN* wish our readers a happy and peaceful New Year.

US/Syrian relations: A bundle of sticks, no carrots, and no policy either

The USA has imposed sanctions and its ally Israel is threatening more action against Damascus. But *GSN*'s soundings suggest Washington still has no real policy to deal with Syria. Oil companies are looking on.

The casual observer might be forgiven for thinking that when Congress passed the *Syria Accountability and Lebanese Sovereignty Act* on 20 November, President **George W. Bush** now had all the sticks he could have wished for apply in his dealings with President **Bashar Al-Assad**'s unpredictable regime *(GSN 722/17)*. Yet *GSN*'s soundings in the Washington policy community suggest that the White House still has no policy to guide the use of its coercive tools – and that ***European Union*** and **Russian** engagement with Syria may undercut the effectiveness of any punitive measures taken by the USA. The result is that US/Syrian relations are increasingly characterised by symbolic gestures that barely conceal the dearth of meaningful sticks, carrots or policy.

Bush was expected to sign the *Syria Accountability and Lebanese Sovereignty Act* into law as *GSN* went to press. But the lack of good options to coerce the Syrian regime continues to give life to the perennial debate between those in Washington who would seek reform through engagement – the State Department and ***Central Intelligence Agency (CIA)*** – and the hawkish think-tank and, to a lesser extent, Department of Defence (Pentagon) advocates who seek to contain or roll back the ***Baath Party*** regime through coercive measures.

Advocates of engagement have recently sought to fashion old swords, such as Syria's designation as a state-sponsor of terrorism, into ploughshares. Individuals with the ear of Secretary of State **Colin Powell** and his Deputy **Richard Armitage** want to give the Syrian government a good reason to meaningfully crack down on **Palestinian** rejectionist groups and ***Hizbollah***, as well as cross-border infiltration into **Iraq**, by offering Damascus the possibility of its removal from the US list of state sponsors of terrorism.

Flynt Deverett, a former CIA and State Department specialist – who has recently been sharing a platform with the exiled opponents of the ***Reform Party of Syria (RPS)*** – told *GSN* that "Syria has been on the state sponsor list since 1979 and it has not advanced US interests one iota. The state sponsor list is not yet a policy tool, it's just a 'feel good' gesture." In the longer term, Deverett and other doves are pushing for a twin engagement with the Syrian state and civil society that would mirror the Helsinki process that saw the gradual breakdown of the Soviet system in the 1970s and 80s.

One State Department official canvassed by *GSN* said this would involve convincing Syria to sign up to a series of progressive standards on human rights and political liberalisation that would empower local civil society movements and foster creeping reform. The objective would be to give Syria a "soft landing" as a democratic state, much as eastern Europe enjoyed.

Human rights and democracy clauses are also written into Syria's expected new association agreement with the ***European Union***.

Whether Syria leaves the list of state sponsors of terrorism or the US President applies sanctions, advocates of engagement are stressing the aid options that could reward good behaviour.

The Middle East Partnership Initiative (MEPI) administered by Vice Presidential daughter **Liz Cheney** could be one surprising avenue for engagement. Designated state sponsors are banned from receiving MEPI aid, but presidential waivers can be granted on a case-by-case basis; they have been extended to a number of **Iranian** civil society groups.

Indeed, *GSN*'s soundings suggest that State Department officials have earmarked an Arab businesswomen's micro-financing project in Syria for potential MEPI aid. The scheme is closely associated with Presidential wife **Asma Al-Assad**, who has an MBA at ***Harvard*** and was an investment banker at ***JP Morgan*** and ***Deutsche Bank*** before marrying.

This deal and others like it will be strongly opposed by hawkish and pro-**Israeli** interests in Washington. The very large majorities which passed the House and Senate versions of the *Syria Accountability and Lebanese Sovereignty Act* were an indication of the depth of feeling. US legislators have developed a deep personal distrust of 'Dr Bashar', who committed the cardinal crime of appearing unpredictable and susceptible to bad influences – notably **Sheikh Hossine Nasrallah** of Hezbollah.

Riding this wave, **Farid Ghadry**, head of the exiled opposition ***Reform Party of Syria (RPS)***, told *GSN* "the US could have worked with **Hafez Al-Assad**, particularly in the pre-9/11 world, but now there can be no deal with a Baathist state that has 8% Allawite minority rule and is led by a man who supports terror."

Opposition figures such as Ghadry have used lofty US rhetoric about the democratisation of the Middle East as a tool to goad US audiences in their recent rounds of visits to Washington, alternately thanking the USA for toppling the regime in Baghdad and then asking when Washington is going to get serious about 'policy-led by values' in other countries.

Though external opposition groups have a very poor record in fostering internal change, they continue to represent a council of despair in Washington, offering a low-cost, long-term solution to problems for which there is no near-term solution. Their stock may rise if the new US legislation is

Syria's exiled opposition: Not the INC

When ***Reform Party of Syria (RPS)*** leader **Farid Ghadry** opened a recent meeting in Washington by stating "I am not the **Syrian Ahmed Chalabi** and I don't want to be", he was highlighting the difficulty that Arab opposition leaders now face in disassociating themselves from the negative fallout from the exiled **Iraqi** opposition. Ghadry claimed his group was not an external opposition party, but merely "using the **US** as our podium", while maintaining most of its membership in Syria. After trying and failing to receive government permission to establish the party in Syria since 2001, the RPS has undertaken a number of meetings outside Syria, including an October 2003 congress in Sofia, **Bulgaria**, and a round of meetings with the press and US government officials in Washington in November. It has a slick website at *www.reformsyria.com* and seems to be the leading voice in a new party grouping, the ***Syrian Democratic Coalition (SDS)***.

Ghadry said his group was different from Chalabi's ***Iraqi National Congress (INC)*** because it sought non-violent regime change from within the country using civil society networks and offering a "third way" that could guide Syria to a future that did not include either a ***Baathist*** or an ***Ikhwan (Moslem Brotherhood)*** dictatorship. Ghadry, a Washington-based businessman, has emerged as spokesman for the SDC, an amalgam of ten groupings, which he embarrassingly could not list when asked by journalists; they are alleged by the RPS to represent some two million Syrians, including some 325,000 tribal and Kurdish voters who enjoy lesser rights under the current regime. The SDC presidency rotates every six months, which makes it difficult to undertake meaningful initiatives but "will display to the Syrian people the breadth of political viewpoints that exist within our coalition," Ghadry said.

He outlined a grassroots campaign that he sought to attract US aid to develop, including the use of "value-driven Arab-American television broadcasts into Syria", and the development of a "rumour-driven campaign that there is something new and exciting happening the Syrians can be a part of." Ghadry told journalists he had previously conferred with tribal leaders who came to meet him in Europe, where the SDC plans a second conference on 17-18 January.

Other SDC speakers in Washington included ***Syrian Democratic Party of Kurdistan***'s **Taufic Hamdosch** and the ***Party of Modernisation and Democracy for Syria***'s **Ali Hussein** (Ghadry said this party, founded by **Firas Kassas**, was "strong among youth and students in Syria"). Other SDC members include the ***Christian Syriac Movement*** (led by **Jean Antar**), ***Syrian Democratic Forum*** (**Hamdan Al-Asi**), ***Syrian Women and Children Association*** (**Badrieh Khalil**), ***Syrian Human Rights Association*** (**Salam Amir**), ***Democratic Center for Research, Palmyra Publications*** (**Khaled Hakki**), a tribal association represented by **Mohammed Al-Gheida** and the ***Syria for All Syrians*** association of expatriates (**Malek Assaf**). At public meetings three other SDC parties asked not to be identified for security reasons.

proven to have a minimal coercive effect on Syria.

Though regional states often over-estimate Washington's clout and react accordingly, there are indicators that Syria could ride out new US political and economic sanctions.

Following warm discussions between Syrian officials and **Italian** Foreign Minister **Franco Frattini** (Italy holds the EU presidency), relations with Europe are likely to improve following association talks in mid-December when Asad makes a state visit to **Belgium**. The Syrian leader plans to visit other European countries, including **Austria** and **Greece**, in 2004.

Oil concession politics

As the new US legislation passed, in late November **Russian**'s *Tatneft* signed a production-sharing agreement for Block 27, close to the **Iraqi** border, demonstrating the alternative economic partners that Damascus can turn to.

Syria and **Turkey** have signed a new energy transportation agreement, which will allow for the piping of **Egyptian** gas to Europe, as well as promoting bilateral relations.

Syrian Petroleum Company (SPC) signed a new exploration and production-sharing agreement (EPSA) with *Petro-Canada* for the 6,800 km^2 Block 2 in the Deir Ezor region only one day after the US Senate passed the *Syria Accountability Act*. At the signing ceremony Oil Minister **Ibrahim Haddad** observed that US sanctions would affect only US companies.

Some of firms are not very worried. In early December, the US-registered *Veritas DGC* secured a $4m contract from SPC to carry out a long-term offshore seismic survey to show Syria's Mediterranean E&P potential.

Most firms are adopting a wait-and-see attitude. US independent *Devon Energy Corporation* (80%) and privately-owned *Gulfsands Petroleum* (20%) paid a $1m signature bonus for Block 26, with a $17m spending commitment. Devon, which acquired the Syrian acreage in its H1 03 *Ocean Energy* takeover, "could actually just walk away from it, at this point," senior vice president **Brian Jennings** told a 3 December investor conference. It would depend on sanctions, he said.

Gulfsands president **John Dorrier**, formerly of *BHP* and his own *Seven Seas Petroleum*, has previously talked about the potential for cross-border field developments following Iraq's liberation. One of Houston-based Gulfsands' three executives, **Mahdi Sajjad**, is an Iraqi-born **British** citizen.

Meanwhile, the US 101st Air Assault Division continues to open up new trade relations between Syria and **Iraq**, assisting in the re-establishment of rail movement, organising 60MW of power supply from Syria, and facilitating crude oil/fuel swaps involving cross-border traffic totalling a reported 500-700 vehicles a day. A partial economic blockade is no blockade at all in Syria's case.

As **Flynt Deverett** argued, the USA has "no policy, just a list of complaints". Although *GSN* has heard Washington hawks complain that "the State Department never saw a dictator it didn't like", those favouring constructive engagement reply that "we cannot hold policy hostage to an open-ended policy of regime change".

As Washington seeks to develop a policy that is hard-nosed, tough-minded, but clear-eyed, the *Syria Accountability and Lebanese Sovereignty Act* could turn out to be just another 'feel good' gesture. As is so often the case in the USA's global war on terror, Washington's most favoured terrain remains its perception of holding the moral high ground.

Kuwait debates boundary changes to reduce the personal component in parliamentary politics

Momentum is gathering behind a campaign to redraw constituency boundaries, to counter the influence of personal and tribal connections, and strengthen policy debate in elections and the National Assembly. Arguments are expected over the government's cautious response.

Deputy Premier and Minister of State for Cabinet and National Assembly Affairs **Mohammed Daifallah Sharar** said on 10 December that nothing would happen "without a comprehensive study on [the suggestions'] effect and expected results." But liberals and some Islamists are throwing their weight behind a call for the present 25 constituencies, each represented by two deputies, to be replaced with just five large districts, each electing ten deputies.

In such larger areas, it would be impossible for candidates to meet all potential supporters in person. Instead of relying on family, friendship and tribal networks, and their ability to help voters with services, jobs and introductions, they would have to win over wider public opinion, with policy ideas and proposals for legislation.

The government is wary of reform, not least because it exercises considerable patronage and behind-the-scenes influence over election results through the current system.

Nor has it gone down well with tribal interests, who, for example, were able to engineer the defeat in Omariyah of *Islamic Constitutional Movement* leader **Mubarak Al-Duwailah** in last July's general election *(GSN 715/7, 714/6)*.

Bruised by their own heavy defeat in that vote, with the loss of prominent reformers such as **Abdallah Naibari** and **Ahmed Al-Rubaie**, liberals have been arguing the case for the move to larger constituencies since the summer. At that stage such a reform seemed unlikely, but pressure for change is mounting, because mainstream Islamists are also worried about that the voting system hampers the development of a modern politics. Many of the new members of parliament (MPs) elected in July support the initiative, even though many owe their seats to tacit government support, or to patronage and tribal connections.

Curiously, the new campaign for change was initiated by **Ahmed Al-Saadoun**, a populist former parliamentary speaker who was one of the most redoubtable opponents of economic reform in the last parliament. Saadoun got a nasty shock in July, coming close to losing his seat. Like a number of other prominent deputies, Saadoun was the target of a sharply focused campaign by opponents.

In the present small constituencies, a few hundred votes can often decide the fate of several candidates. In big electoral districts the switch of small numbers of votes would be less significant and campaigning would be less personalised.

Islamists and liberals have mounted targeted campaigns designed to bring down prominent opponents. But in the longer term, although they disagree on many issues, both are movements based around ideas and policy proposals; they thus have an interest in seeing Kuwait move towards a new politics based around a public debate between their contrasting visions of the future.

The biggest losers from reform would be the so-called "service MPs", who base their appeal to voters not on their view of national policy concerns facing Kuwait but on their ability to arrange services and jobs for their constituents. About ten of the current National Assembly membership fall into this category, and they are firmly opposed to a change that would create big voting districts where it was much harder to develop such personal connections.

Parliamentary Speaker **Jassem Al-Khorafi**, who has built a strong power base in his inner suburban Shuwaikh constituency, is also opposed to the change. On this, as on many other issues, he is a defender of the status quo, unconvinced of the need for major change.

On the contentious issue of women's political rights Khorafi is continuing to sit on the fence, waiting to see whether a consensus view will emerge in Parliament.

The redrawing of constituency boundaries might help prepare the ground for female suffrage. Opponents note that women do not participate in Kuwait's lively culture of *diwaniyas*, where men gather to socialise and debate.

Diwaniyas are an important forum where candidates meet voters. But in a system of big constituencies, much more campaigning would have to take place in large public meetings or on television – fora in which women are present.

Meanwhile Prime Minister **Sheikh Sabah Al-Ahmed Al-Jaber Al-Sabah** is to press ahead with important liberalising economic measures, including a proposal to end the 49% limit on foreign shareholdings. In voting out so many MPs in July, the public expressed its frustration at political wrangling and loss of economic momentum; the new reform package thus met a relatively warm reception. More contentious is education curriculum reform *(see Finance and policy)*.

IRAQ FOCUS: Long haul as Sunni resistance digs in

The rotation of new **US** military units into Iraq in 2004 – a sequel operation dubbed *Iraqi Freedom II* by the Pentagon – will have to work better than the original if it is to succeed in the face of an insurgency that has rolled with every blow the Coalition forces have thus far thrown at it and shows signs of deeply embedding itself within Iraq's Sunni communities.

The latest issue of the monthly ***Iraq Focus*** sees "co-evolution" as a key trend in the post-war security environment, as the resistance and Coalition forces have successfully adapted to each other's operations.

This ability to adapt means the outlook for Iraq's security hangs in the balance, and it is increasingly clear that resistance forces will pose a threat for years to come – probably even if **Saddam Hussein** is captured or killed.

A US ***Defense Intelligence Agency (DIA)*** source said the emerging picture from recent incidents and information gleaned from the hundreds of alleged resistors seized by the Coalition was very complex. The official told *Iraq Focus*: "For whatever reason, the Coalition leadership decided to simplify the characterisation of the resistance effort as 'regime dead-enders', whilst understanding that the reality is much more complex." Secretary of Defence **Donald Rumsfeld** coined and extensively used the label of "regime dead-enders" during the early post-war period.

The picture emerging is one of a loose network of resistance groups that are held together by a complex range of shared interests, fighting against the Coalition presence. Current US intelligence estimates suggest that former regime loyalists are the core of the resistance effort, providing logistical and financial backing and the majority of combatant groups.

But radical Sunni mosques also play a major role in the resistance effort, providing inspiration, co-ordination, and shelter to bomb-making and attack cells in areas such as Fallujah, Baghdad, and Samarra, where two US convoys were simultaneously attacked on 30 November.

The Baathist state was nothing if not a kleptocracy, and criminal elements play an important role in the resistance. The attacks in Samarra – which targeted US convoys carrying large quantities of cash – are illustrative of the nexus of interests that can draw apolitical Iraqis into resistance operations.

Although the impact of foreign fighters is generally discounted as a significant element of the resistance (analysed in *Iraq Focus*, November 2003), ***Ansar Al-Islam*** is the one *bona-fide* terrorist group in Iraq that Coalition leaders consider to be an integral feature of the insurgency.

US military and intelligence figures are broadly in agreement that the resistance is very loosely structured and that senior Baathist leaders at large may be inspiring and logistically or financially supporting operations without actually directing the selection of targets or other operational details.

Saddam Hussein is felt to be focused entirely on survival and the maintenance of a low profile and many US officials believe that he could not have evaded capture this long in Iraq and is most likely hiding in **Syria**. **Izzat Ibrahim Al-Douri**'s role in the resistance is believed to be largely symbolic, and the details of resistance activities are believed to have devolved to the local level before the war even ended.

Though Pentagon analysts are hesitant to view the October/November period as either the high-tide mark of the insurgency or a tipping point, the resistance displayed rapid increases in capability during this period, bouncing back from each major counter-insurgency drive with ingenuity and determination.

The numbers of daily attacks have fallen back from their Ramadan high point of around 50 per day, once again averaging the late summer rate of around 20 per day, but there are no indications that the resistance will remain quiescent. As well as what DIA analysts term the 'Chinese water torture' of daily attacks, the resistance has displayed a penchant for the spectacular, attacking US helicopters, heavy armoured vehicles, and fortified enclaves with regularity.

Nine months into the insurgency, recent resistance attacks have demonstrated a number of key advances that suggest the threat of insecurity will be a constant feature for years to come.

These trends are analysed in depth in *Iraq Focus 4*, to be published this month.

Pentagon bans critics 'to protect essential security interests'

The decision of **US** Deputy Defence Secretary **Paul Wolfowitz** to bar **French**, **German** and **Russian** companies from competing for contracts under the $18.6bn US-financed reconstruction programme signals a clear victory for **Bush** Administration hardliners just a couple of months after senior Pentagon sources had stated exactly the contrary.

The ban takes the form of a Pentagon directive, issued by Wolfowitz, which states that only companies from the USA, Iraq and 61 designated Coalition countries can bid. Others are excluded "to protect the essential security interests of the

United States", the document says. Yet in London in October, Deputy Under Secretary of Defence for International Technology Security **John Shaw** said that companies from all states that had trade agreements with the USA would be allowed to bid.

Interviewed by *GSN* and other media, Shaw made it explicitly clear that because the ***European Union*** had trade accords with Washington, all member states, including France and Germany, would be eligible to bid for contracts.

But it soon became clear that those in Washington who favoured a conciliatory approach to friendly countries that opposed the Iraq war had not won the argument. At the 23-24 October Madrid donor conference, Coalition Provisional Authority (CPA) officials declined to answer questions of whether tenders would be open to all; subsequent *GSN* requests for clarification failed to produce a response.

The appearance of Wolfowitz's directive, given public support by President George W Bush, signals that the argument has been settled in favour of a firm line.

This may be because the CPA is moving away from the *ad-hoc* contracting arrangements that prevailed in the early aftermath of war, under which US groups with links to the Bush Administration did particularly well. The authority is now committed to adopting transparent and competitive procurement, setting up a Project Management Office, modelled on the US Office of Management and Budget.

If the new procedures were applied rigorously, some contracts might have gone to firms from France, Russia and Germany – which have ample experience of infrastructure work in emerging countries.

The contracts ban has met with cross-party criticism. It was no surprise to see **Joe Biden**, senior ***Democrat*** on the Senate Foreign Relations Committee and a frequent critic of Bush Administration policy, dismiss the ban as a "totally gratuitous slap" that "does nothing to protect our security interests and everything to alienate countries we need with us in Iraq".

But this view was shared by ***Republican*** congressman **Christopher Shays**. "We should do whatever we can to draw in the French, the Germans, the Russians and others into the process," said Shays, who recently visited Iraq. "I would expect that most of the contracts would go to countries who have done the heavy lifting, but I wouldn't want to see any arbitrary effort to shut anyone out."

In response came talk of complaints to the ***World Trade Organisation (WTO)*** and the ***Organisation for Economic Co-operation and Development (OECD)***, which regulates tied and untied aid. An 11 December appeal by Bush for big creditors – notably France, Germany and Russia – to forgive Iraq's debts was seen as especially bad timing.

The security rationale behind the Wolfowitz directive seems tortuous, based on the premise that reserving contracts for those that support US security and defence policy would encourage more countries to take Washington's line in future. The security case is especially shaky; firms from non-Coalition countries will be allowed to tender for sub-contracts.

Growing evidence suggests the restrictive US approach to contracting in Iraq is economically wasteful and politically damaging, if international opinion counts for anything. Congressional enquiries have exposed the high prices charged by ***Halliburton*** for the fuel it brings into Iraq from **Kuwait** and **Turkey** under an exclusive contract. Critics say these orders suffer from lack of transparency.

Questions about the cost-effectiveness of US-financed procurement will be further highlighted as the parallel system for contracts funded by the international community gets under way. All work funded out of ***World Bank*** and ***United Nations Development Programme (UNDP)*** trust funds will be subject to standard open international tender.

Meanwhile, the World Bank, ***International Monetary Fund***, UNDP and ***Arab Fund for Economic and Social Development*** have been pressing on with final arrangements for the ***International Advisory and Monitory Board***, whose job is to oversee the sale of Iraqi oil and ensure that revenues – paid into the ***Development Fund for Iraq*** – are transparently used.Oil funded contracts will be subject to neutral international bid procedures.

Defence/security interests apparent in new UAE/UK parliamentary group

Traditional UK defence interests are reflected in the membership of the new ***UAE All-Party Parliamentary Group***, which has just held its inaugural meeting. Chairman **Kevan Jones**, ***Labour*** member of parliament (MP) for North Durham, sits on the House of Commons Defence Select Committee; he has taken a special interest in radical Islam and visited post-war **Iraq** and **Afghanistan**. Jones has called for "a greater and more unified response" to militant Islam "from moderate Muslims, not just in the UK but throughout the world". Early in 2004, the Defence Select Committee will publish a report on the lessons to be learnt from the interventions in Iraq and Afghanistan.

The new UAE group has two vice-chairs. East Devon ***Conservative*** MP **Hugo Swire** is a ***Sandhurst***-trained former military officer with a special interest in Arab affairs. He is already treasurer of Parliament's **Oman** group, vice-chair of its **Lebanon** group and joint chair of the Conservative policy group on defence and foreign affairs. The interests of ***Liberal Democrat*** **John Thurso** reflect a more recent component of Anglo/UAE relations – the tourism and leisure industry. Hotelier and restaurateur Thurso is former a managing director of the ***Champneys*** health resorts group. He is also a hereditary peer; after losing his guaranteed place in the House of Lords, he won a seat in the Commons representing the thinly populated northern **Scottish** constituency of Caithness, Sutherland and Easter Ross.

The group's secretary, Birmingham Perry Barr Labour MP **Khalid Mahmood**, represents an increasingly important voice in UK relations with the Middle East – the country's large Muslim community. Mahmood already has strong links with the UAE and in the early 1990s he worked in **Kuwait** for three years. He was part of a delegation of prominent UK Muslims who visited the region after the 11 September attacks to reassure Middle Eastern leaders of the strength of moderate Islamic opinion in the UK and the increasingly prominent role of Muslims in British public life.

Bahrain consolidates US connection to build on Major Non-NATO Ally status

Bahrain, the focus for the latest article in GSN's series on Gulf militaries, has a long-standing military relationship with the USA which the Al-Khalifas continue to consolidate.

Since President **George W Bush** announced that the global 'war on terror' had begun in late 2001, the USA's relationship with Bahrain, which was always good – with the island hosting American naval facilities for five decades – has become closer still. As Bahrain renewed its ten-year basing agreement with the USA in October 2001, Washington promoted it to the status of Major Non-NATO Ally, which only eight other countries hold. **Egypt** and **Jordan** are the only other Arab members of this select club, which makes the facilitation of advanced technology transfers (including depleted uranium ammunition) far easier.

In October, a series of high-level military meetings between US regional commander General **John Abizaid** and Commander-in-chief **Crown Prince Sheikh Salman Bin Hamad Al-Khalifa**, sealed the ongoing hosting of the US Fifth Fleet headquarters in Bahrain, and underlined the fact that the kingdom's military ties with the USA are close, even by ***Gulf Co-operation Council (GCC)*** standards.

This will guarantee generous US military aid in the next five to ten years, with the result that Bahrain's small but professional military is likely to develop into an almost entirely US-equipped force that will closely mirror the training and equipment pattern of American forces as the Pentagon distributes its 'legacy systems' to close allies as so-called Excess Defence Articles (EDA).

The military role Bahrain plays in GCC and Western regional planning has long outstripped Manama's financial capabilities, and Bahrain has been unique among Gulf states in receiving strong and sustained US military aid. Bahrain is by far the GCC's smallest spender on defence on a *per capita* basis and as a percentage of GDP the region's lowest. It is, however, still well above the global average.

Thanks to generous US aid and careful procurement, Bahrain has reversed a trend that saw it consistently overspending its defence budgets. After the recent drop in defence expenditure, budgets should increase modestly after reaching almost $400m at the end of the 1996-2001 plan. In the 2003-05 period, Bahrain is likely to spend an average of around $380m/yr on current estimates, but this spending will be greatly boosted by US military aid, which will ease budgetary restrictions on new purchases and maintenance.

US support has become essential to bolster a key ally since **Saudi Arabia**'s budgetary concerns eliminated it as a source of military funding for Bahrain. Saudi money played a large role in kick-starting Bahrain's F-16 programme and underpinned the 1987 Peace Crown I agreement. As Riyadh has backed out of aid commitments, Washington has stepped in, providing increasing amounts of surplus US military equipment as EDA plus credits for purchases of equipment and training.

Bahrain's share of US foreign military financing aid has increased dramatically since 2002, when Bush Administration supplemental funding linked to the 'war on terror' began to trickle down to US allies in the Gulf. Since 2002 the USA has given $28.5m of foreign sales credits and over $850,000 worth of training assistance to Bahrain – almost ten times the combined total provided over the preceding decade.

This spending will allow Bahrain to focus its national spending on new systems and critical maintenance and training. Thanks to Bahrain's Major Non-NATO Ally status, very few advanced technologies are completely out of Manama's reach if it makes a determined acquisition attempt.

Key defence priorities

In line with the emerging global trend, Bahrain's armed forces will seek a range of new and improved capabilities that support the missions of anti-terrorism and border control. Bahrain is likely to invest in new manned and unmanned airborne surveillance assets and command and control infrastructure to give decision-makers a clearer picture of internal security situation and increase their decision space.

Anti-missile countermeasures are now being fitted on some royal aircraft, but these may be more widely deployed in time *(GSN 723/4)*. Bomb disposal units currently in training are likely to require modernisation and expansion.

Although only encompassing an area of 676km², Bahrain is an archipelago, comprising many small islands, so there will be

BAHRAIN: Trend of defence expenditure

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Defence expenditure ($ m)	222	223	251	261	273	279	304	410	441	322	364

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

Who's who in the Bahrain military

Reflecting the political make-up of the islands, the senior ranks of the Bahrain military include a number of ruling **Al-Khalifas**, several of whom have been in position for a decade or two. The ***Bahrain Defence Force (BDF)*** was created by the then crown prince – now King – **Sheikh Hamad Bin Isa Al-Khalifa** in 1968. The King now holds the title Supreme Commander of the BDF. Like his father before him, the BDF's Commander-in-chief is the Crown Prince, **Sheikh Salman Bin Hamad Al-Khalifa**. Defence Minister and Deputy Commander-in-chief is Lieutenant General (Sheikh) **Khalifa Bin Ahmed Al-Khalifa**, who was appointed in March 1988, when the Defence Minister position was created by Sheikh Hamad to "meet the needs of an increasingly sophisticated defence force". Major-General **Rashid Bin Abdallah Al-Khalifa** is BDF Chief-of-staff.

Other senior serving and retired officers include the following. This list was compiled by *GSN* from non-official sources, some of which we have been unable to confirm:

- Brigadier General **Sheikh Ahmed Bin Salman Al-Khalifa**: the BDF Assistant Chief of Staff (ACOS) for Intelligence and Security from 1981.
- Brigadier General **Sheikh Mohammed Bin Isa Bin Salman**, Commander of the Bahraini National Guard since 7 January 1997, when he was the first officer to be appointed to this position.
- Brigadier General **Abdelaziz Al-Fahdel**: BDF ACOS for Operations since October 1988.
- Brigadier General **Ahmed Abdelkarim Buallai**: ACOS for Supply and Provisioning since January 1996.
- Colonel **Sheikh Rashid Abdallah Ahmed Al-Khalifa**: BDF ACOS for Operations since January 1996, when he replaced Brigadier General Abdelaziz Al-Fahdel.
- Colonel **Yousef Ahmed Al-Jalahma**: Director of the BDF's Office of Military Co-operation, since October 1989.
- Colonel **Sheikh Daij Mohammed Al-Khalifa**: Commander, BDF Special Forces since the early 1990s.
- Colonel **Yousef Ahmed Malallah**: Commander of the Bahrain Emiri Naval Force from 1 March 1987.
- Lieutenant Colonel **Hamad Bin Abdallah**: Commander of the ***Bahrain Emiri Air Force (BEAF)*** from September 1985.
- Lieutenant Colonel **Mohammed Kumaihan Al-Otaibi**: Director of the BDF's Defence Intelligence Directorate (DID) since 28 November 1997, when he replaced Colonel **Abdallah Fadhel Al-Noaimi**.
- Colonel **Sheikh Abdelaziz Attiyatullah Al-Khalifa**: Governor of Manama and a controversial former director in the Interior Ministry.

a strong demand for intelligence, surveillance and reconnaissance systems and coastguard forces that can cover this relatively long coastline against criminal or terrorist infiltration.

Air and helicopter forces will remain Bahrain's principal means of deterring and defending against minor territorial encroachments that may occur below the threshold of the US security guarantee. In the purchase of its advanced Block 50/52 F-16 aircraft and AH-1 armed helicopters, Bahrain has already made the major capital investments (although the latter were largely cost-free EDA grants from the USA). Future investments are likely to come in the form of upgrades, advanced munitions, data-link, training and maintenance.

BAHRAIN: A threat assessment

Under **King Hamad Bin Isa Al-Khalifa**, sectarian and domestic political threats to Bahrain's internal security have decreased – but have not gone away entirely – through a combination of political liberalisation and economic development. **Iran** is unlikely to dabble in the country's religious politics to the same dangerous degree that transpired in 1981 and possibly again in 1996, when Iranian-backed Shiite coup attempts were unravelled. The tenuous Iranian claim on Bahrain was rejected first by the late Shah and later again by the Islamic government in Tehran, and is unlikely to re-emerge. Bahrain's security forces show little sign of relaxing their surveillance, and will maintain their capacity for direct action, either through the security and intelligence services paramilitary elements, the Public Security Forces, or – in the direst circumstances – the military option of the Bahraini Defence Forces (BDF).

The kingdom must also respond to emerging terrorist threats linked to the country's unequivocal support of the **USA**. Bahrain will also strive to maintain a degree of indigenous high-intensity military capability for use in regional contingencies that occur below the threshold of the US security guarantee. The key area remains Bahrain's shared maritime border with **Qatar** – including Hawar Island, and the Fasht Al-Dibel and Jarada shoals – and the Zubara enclave on the Qatari mainland. Since International Court of Justice (ICJ) arbitration in 2001, the dispute over the Hawar islands and the Fasht Al-Dibel rocks appears to have receded. If the two states clashed over this or other issues in the future, the conflict would quickly become politicised and, on past form, could spill over into armed clashes *(GSN 723/7)*. While he was crown prince, King Hamad was outspoken on the issue of Bahrain's territorial integrity, stating that "we must remain ready at any time to defend it and die for its sake".

The eclipse of the threat posed by Iraq has reduced the likelihood of high-intensity attacks on Bahrain, yet – recalling the 1991 Scud missile attacks on the country – the Bahraini state will continue to prepare for the threat of conventional and weapons of mass destruction (WMD) attacks originating from a regional state. Considering the central role of Bahrain's harbours and headquarters facilities in the US naval posture in the Gulf, and Sheikh Isa Airfield's role in the portfolio of possible US air bases in the region, defence analysts suggest that Bahrain must prepare for the possibility that Iranian or even Pakistani missile or air attacks could be launched against the country to disrupt its utility as a US hub.

For other scenarios, where an external state adversary threatens national security, these capabilities will prove useful in instances where short warning means that sufficient US forces are not at hand as the conflict begins. **Joe McMillan**, a *National Defense University* authority on the US Gulf security posture, estimates that there is likely to be a US carrier battle group present in the region for approximately 240 days/yr in the future, demonstrating the need for indigenous combat and mine counter-measures capabilities.

The length of time before US forces can intervene could be affected by 'anti-access' strikes, which aim to prevent US use of local airbases and ports. US threat analysts believe that in the Gulf this would most likely take the form of **Iranian** cruise and ballistic missile attacks, which could increase considerably in potential sophistication during the latter half of this decade.

As well as a vital link in the developing GCC air defence system, Bahrain hosts one of the highest priority US targets in the Gulf. Bahrain covers an area less than 128km deep and 64km wide, obviating the need for an extensive overland radar network, and instead the country is likely to continue to intensify its surface-to-air missile (SAM) coverage, with special focus on the interception of land-attack cruise and anti-shipping missiles.

As occurred during *Operation Iraqi Freedom*, Bahrain is likely to functional as a launch area for US missile defence forces such as THAAD and PAC-3, but the country is likely to invest in greater numbers of low-level air defence systems such as mounted gun units and shoulder-mounted SAM. As a member of the US Co-operative Defence Initiative, Bahrain is also likely to improve its WMD early warning, defence and consequence management capabilities.

Bahrain and Dubai's financial ambitions

Continued from page 20

development under Crown Prince **Sheikh Mohammed Bin Rashid Al-Maktoum**.

Heavy infrastructure and promotional spending hold risks. Neither Dubai nor Bahrain have **Abu Dhabi**'s long pockets and ability to walk away from a problem development like the failed Saadiyat Island financial centre scheme unscathed. Bahrain can no longer count on **Saudi Arabia** to bail it out, and Dubai must be concerned at occasional rumblings from Abu Dhabi about pressures to provide discrete financing when the burden of development costs gets too great.

These are high-risk developments, but perhaps there is room for a dual success. After all, Dubai is already an important financial centre, with a wide range of international banks, especially active in areas such as trade finance and real estate. This has not prevented Bahrain from maintaining its pre-eminence as the accepted offshore international banking hub of the Gulf, indeed the Middle East.

There is a lot of capital sloshing around the region, although much more is exported to the Western financial markets. Perhaps an injection of more local competition will encourage Gulf investors to keep more of their funds at home – a trend that has been accelerating since late 2001. The Gulf could also have attractions for **Pakistani**, **Indian** and South-east Asian interests, seeking to diversify their portfolios.

An indication of the possible scope for both Manama and Dubai to grow has come from the fast-expanding Islamic finance sector. Some institutions have opted to base themselves in one city, some in the other; there appears to be no clear consensus on which is the preferred location.

One of the factors sustaining Islamic finance growth is the strength of the local market. The sector caters for personal as well as business clients and this gives it a vast potential customer base within the region.

In conventional corporate financing, the Middle East could provide many of the extra customers that will be needed if both Bahrain and Dubai are to thrive. As Gulf states increase the role of the private sector in their economies, a growing number of commercial entities will be needed to mobilise offshore capital and credit if they are to take up new opportunities in industry or infrastructure provision.

PERSPECTIVE: Twelve years ago

Fundamentalist extremists have been making a lot of noise, and it is evident that the royal family, government and traditionalist religious establishment are deeply worried. Hopes among many Western-educated Saudis that the huge influx of Western personnel during the Gulf crisis might provoke the beginning of change in the restrictive religious climate have been disappointed. On the contrary, calls for liberalisation – however timid and discreet – seem to have set off a violent (verbally, at least) backlash from the current of Islamic radicalism which runs particularly strongly among the country's 200,000 students and 300,000 civil servants.

The fundamentalists appear to co-ordinate their activities through religious societies and mosques. They are becoming more and more outspoken, adopting a strategy of openly attacking government policies in public speeches in mosques and in lectures at religious educational institutes. Perhaps more important, they are reaching a wider audience by recording and distributing their assaults on government policies and personalities (including several ministers, newspaper columnists and traditional religious leaders in hundreds of thousands of cassettes which are freely available throughout the Kingdom. Not surprisingly, the authorities regard the situation with alarm and fear a menacing subversive campaign.

They are unquestionably under mounting pressure. "The Gulf crisis stirred up a broad and sweeping debate on domestic and foreign policy", a senior Arab diplomat in Riyadh remarked. "You've got petitions to the King now that are coming out almost as a routine matter from liberals and conservatives alike.This was unheard of only two years ago."…

The modernising liberals are little more than an unorganised fringe group with limited influence on the Kingdom's political and social evolution. The vast majority of Saudis are probably swayed more by what the religious authorities have to say, while the chief function of the Westernised liberals is to fan the flames of extremist reaction. The establishment feels distinctly threatened.

Gulf States Newsletter, Vol. 17, No. 427, 13 January 1992

Bruised by *Cole* and *Limburg*, Yemen seeks new Aden port contractor

Yemen is poised to invite new international bidders for the contract to manage Aden's container port – from which the **Singaporean**-owned *Yeminvest* withdrew in October, bruised by the slump in traffic that followed the terrorist bombings of the *USS Cole* and the **French** tanker *Limburg*. Officials are now finalising terms of reference for a new tender offer.

Their hopes of attracting a credible new operator have been raised by the decision of the container line *PIL* to resume calls at Aden by its deep-sea vessels on services from the Far East.

After the withdrawal of Yeminvest – 60%-owned by an offshoot of the *Port of Singapore Authority (PSA)* and 40% by **Saudi Arabia**'s *Bin Mahfouz* group – the government of President **Ali Abdallah Saleh** was forced to assume responsibility for the port.

Another Asian firm, *Overseas Port Management (OPM),* headed by **MMJ Subramaniam** has been hired to run the facility for a six-month transitional period. Subramaniam is a former PSA vice-president with past experience of Aden.

Also expected is a government decision on how the Aden Distripark industrial estate should be managed. Like the port, this is part of the *Aden Free Zone*. The park has 30ha of prepared ground, with power, water and roads in place; although no foreign companies have yet signed up, it has already secured four local tenants who are preparing to build premises.

Some allegations of corruption have surfaced in the local media. But these have been rejected by Prime Minister **Abdel Qader Bajammal,** who has denied suggestions of any secret deal between government and Yeminvest over development terms for the $238m free zone project.

Yeminvest's decision to pull out appears to be explained by the disastrous slide in business that followed the bomb attacks on foreign vessels. The October 2000 assault on the *Cole* in Aden highlighted the difficulty of protecting ships berthed at the quayside from attacks by small suicide boats. Two years later, the attack on the French tanker *Limburg* off the Ash Shihr oil terminal near Mukalla dispelled any hopes that civilian vessels might be exempt from the Islamist threat.

This struck a serious blow at the viability of the container port, which sought to take advantage of Aden's location at the mouth of the Red Sea, on the main Europe-Far East shipping route. The terminal's prime selling point was that deep-sea "mother ships" operated by international groups such as *APL* of the **USA** or **Taiwan**-based *Evergreen* could call directly into Aden without significantly diverging from their course. From Aden, cargo could be transhipped to the Gulf, East Africa and other regional destinations.

But the bombings made shipping lines wary of bringing their main vessels into Aden, thus undermining the port's ambitions to become a major transhipment and distribution hub. Before the *Limburg* attack, traffic was running at 42,000 twenty foot-equivalent units (teu) per month. Afterwards, as major lines pulled out, business slumped to just 5,000-8,000 teu/month, mainly import business for the local market.

Although some lines maintained feeder connections, notably to **Dubai**, Aden had clearly suffered a major blow in its competitive struggle with the rival east Arabian ports of Khor Fakkan – on **Sharjah**'s east coast – and Salalah in **Oman**. This was a big setback to the Distripark, whose excellent export/import connections had been a key selling point.

The final blow came when Yeminvest decided to quit altogether, in October. But in November, local managers' spirits were revived by PIL's decision to resume direct services. That month, traffic bounced back, reaching 26,000 teu. December is set to be even better.

The government claims to have persuaded insurers to lower the high premiums that had been imposed on ships calling at Aden.

Distripark management is hopeful that the restoration of direct deep-sea transport links will also help them revive investor interest. They point out that local labour costs are much lower than those in the Gulf – and based essentially on a local workforce rather than expatriate migrants.

But it is too early to be sure of Aden's revival prospects. Given Yemen's limited financial resources, the port has to be developed on a viable commercial basis. It cannot count on the massive injections of state-backed development capital generally available for new projects in the Gulf states. By contrast, Sharjah's Khor Fakkan has just announced a further round of costly expansion.

It would only take another terrorist assault to renew shipping line jitters and send insurance premiums for Aden calls soaring once again.

BAHRAIN

Sand shortage adds to property price rise

Bahrain has enjoyed a year of rising property prices and the commencement of a slew of new projects, from the Bahrain Financial Harbour to the Al-Hidd superport, a new Formula 1 track and luxury real estate developments at several locations around the island *(GSN 723/12)*. But a shortage of sand has begun hampering plans and driving up construction costs.

Most of Bahrain's sand for concrete production is shipped from **Saudi Arabia**, and has been for decades. But sand deliveries across the King Fahd Causeway – amounting to some 6,000 - 8,000 t/d – stopped suddenly in July.

Even the Bahraini government was not notified of a reason for the suspension, sources told *GSN*. Several explanations have been floated: deliveries may have been stopped out of concerns for the environment, or the Saudis may have mounted an attempt to regulate their sand and aggregate export sector, which reportedly operates largely informally.

Saudi Arabia has also taken steps to boost its own cement- and concrete-producing industries, which may have contributed to the Kingdom's unwillingness to part with what has become a valuable resource.

The shortage has not affected road works in Bahrain, since these can use sand dredged from the sea floor. But because of their high chlorine and salt content, such supplies are of low quality and are very expensive to process. Some 3 m^3 of fresh water are required to cure 1 m^3 of dredged sand.

The shortage of sand has reportedly driven construction costs up as much as three-fold in some cases. Regardless, Bahrain's property market has soared in the last year, outpacing the stock market, which has risen almost 30% in 2003. Local house prices have doubled in some towns, with prices averaging around $40/$ft^2$ but topping $100/$ft^2$ in prime locations, according to ***Norwich Property Consultants*** managing director **Neil D'Silva**, who says Bahrain's property boom should continue for the next decade. Construction prices range from $25/$ft^2$ to $50/$ft^2$, including labour costs.

The rise has come in part from looser expatriate residential and property owning restrictions, which has reportedly led more **Kuwaitis** and Saudis to buy homes in Bahrain. Some are second homes, some house expats working just across the causeway in Saudi Arabia but who prefer to sleep and socialise amid the calmer atmosphere of Bahrain.

Bahrain Monetary Authority (BMA) has authorised some banks to offer low-interest mortgage facilities to expats who meet certain criteria.

Bahrain takes further steps to regulate banks and equities

The ***Bahrain Monetary Agency (BMA)*** plans to reinforce its regulatory credentials by signing up to the ***International Monetary Fund***'s Financial Sector Assessment Programme, according to BMA governor **Sheikh Ahmed Bin Mohammed Al-Khalifa**.

Regulation, enforced by the BMA, is seen as a major instrument for consolidating Bahrain's position as the Gulf's pre-eminent financial centre. Notable strides have been made recently in the regulation of Islamic institutions.

The BMA is also working to upgrade its longer term financial services planning, with a dedicated unit now up and running, basing its approach on studies drawn up by ***McKinsey & Company.*** According to the BMA, Bahrain now hosts 355 financial institutions and 1,562 funds are registered.

Possible stock exchange privatisation

The ***Bahrain Stock Exchange (BSE)*** is working with the BMA to regulate information disclosure requirements as part of moves to boost business in an equities market that is booming in percentage terms, but continues to disappoint investment professionals.

According to BSE director **Fouad Rashid**, the exchange is preparing for privatisation, possibly by 2005. But first the BSE needs to raise its trading volumes and encourage new listings to add to its $8.1bn end-2002 market cap.

The BSE has only 85 listed instruments – 43 companies, 29 mutual funds and 13 bonds – and trading volume of just under $209.5m in 2002. Privatisations are one way the BSE's business could be boosted, but the biggest recent interest in new listings has come from issuers of Islamic corporate bonds.

CORPORATE

Jordanians fret over Hariri's plans for Arab Bank

The sale of a **Shoman** family shareholding in Amman-based ***Arab Bank*** to ***Saudi Oger***, **Lebanese** Prime Minister **Rafiq Hariri**'s **Saudi**-based diversified construction company, has provoked a renewed bout of anguish in **Jordan** that the billionaire PM is looking to take majority control of the bank and relocate its headquarters to Beirut.

Saudi Oger has acquired an 11% stake in Arab Bank, the second biggest bank in the region, in a deal reportedly worth $375m. But Oger will only get 5% of the shares; it must sell on 4% of its stake to Jordan's ***Social Security Corporation (SSC)*** and 2% to family members **Abdelmajeed Shoman** and **Abdelhamed Shoman**. Hariri has also given assurances that he will not attempt a takeover of the bank.

As a result of the purchase, Oger's stake will increase to 13.9%, almost matching the SSC's 14.5%.

Founding family member **Omar Khalid Shoman** sold the shares to Hariri, reportedly as a result of a failure of an attempt by an Arab-American financier to acquire the shares. After the deal fell through, Hariri quickly stepped in. The reason for the sale is not clear, but it is Saudi Oger's biggest deal outside **Saudi Arabia** this year.

Some Jordanians have questioned the decision. In 2001, when ***Kuwait Investment Authority (KIA)*** sold off its 400,000 shares in Arab Bank to SSC, rather than Saudi Oger, SSC director general **Ahmed Abdelfattah** described the deal as a "national political and economic victory preventing private foreign control over the Arab Bank." Jordanian national sensitivities over losing its prize banking asset are only heightened by Hariri's Saudi connections.

But Shoman family shareholders view the increased presence of Saudi Oger as a potential confidence booster. "The bank sees it as a very positive move as it strengthens the ownership," **Liz Jackson-Moore**, managing director of **Cyprus**-based ***Moody's Interbank Credit Service***, told *GSN*.

"Hariri been very supportive of Arab Bank in the past and Arab Bank has been very supportive of him," Jackson-Moore said. " When he needed help from the bank, he got it."

Other Arab Bank shareholders include the Saudi Ministry of Economy and Lebanon's Finance Minister **Fuad Siniora**. Hariri's wife **Nazek** is also a board member at Arab Bank.

The acquisition furthers Saudi Oger's increasingly diversified portfolio of interests. Aside from owning cellular phone licenses in **South Africa**, Central Asia and the Middle East, the company is also pursuing a petrochemicals venture in Iran. That transaction is expected to be finalised in February.

SAUDI ARABIA

Investment banks line up

HSBC is set to follow ***Deutsche Bank*** in applying for a licence to carry out investment banking operations in Saudi Arabia, in a further sign of the progress in opening up the banking sector.

The London-headquartered bank and its ***Saudi British Bank*** affiliate are to establish a joint venture investment bank in the Kingdom, **David Gore-Booth**, adviser to the chairman of HSBC and a former **British** ambassador to Riyadh, told a *MEED* conference in London.

Gore-Booth said a licence had already been applied for under the *Capital Markets Law*. The Law has been approved but has yet to come fully into force.

The new investment bank would focus on infrastructure projects and offer a range of financial services to large Saudi family-owned businesses.

Deutsche was granted a Saudi banking licence in mid-October, the first issued to an international bank since the late 1970s. The bank will also focus on investment banking, particularly in debt and equity markets.

The arrival of two international banking giants has raised suggestions that the imminent passage of the long-awaited *Capital Markets Law* might augur a wave of new market participants. Investment banking is seen as an untapped area, particularly in light of the ***Saudi Stock Market***'s strong performance in the past year. The *Tadawul All-Share Index* had grown by 70% in the year to early December, with a 400% increase in volume trade. According to Tadawul general manager **Abdallah Al-Suweilmy**, Saudi Arabia is now 23rd in the league of global stock exchanges in terms of market cap.

But analysts caution against exaggerated expectations on new market entrants. "It's good to have a local presence in the Kingdom, but these giants have been able to participate in Saudi operations for years without being here," said **Mardig Haladjian**, Gulf bank analyst at ***Moody's Investors Service***.

Saudi banks have reaped the rewards of robust oil prices in 2003 with average nine-month earnings up by 14.3% over January-September 2002. All local banks reported higher profits this year, except ***Saudi American Bank***, whose net income fell by more than 2% in the first nine months.

Banks are unlikely to feel the impact of competition in the short-term. "As far as local banks are concerned, we won't see a major impact from the big boys coming to town. But if over the years they invest and grow their operations, then they could get bigger chunks of Saudi business," said Haladjian.

Tadawul's Suweilmy said the ***Capital Market Authority***, the new regulatory authority, would be up and running by end-February. "The licensing process for gaining investment banking licenses is very transparent and I expect we will have them operating before summer," he said.

KUWAIT: Reform agenda

Prime Minister **Sheikh Sabah Al-Ahmed Al-Jaber Al-Sabah** seems set to press ahead with important liberalising economic measures, including a proposal to end the 49% limit on foreign shareholdings in local companies. Tax law amendments are already being considered by the National Assembly's Finance and Economics Committee.

Economic liberalisation, a hard-fought battlefield during the last parliament, appears likely to get an easier ride this time, and not only because the populist Ahmed Saadoun, who led opposition in the old Parliament, has been weakened. A relaxation of foreign ownership controls is exactly the sort of change that would have aroused old nationalist hackles, but which may now meet with a much less hostile reception. In voting out so many members of the last Parliament in July, the Kuwaiti public expressed its frustration at political wrangling and the loss of economic momentum, at a time when potential rivals like **Dubai** are surging ahead and regime change in **Iraq** has altered the regional balance of power.

This means the government's new reform package, introduced as part of a campaign to attract foreign investors, has met a relatively welcoming political reception. Ministers are pressing ahead with some changes already, because these are allowed under existing legislation. Government and business leaders will make a promotional tour of Europe and the **USA** in Q1 04.

Ministers are also quietly preparing to look at the contentious subject of education curriculum reform, which means playing down the role of religious ideology in Kuwaiti schools – a much more delicate issue. ***National Democratic Movement*** secretary general **Ahmed Bishara** was privately congratulated by supporters after writing an article in the *Arab Times* pressing the case for reform. But ministers refrained from public endorsement, although a number privately indicated their sympathy for change. The leadership wants to avoid being seen as being pushed into change, hoping to advance reform in a low-key manner and avoid a confrontational debate with defenders of Islamist influences in education.

Even so, the issue is gradually moving into the open agenda. In the post-9/11 world, it has also been discussed in **Saudi Arabia**, and some sources believe it will feature on the agenda of the late-December ***Gulf Co-operation Council*** summit, hosted by Kuwait.

Saudi oil giant mulls expansion upstream and downstream

Saudi Aramco is devising a new corporate strategy, now IOCs have been sidelined by the core ventures' demise. This could mean a return to oil exploration, but in the post-gas initiatives world, refining is king.

Having sidelined international oil companies with the collapse of the integrated core gas ventures, ***Saudi Aramco***'s technocrat leadership has been busy devising a new corporate strategy focused on export-oriented downstream growth. The state energy giant is also mooting a reactivation of its long-dormant upstream oil exploration programme, as Saudi Arabia mulls an increase in crude production capacity.

The traditionally secretive Saudi oil giant offered an intriguing glimpse into corporate thinking in early December, with an unusually frank insight into its energy plans from **Khalid Al-Falih**, head of Aramco's new business development organisation. The unit, set up in February, has an explicit mandate to develop new revenue streams and encourage private sector participation in oil and gas projects.

Falih has put out the feelers to foreign partners, inviting investors and suppliers to take advantage of the Kingdom's natural feedstock advantages through long-term relationships with Aramco.

Aramco chiefs' reaching out to foreign investors is more than just a public relations wheeze – although they know they need to win back some international credibility after their successful hatchet job on the natural gas initiative, which was pushed by **Crown Prince Abdallah Bin Abdelaziz** and Foreign Minister **Prince Saud Al-Faisal**, but was effectively torpedoed by Aramco veteran, Oil Minister **Ali Al-Naimi** and his allies in the ruling family, who include several of **King Fahd**'s Sudeiri brothers.

Opening the coffers in a bid to revamp upstream and downstream capacity leaves a host of opportunities available to foreign players, from drilling and seismic contractors to service companies.

Falih – a key figure in the negotiations with IOCs until the gas initiatives' demise in June – told ***MEED***'s early December *Investing In Saudi Arabia* conference in London that total spending in the 2003-07 period would exceed $18bn. The main thrust of Aramco's expenditure is directed at securing the Kingdom's position as the world's main exporter of refined products. It is already the largest exporter to Asia.

Refining is now regarded as the platform for future corporate growth. With global refining capacity largely absorbed, Aramco forecasts the need for significant new capacity by as early as 2005 – and sees itself as the prime candidate to meet the next wave of demand.

Crucially, Aramco wants to build up new capacity at home rather than overseas. "We feel that capacity should be not where sales or markets are but where the resources are," Falih said: "We see Saudi Arabia as a natural location for the next wave of refineries to be built to meet global energy demand."

Aramco's current refined products production is around 2m b/d, with some 840,000 b/d earmarked for export in 2004. Its first major new investment is the upgrade of the 400,000 b/d Rabigh refinery on the Red Sea coast. It is expected to appoint a project partner early in 2004 to assist its integration with the domestic petrochemical industry. The aim is to maximise value from significant existing infrastructure investments, with the product slate of the new refinery meeting high and sustainable demand growth.

The other major refinery project is at the 500,000 b/d Ras Tanura facility, where Aramco is looking to extend its reach further into the petrochemicals sector. Falih mooted a possible mixed xylene unit, cumene unit, isobutane facility and petroleum coke and pitch plant. "With more value-added products and integrating with petrochemicals, we can create a lot of synergies," he said.

More than a dash of gas

Aramco is still talking up its gas capabilities, driven by dramatic increases in Saudi gas reserve potential. According to Falih, two new studies had indicated around 300trn ft^3 of reserves in the largely unexplored Rub Al-Khali (Empty Quarter) in the south-east. This is on top of the 231trn ft^3 of proven reserves, of which 93trn ft^3 is non-associated.

Saudi project market booms

The total Saudi materials and services market is estimated to be worth $39.8bn in the 2003-07 period, including ***Aramco***'s own $18.8bn investment requirements, ***Saudi Basic Industries Corporation (Sabic)***'s $9bn for mainly petrochemicals developments, $7bn for water treatment and $5bn for power. Aramco's plans alone envisage the design and construction of more than 20 offshore platforms, gas-oil separation plants, process plants, about 2,300km of flow lines and long-distance pipelines, as well as roads, well sites and pipelines.

According to Aramco, drilling and seismic contractor services – covering 200 rig-years and about 20m vibration points of 2D and 3D seismic data – will provide significant new opportunities. Service companies will also see potential contracts in wireline, stimulations, testing, cementing, chemicals and mud systems, as well as technical support and analysis and oil field equipment.

Aramco acknowledged that the independent estimates – by the *US Geological Survey (USGS),* which estimated 303trn ft^3, and the 262trn ft^3 predicted by ***Robertson Research International*** (now part of the **Netherlands**-based ***Fugro*** group) – are little more than guesses, and should be treated with a degree scepticism. Only 15% of the total prospective gas area has had modern seismic coverage. Yet even if the Rub Al-Khali has only a fraction of these reserve estimates, it would still catapult the Kingdom into pole position in terms of gas reserves.

Aramco forecasts demand will reach 12.2bn ft^3/d by 2025, from just over 5 ft^3/d now. "To meet [this] figure we need to use primarily non-associate gas as associated production is linked to oil production. But we have high expectation of additional reserves in the Rub Al-Khali," Falih said.

Harnessing gas reserve potential is a major challenge for Aramco and a key factor behind the upstream licensing round and the gas deal reached with supermajors ***Royal Dutch/Shell*** and ***Total*** in November *(GSN 722/14)*. Saudi Arabia's rapid demand growth rates for gas and associated products, forecast at 3.1%/yr in the period up to 2025, cannot be borne by Aramco alone.

Aramco is beefing up its liquid gas production. It is already the world's largest natural gas liquids (NGL) producer with an estimated 30-35% global market share and capacity is due to hit 780,000 b/d with the commission of the Berri NGL extraction plant. IOCs are being encouraged to boost NGL production, with the incentive of selling these at export rates – even for domestic use.

Oil output growth

Falih sees room for growth of oil production, even though Saudi Arabia maintains shut-in capacity of more than 2m b/d. That excess capacity will be kept on as a buffer as oil production capacity grows, in keeping with Saudi policy to ensure long-term price stability.

Aramco is also to bring in five new crude increments over the next few years. These fields are designed to compensate for natural depletion elsewhere.

Aramco's vision of foreign investors partnering it in new refining and petrochemicals projects could be a strong draw, but its success depends on a range of other factors. Security is one black spot. But commercial terms are equally important: the obvious incentive of access to cheap feedstock, guaranteed under the Kingdom's "dual pricing" policy, might not pertain for much longer if ***World Trade Organisation*** negotiators push Riyadh to end subsidised domestic fuel prices.

Aramco is pleading a special case, insisting that gas that isn't exported or liquefied essentially has no international trade price. It also contends that as the Kingdom enjoys such an abundance of the commodity – far beyond what the global market can absorb – the issue of international prices does not arise. Furthermore, it says foreigners are not treated unfairly if they set up shop in Saudi Arabia because, as Falih put it, "prices are consistent for all investors in the Kingdom".

Abu Dhabi develops offshore project, seeks new downstream investments

Abu Dhabi is moving ahead with plans to develop the largest oil services complex in the Middle East, in a project being pushed by ***Abu Dhabi Economic Department (ADED)*** chairman **Sheikh Hamed Bin Zayed Al-Nahayan**, with the backing of **Crown Prince Sheikh Khalifa Bin Zayed.** ADED is leading the project, rather than ***Abu Dhabi National Oil Company (Adnoc)*** – which some officials in the Emirate believe should focus on its core capabilities in the upstream-downstream petroleum value chain. The scheme is underpinned by forecasts showing that oil and gas developments in the Middle East region – including **Iraq**, **Iran** and the Caspian – could require oil field services costing $155bn in the period to 2015.

Senior officials told *GSN* that ADED was in the second stage of feasibility studies for the scheme, showing management structures, infrastructure requirements and possible locations. Initial studies suggested the project should be established on a free market basis and was commercially feasible. Once phase two studies are complete, the project will be presented to the Abu Dhabi Executive Council, probably in 2004.

Meanwhile, the Abu Dhabi government-owned ***International Petroleum Investment Company (IPIC)*** is seeking out new investments abroad, favouring projects that add value to the Emirate's crude, gas and product exports. According to managing director **Mohammed Nasser Al-Khaily**, IPIC takes a proactive management interest in its investments. Its current portfolio is a mix of quoted and privately held equity investments, reflecting a broad hydrocarbon sector exposure, which helps to act as a hedge for the Abu Dhabi economy as a whole. These are shown in the table below, which shows direct IPIC shareholdings (and not cross-shareholdings; for example, ***OMV*** holds shares in ***Borealis)***.

IPIC's investment portfolio

Company	Shareholding %	Sector	Location/Market focus
Hyundai Oil Co.	50.0	Oil refining and marketing	South Korea/ Far East
Cepsa Maghreb	50.0	Oil marketing	Morocco/North Africa
Pak-Arab Refinery (Pafco)	48.0	Nitrogenous fertilisers	Pakistan/Asian subcontinent
Pak-Arab Refinery (Parco)	30.0	Oil refining/ products pipeline	Pakistan/Asian subcontinent
Borealis	25.0	Petrochemicals	Copenhagen/Middle East-Europe/ Far East
OMV	19.6	Integrated oil	Austria/central & eastern Europe
Arab Petroleum Pipelines Company (Sumed)	15.0	Crude oil pipeline	Egypt/ Mediterranean
Compania Espanola de Petroleos (Cepsa)	9.5	Integrated oil/ petrochemicals	Spain/Iberia

Source: International Petroleum Investment Company (IPIC), Abu Dhabi.

GSN Risk Grade — B-/2: Politics stable despite security concerns; trade and industrial growth planned

Political and social developments

Overview: King Hamad Bin Isa Al-Khalifa is facing real opposition from the groups outside parliament who boycotted the 2002 elections, though the atmosphere seems to have calmed for the time being, leading *GSN* to upgrade Bahrain's political risk rating to B-. Civil disturbances prompted by external stimuli have receded since the war in Iraq, and fewer protests are seen concerning issues such as unemployment, prison conditions and political reforms.

Opposition: The row over allegations that the government has tried to manipulate elections by granting citizenship to Saudi-based Sunnis continues, with the Shiite minority also complaining of continued discrimination in employment and throughout the largely Sunni government bureaucracy. Opposition groups led by Wefaq, NDAS, Islamic Action and the ex-Baathist NDS (the groups that boycotted the 2002 elections) have led the dissent, and new claims have arisen that the government has imported new "citizens" from as far away as Jordan. King Hamad has also come under fire for donating money to Shura Council members; the opposition say the donations amount to bribes.

Security: The civil disturbances seen during the Iraq war have receded, but security services remain vigilant. Domestic disturbances have given some resident expats pause. Turnout for Jerusalem Day was reportedly larger than usual, with as many as 45,000 taking to the streets. Two concerts by a Lebanese singer inspired 100 protestors in late October, and a child's Halloween party was shut down during Ramadan by a small mob threatening violence. Worsening conditions could lead to expats reconsidering their investments.

External relations: Relations with the USA remain close – Bahrain has 'Major Non-NATO Ally' status and houses the Fifth Fleet, making it a potential target for anti-US terrorists. Bahrain continues to push for the release of six nationals detained in Guantanamo. While close dialogue is kept with GCC states, Qatar's recent seizure of a number of Bahraini fishing vessels that strayed into Qatari waters demonstrates a continued edginess in relations. Relations with Saudi Arabia remain of central importance; a decades-old arrangement for the supply of sand, important to construction in Bahrain, has been suspended for unknown reasons. There have been increasingly frequent high-level contacts with Iran, including seven co-operation agreements signed in May. Bahrain is the present chair of the League of Arab States.

Economic outlook

Overview: The economy has recovered from a dip experienced during the war in Iraq, with the government forecasting 5-6% GDP growth in 2003, following 5.1% growth in 2002. Unemployment, however, remains a real concern at around 15% for nationals. A big boost could come from a planned Free Trade Agreement with the USA; negotiations begin early 2004. Infrastructure such as the Bahrain Financial Harbour, Durrat Al-Bahrain resort and the new Formula 1 race track will help create new jobs. The oil industry is minimal, contributing 16.6% of GDP in 2002, though the Oil Ministry is pushing for new exploration. Expansion is under way at the refinery, and new potlines are being planned or considered at the aluminium smelter, already one of the largest in the world.

Financial sector: Bahrain is a regional leader and despite some concerns over defaults, there are encouraging signs of further growth. Bahraini-incorporated banks posted combined profits of $377m for H1 03, compared with $289.7m for H1 02. The Bahrain Stock Exchange (BSE) has risen to new heights, passing the 2,000 point mark and in early September reaching its highest point in three years, while a debut five-year $500m sovereign eurobond was launched in January, rated A- by Standard & Poor's. S&P in early December revised its foreign currency outlook on Bahrain to positive, from stable.

Budget: A BHD744.6m ($1.95bn) combined budget deficit of 10% of GDP is forecast for 2003 and 2004 (BD362m for 2003 and BD383m for 2004). Projections, however, are based on an average $18/bbl oil price. S&P expects the 2003 deficit to come in at only 1.5% of GDP. BD330m has been set aside for development projects in each year. Foreign investment will be required in order to meet targets. S&P expects government debt to stand at 37% of GDP at end-2003. Islamic bonds and loans represent around 80% of domestic debt.

Liberalisation: Bahrain expects around $700m FDI from privatisation sales in 2003. MTC-Vodafone won the second GSM licence in mid-April, and is due to start user trails on 15 December. The telecoms sector is slated for full liberalisation by the end of H1 04. A committee has been created to prepare a feasibility study to privatise the electricity and water sectors. Transport sell-offs could include management of Mina Salman and Khalifa Bin Salman ports. A 3% base rate income tax has been mooted. Free trade talks with the US are scheduled to start in January 2004.

BAHRAIN: Key projects

Al-Hidd superport: $660m project on 800ha, including a 247km^2 Free Trade Zone to handle super-cargo ships, due for completion by H1 05.

Airport expansion: New runway, control tower, terminal building, retail complex and cargo facilities all due for completion 2004-05, at cost of more than $300m.

Aluminium Bahrain: Fifth potline for completion at majority state-owned Alba Jun 05; Bechtel began construction Feb 04. Five-tranche $1.05bn commercial bank facility secured; $300m European export credit tranche also sought. Alstom has a 650MW power contract. USA's Alcoa is mulling a sixth potline to raise output to 1m t/yr. Alcoa has an MoU to buy a 26% stake in long-term partner Alba, in a major step forward for encouraging foreign investment via privatisation.

Bahrain Financial Harbour: $1bn project planned in 202,272 m^2 plot, including twin 50-storey towers and mall intended to attract banks and financial services companies. First phase construction started Dec 02 for completion Oct 05.

Bangas LPG: Debottlenecking and 20m-30m ft^3/d expansion to existing 280m ft^3/d processing plant. EPC tender expected Q1 04 for 2006 completion.

Sitra refinery expansion: Planned $600m, 40,000 b/d low-sulphur diesel production unit at Bahrain Petroleum Company's 250,000 b/d refinery. EPC award is awaited with JGC Corporation as low-bidder.

F1: Bahrain's new race circuit has been included in the 2004 Grand Prix schedule. Subject to completion, which is expected by 7 March, Bahrain will host its first Grand Prix on 4 April.

GSN Risk Grades

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

BAHRAIN: Economic Indicators

($ million)	1998	1999	2000	2001	2002
GDP current prices	6,166	6,601.1	7,947.3	7,911.7p	8,100e
GDP growth (%)	–2.6	7.1	20.4	–0.5p	0.5e
Exports	3,260.7	4,350.0	6,176.3	5,562.1	5,354.6
of which: hydrocarbons	1,689.2	2,767.7	4,464.3	3,671.4	3,530.2
Imports	3,555.6	3,686.8	4,619.7	4,294.4	4,619.9
Trade balance	–294.9	663.2	1,556.6	1,267.6	734.7
CPI (percent)	–0.4	–1.3	–0.7	–1.8	0.5e
Current account	–775.1	–339.7	112.7	182.0e	–440.0e
Foreign exchange reserves	1,290	1,369	1,564	—	—

p – preliminary. e – estimate. GDP – Gross domestic product. CPI – Consumer price inflation.

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

GSN Risk Grade – E/3-: Domestic, external crises impinge on reform efforts, privatisations awaited

Political and social development

Overview: The USA's problems in Iraq mean advocates of regime change have taken a step back from advocating immediate action on Iran – a trend welcomed by advocates of 'constructive engagement' such as the UK and its European Union partners. But questions about Iran's nuclear ambitions will not go away, and the chronic struggle between President Mohammad Khatami and his reformist allies and conservative clerics and forces of reaction, including the Ansar e-Hizbollah militia, continues. Dissatisfaction of a youthful population is very apparent, with clashes resulting in human rights abuses and increased alienation from the Velyat e-Faqih system.

Majlis elections: Parliamentary elections in February will provide a stern test of Khatami's continued ability to woo voters, with the Second Khordad Front of 18 reformist groups unclear on strategy and key member, the Islamic Iran Participation Front, led by presidential brother Mohammad Reza Khatami, threatening to boycott. Nobel Prize for rights activist Shirin Ebadi is not sufficient to paper over the cracks in the reform movement

Nuclear standoff: The prospect of an Iranian deterrent is popular across most sections of Iranian society but is anathema outside. The International Atomic Energy Agency's 26 November resolution represented a compromise, with the USA backing down from insisting Iran's case is referred to the UN Security Council for breaching the Non-Proliferation Treaty. The IAEA's Mohammed El-Baradei talked of his 'deep concern' while welcoming Tehran's recent efforts. Russia has agreed to take a tougher line on the Bushehr power plant, but questions remain about Iran's enrichment capabilities and end-use – an especially hot issue since last summer's successful Shahab-3 missile test (capable of hitting Israel).

External relations: Diplomatic relations with the UK have been strained by the case of former Iranian ambassador to Argentina Hadi Soleimanpur and attacks on the British Embassy in Tehran. Human rights issues are again taking prominence, with Amnesty International concerned at an "alarming spiral of human rights violations" and the UN Human Rights Committee passing a resolution tabled by Canada condemning Tehran. Trading relations with Gulf Co-operation Council members are strong, with signs that an eventual accommodation may be possible with the UAE over the disputed Tunbs islands and Abu Musa. Security ties are also developing as a by-product of the 'global war on terror'. In a quiet nod to the USA, Tehran has recognised the Interim Governing Council in Iraq.

Economic outlook

Overview: Iran has made significant economic progress but there are signs the tense political situation is impacting on business. Despite a positive growth performance in the 2002/03 Iranian year, the International Monetary Fund has warned about expansionary policies. The government is forecasting GDP growth of more than 7% for 2003/04 (to 20 March) with inflation around 16%. Unemployment is officially 16%. Bureaucracy and corruption must be addressed. Resistance to "de-nationalisation" has slowed privatisation, with 350-plus enterprises planned from divestment.

IMF concerns: The Fund's most recent Article IV consultation warned the government against dipping into its Oil Stabilisation Fund at a time of high oil prices. The IMF is also concerned about rising inflation. Despite some liberalisation measures, the banking sector was singled out as needing accelerated reforms to continued state domination and under-capitalisation. On a positive note the IMF commended real growth of 6.8% over 2002/03 and non-oil sector growth of 7.9%.

Debt and payments: With increased flows from non-US export credit agencies and banks, debt is steadily rising but remains under control. The Bank for International Settlement (BIS) estimated foreign debt at $12.4bn in H1 03, up from $10.3bn at end-2002 – itself a higher figure than published by Bank Markazi (Central Bank of Iran), of $8.7bn. There is more borrowing to come, with state oil and petrochemicals companies planning eurobonds worth around $300m each before March 2004. Iran is not expected to need rescheduling in the next five years; its credibility with foreign investors has been boosted by a good repayments record.

Liberalisation and its limits: Bank privatisation is planned (see below), but problems of de-nationalisation remain, and an effort to privatise Bank Saderat Iran was cancelled by the Attorney General on constitutional grounds. Further legislative changes are needed to advance the financial privatisation programme. WTO membership is blocked by the USA. Talks have opened about membership of the World Bank Group's Multilateral Investment Guarantee Agency (MIGA). The government has pledged to cut subsidies and target social support more narrowly to benefit the poor but these are political as well as economic issues, a fact that may affect progress. A two-tier exchange rate was scrapped March 2002; import procedures have been streamlined but restrictive elements remain. Urgent reforms are required to labour and commercial laws. A revised investment law with major changes was passed in May 2002.

BANK PRIVATISATION: Legislation has gone to the Majlis, with Economy and Finance Minister Tahmaseb Mazaheri committed to privatising assets of nine banks and four insurance companies by end-2005. Four private banks have been licensed – Bank Eqtesad-e-Novin, Karafarin Bank, Parsian Bank and Saman Bank – and the state-owned Karafarin Bank is quoted on the Tehran Stock Exchange; more listings are expected including Banks Saderat Iran and Sepah.

IRAN: Key data and forecasts*

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

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

[p] Preliminary. [f] Forecast.

Sources: IMF, Washington; Bank Markazi, Tehran.

IRAN: Key projects

South Pars gas field: Initial 12 phases; work under way on phases one and four to ten (phases two and three were commissioned in H1 03). Award of phases 11-12 awaited after revised bids. Shell reportedly interested in 13 and 14. Iran's project finance potential underlined by $1.745bn financing led by Deutsche Bank to cover 75% of phases 9-10 for National Iranian Oil Company (NIOC). Package includes $1.22bn export credit and $525m bank debt; lead contractor is LG Engineering & Construction. Phases 15-16 bids expected in December.

LNG: Four projects under discussion. BG and Agip are partnering National Iranian Gas Export Company, which has launched prequals for the first of two 4.5m-5m t/yr trains. Contracts for Total-led (Pars LNG) and Shell-led (Persian LNG) projects awaited. BP and India's Reliance also studying a project (Iran LNG).

Independent power projects: Poor turnout to buy 350MW Khoy gas/steam plant. State-owned Tavanir is tendering six 500MW projects: award of Zanjan one and two expected H1 04. Tenders for Khoram Abad one and two expected; bidding for plants in Mashad and Kashan will follow.

Azadegan oilfield development: IOCs including Total and Statoil expected to bid in Q1 04 for $2bn-plus contract award by end-04, although project confused by continuing talks between NIOC and Japanese consortium.

Kharg Island petrochemicals: Grassroots complex planned by National Petrochemicals Company, with contract for Technip and local Nargan to build a 500,000 t/yr ethane cracker, bids in for 730,000 t/yr methanol plant, and tenders expected for 500,000 t/yr monoethylene glycol unit.

DIARY: Events around the region

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 London-based trade group the Middle East Association with UK Trade Partners backing. Contact Michael Thomas: +44 (0)20 7839 2137.

28-29 January. Iranian oil licensing round conference

An *Introductory Conference on the New International Tender for the Exploration and Development of 16 Onshore & Offshore Blocks in Iran* is to be held at Kurhaus, The Hague in The Netherlands. Confirmed speakers include Deputy Petroleum Minister and National Iranian Oil Company managing director Seyed Mehdi Mir Moezzie, to discuss the planned call for bids on the first 16 of 51 new exploration blocks identified by NIOC in different parts of Iran. Organiser IBC observes that "in a reversal of past practice, NIOC will be able to sign the exploration, description and development phases of each block as part of the same contract, to run for up to 25 years. Contact: Sukhvir Hayre on +44 20 7017 4042. Fax +44 20 7017 4084. Email sukhvir.hayre@informa.com. Web: www.ibcenergy.com/iran.

1-4 February. Eid-al-Adha

The Eid holiday can vary slightly from country to country.

9-10 February. MENA Trade & Export Finance Forum 2004

A conference to be held in Dubai that promises to focus on a wide range of trade and export finance issues and product. Contact Exporta Group. Tel: +44 (0) 208673 9666. Email: sales@exportagroup.com

11-12 February. 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: The CWC Group: +44 (0)207 089 4200. Internet: www.thecwcgroup.com/conferences

9-10 March. Finance & Investment in Qatar

IBC's second annual event will take place at the Carlton Tower hotel in London, boasting a line-up that includes First Deputy Prime Minister and Foreign Affairs Minister Sheikh Hamad Bin Jassim Bin Jabr Al-Thani; Second Deputy Prime Minister and Energy, Industry, Electricity and Water Minister Abdallah Bin Hamad Al-Attiyah; Economy and Commerce Minister Sheikh Hamad Bin Faisal Bin Thani Al-Thani; Qatar Central Bank Governor Abdallah Bin Khaled Al-Attiyah; and senior executives in Qatar's booming energy companies. Contact: Lorraine Ward at IBC on +44 (0)1932 893875.

DATA: Stock markets, trade payments and exchange rates

Stock Market (Index)	Index value (5* &11** Dec 03)	Index % change Change ()		Index % change From 31 Dec 02	Collection experience	Preferred terms	$	Exchange rate £	€	¥
Bahrain[1]	2,330.85*	1.6	↑	28.0	Fair-Good	ULC	1 Dinar = 0.37700	0.65830	0.46140	0.34840
Iran[2]	10,250.11**	3.4	↑	103.2	Fair-Good	CIA	1 Rial = 8322.00	14531.9	10185.3	7690.96
Iraq	—	—		—	Poor	CIA	1 Dinar= 0.31100	0.54310	0.38060	0.28740
Jordan[3]	260.77**	1.9	↑	53.0	Fair-Good	ULC	1 Dinar = 0.70900	1.23810	0.86770	0.65520
Kuwait[4]	4,581.18**	-0.8	↓	92.0	Fair-Good	ULC	1 Dinar = 0.29470	0.51460	0.36070	0.27240
Oman[5]	271.23*	0.3	↑	41.4	Fair	ULC	1 Riyal = 0.38500	0.67230	0.47120	0.35580
Qatar[6]	711.72*	-3.0	↓	69.3	Fair	CIA	1 Riyal = 3.64000	6.35630	4.45490	3.36400
Saudi Arabia[7]	4,383.57**	0.3	↑	74.1	Fair-Good	ULC	1 Riyal = 3.75020	6.54870	4.58975	3.46590
Syria	—	—		—	Fair-Good	CLC	1 £ = 48.5150	84.7169	59.3775	44.8362
UAE	4,460.47*	0.7	↑	30.9	Fair	ULC	1 Dirham = 3.67280	6.41350	4.49500	3.39430
Yemen	—	—		—	Fair-Poor	CIA	1 Rial = 178.005	310.832	217.860	164.507

[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.

Civil engineering before financial engineering in Bahrain and Dubai

Two of the Gulf's most ambitious leaderships are looking to a heavy investment in physical infrastructure to gain advantage in their unspoken competition to be the regional leader in financial services. Both are accompanying this investment drive with the language of globalisation in the belief that Gulf centres can compete with New York, London, Frankfurt and **Singapore**. And so they can, if the glitz of **Dubai**'s ever rising skyline and **Bahrain**'s plans for huge towers to rise as an expression of its long dominance of the Gulf financial services industry are anything to go by.

The designers of Bahrain's $1.3bn financial harbour project are nothing if not ambitious, judged by the glitzy computer mock-ups of the completed scheme: a dozen office and residential towers, their sheen and spiky irregular shapes straight out of an international architect's handbook, some on an island linked to the mainland by a new bridge. But the initial design and build contract – whose tender deadline was extended at the last minute to 1 December – betrays rather more down-to-earth projections: it calls for two towers, albeit each 50 stories high, together with an eight-floor "financial mall" and a harbour-side building.

The grand long-term vision of the regional stature Bahrain would like to attain is evident in the mini-Manhattan sketches. But the more limited, if still impressive, specifications for the project actually going ahead now are a better indication of what the island state believes is within its grasp in the plan-able future.

For officials in Manama are well aware of the competitive challenge developing lower down the Gulf in Dubai, which has already carved out a niche as the regional hub for most service activities, other than offshore banking. That is still the preserve of the Bahrainis – whose long tradition of good regulation provides a strong card in the regional competition that rarely, publicly, speaks its name. But how long Bahrain remains top dog will depend on the **Al-Khalifa** leadership and Manama banking community's ability to adapt to the fast-changing conditions of contemporary markets.

Each side has strong cards to play.

Dubai has established itself as a favourite leisure and residential base for expatriates – a powerful draw in an industry that relies more than most on a workforce of internationally mobile specialists, as ready to live in Singapore, Tokyo or even Moscow as in London or New York.

Dubai forms part of the **UAE**, which has a large public sector, a big government-friendly business community and a developing capital market. The Emirate has demonstrated an impressive capacity to bring projects that initially seemed implausible rapidly to profitable fruition *(GSN 720/1)*.

Bahrain has the offshore banking track record. Its position as a significant financial hub is well settled. Many top names are already present. The country has built up a reputation for regulatory probity and effectiveness, which is consolidating by taking a global lead as a regulator in a major boom market, Islamic financing *(see Finance and policy)*.

When it comes to telecommunications and air links, both cities are already well-served, with long haul and local connections. Bahrain's former monopoly **Batelco** now sees advantages from liberalisation and competition.

Both Bahrain and Dubai are prepared to develop more real estate to accommodate new investors, so basic infrastructure should not be a problem. When it comes to real estate development, Dubai is well ahead of the Gulf curve, but Bahrain's leaders were, at least, among the earliest in the *Gulf Co-operation Council* to understand the significance of Dubai's

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

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